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

MEMBERS' HANDBOOK

Update No. 33

(Issued October 2006)

Document Reference and Title	***Instructions***	***Explanations***
VOLUME III		
Contents of Volume III	Insert revised pages (i), (ii), (iii) and (iv) and discard the replaced pages (i), (ii), (iii) and (iv)	Revised contents pages
HONG KONG STANDARDS ON AUDITING (NEW)		
HKSA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*	Insert these pages after HKSA 620	Note 1
HKSA 701 *Modifications to the Independent Auditor's Report*	Insert these pages after HKSA 700	Note 1
HONG KONG STANDARDS ON AUDITING (REVISED)		
HKSA 200 (Revised) *Objective and General Principles Governing an Audit of Financial Statements*	Insert these pages after HKSA 200	Note 2
HKSA 560 (Revised) *Subsequent Events*	Insert these pages after HKSA 560	Note 3
HONG KONG STANDARDS ON AUDITING (EXISTING STANDARDS)		
HKSA 200 *Objective and General Principles Governing an Audit of Financial Statements*	Insert revised pages 1 - 2 and discard the replaced pages 1 - 2	Note 2
HKSA 210 *Terms of Audit Engagements*	Insert revised pages 1 - 2 and 19 - 25 and discard the replaced pages 1 - 2 and 19	Note 4
HKSA 560 *Subsequent Events*	Insert revised pages 1 - 2 and discard the replaced pages 1 - 2	Note 3

STATEMENTS OF AUDITING STANDARDS

SAS 600 *Auditors' reports on financial statements*	Insert the revised pages 1 - 2 and 13 - 14 and discard the replaced pages 1 - 2 and 13 - 14	Note 5

Notes:

1. New Hong Kong Standards on Auditing 700 and 701 are effective for auditor's reports dated on or after 31 December 2006 and replace SAS 600.
2. HKSA 700 gave rise to conforming amendments to HKSA 200. The conforming amendments are reflected in HKSA 200 (Revised) and are effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor's reports are dated on or after 31 December 2006.
3. HKSA 700 gave rise to conforming amendments to HKSA 560. The conforming amendments are reflected in HKSA 560 (Revised) and are effective for auditor's reports dated on or after 31 December 2006.
4. HKSA 700 gave rise to conforming amendments to HKSA 210. Implementation of these amendments in ISA 210 (HKSA 210 equivalent) has been deferred by the IAASB (effective date yet to be determined). It is attached as Appendix 3 to HKSA 210 for reference only and will be issued as a revised standard when the effective date is determined by the IAASB.
5. Revised pages to reflect that SAS 600 is effective for auditors' reports dated on or after 1 May 2000 but before 31 December 2006.

October 2006

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

MEMBERS' HANDBOOK
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(Updated to October 2006)

Issue/Review date

PRACTICE NOTES

HKSA 700
Issued October 2006

Effective for auditor's reports dated
on or after 31 December 2006

Hong Kong Standard on Auditing 700

The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements

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

HONG KONG STANDARD ON AUDITING 700

THE INDEPENDENT AUDITOR'S REPORT ON A COMPLETE SET OF GENERAL PURPOSE FINANCIAL STATEMENTS[1]

(Effective for auditor's reports dated on or after 31 December 2006)[*]

CONTENTS

Hong Kong Standard on Auditing (HKSA) 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

1 This HKSA is applicable for auditor's reports on financial statements described in paragraph 1 of the HKSA.

* HKSA 700 gave rise to conforming amendments to HKSA 200, "Objective and General Principles Governing an Audit of Financial Statements", HKSA 210 "Terms of Audit Engagements" and HKSA 560, "Subsequent Events". As a result of these conforming amendments, HKSA 200 (Revised) and HKSA 560 (Revised) have been issued together with HKSA 700 to reflect the conforming amendments. As the conforming amendments to HKSA 210 are not yet effective they are included in the Appendix to HKSA 210.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the independent auditor's report issued as a result of an audit of a complete set of general purpose financial statements prepared in accordance with a financial reporting framework that is designed to achieve fair presentation. It also provides guidance on the matters the auditor considers in forming an opinion on those financial statements. As described in HKSA 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements," "general purpose financial statements" are financial statements prepared in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users.[2]

2. This HKSA addresses circumstances when the auditor is able to express an unqualified opinion and no modification to the auditor's report is necessary. HKSA 701, "Modifications to the Independent Auditor's Report" establishes standards and provides guidance on the modifications to this report for an emphasis of matter, a qualified opinion, a disclaimer of opinion, or an adverse opinion.

3. *[See paragraph 1 of Appendix 1]*

The Auditor's Report on Financial Statements

4. **The auditor's report should contain a clear expression of the auditor's opinion on the financial statements.**

5. As stated in HKSA 200 (Revised), the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

6. Unless required by law or regulation to use different wording, the auditor's opinion on a complete set[3] of general purpose financial statements prepared in accordance with a financial reporting framework that is designed to achieve fair presentation (for purposes of this HKSA referred to as "financial statements") states whether the financial statements "give a true and fair view" or "are presented fairly, in all material respects," in accordance with the applicable financial reporting framework. These phrases "give a true and fair view" and "are presented fairly, in all material respects," are equivalent. Which of these phrases is used in any particular jurisdiction is determined by the law or regulations governing the audit of financial statements in that jurisdiction, or by established practice in that jurisdiction.[3a]

7. In some jurisdictions, law or regulation governing the audit of financial statements may prescribe wording for the auditor's opinion that is different from the phrases described in paragraph 6. Although the auditor may be obliged to use the prescribed wording, the auditor's responsibilities as described in this HKSA for forming the opinion remain the same.

8. When wording prescribed by law or regulation differs significantly from the phrases in paragraph 6, the auditor carefully considers whether there may be a risk that users might misunderstand the assurance obtained in an audit of financial statements. For example, the wording might convey to readers that the auditor is attesting to the accuracy of the financial statement amounts rather than expressing an opinion on whether the financial statements give a true and fair view or are presented fairly, in all material respects. In such circumstances, the auditor considers whether the risk of misunderstanding can be mitigated through appropriate explanation in the auditor's report (see HKSA 701).

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[2] HKSA 200 (Revised) (amended as a result of HKSA 700) is effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor's reports are dated on or after 31 December 2006.

[3] As explained in paragraph 35 of HKSA 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements," the financial reporting framework determines what constitutes a complete set of financial statements. A complete set of financial statements under Hong Kong Financial Reporting Standards (HKFRSs) comprises a balance sheet, an income statement, a statement of changes in equity (or statement of recognised income and expense), a cash flow statement and a summary of significant accounting policies and other explanatory notes.

[3a] In Hong Kong, the Companies Ordinance, the Main Board Listing Rules and GEM Listing Rules adopt the phrase "true and fair view".

Applicable Financial Reporting Framework

9. The auditor's judgment regarding whether the financial statements give a true and fair view or are presented fairly, in all material respects, is made in the context of the applicable financial reporting framework. As discussed in HKSA 210, "Terms of Audit Engagements," without an acceptable financial reporting framework, the auditor does not have suitable criteria for evaluating the entity's financial statements.[4] HKSA 200 (Revised) describes the auditor's responsibility to determine whether the financial reporting framework adopted by management in preparing the financial statements is acceptable.[5]

10. In the case of financial statements that are within the scope of this HKSA, application of a financial reporting framework determined to be acceptable for general purpose financial statements will, except in the extremely rare circumstances discussed in paragraph 15, result in financial statements that achieve fair presentation. Although the financial reporting framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework. Thus, the financial reporting framework provides a context for the auditor's evaluation of the fair presentation of the financial statements, including whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework for particular classes of transactions, account balances and disclosures.

Forming an Opinion on the Financial Statements

11. **The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements.**

12. When forming an opinion on the financial statements, the auditor evaluates whether, based on the audit evidence obtained, there is reasonable assurance about whether the financial statements taken as a whole are free from material misstatement. This involves concluding whether sufficient appropriate audit evidence has been obtained to reduce to an acceptably low level the risks of material misstatement of the financial statements[6] and evaluating the effects of uncorrected misstatements identified.[7]

13. Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework involves evaluating whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework for particular classes of transactions, account balances and disclosures. This evaluation includes considering whether, in the context of the applicable financial reporting framework:

    (a) The accounting policies selected and applied are consistent with the financial reporting framework and are appropriate in the circumstances;

    (b) The accounting estimates made by management are reasonable in the circumstances;

    (c) The information presented in the financial statements, including accounting policies, is relevant, reliable, comparable and understandable; and

    (d) The financial statements provide sufficient disclosures to enable users to understand the effect of material transactions and events on the information conveyed in the financial statements, for example, in the case of financial statements prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs), the entity's financial position, financial performance and cash flows.

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4 Implementation of the conforming amendments to HKSA 210 (amended as a result of HKSA 700) has been deferred pending the revision of ISA 800 "The Independent Auditor's Report on Special Purpose Audit Engagements" (See paragraph 1 of Appendix 1). These conforming amendments are included in Appendix 3 of HKSA 210.

5 See footnote 2.

6 See HKSA 330, "The Auditor's Procedures in Response to Assessed Risks."

7 See HKSA 320, "Audit Materiality."

14. Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework also involves evaluating the fair presentation of the financial statements. The auditor considers whether the financial statements, after any adjustments made by management as a result of the audit process, are consistent with the auditor's understanding of the entity and its environment. The auditor considers the overall presentation, structure and content of the financial statements. The auditor also considers whether the financial statements, including the note disclosures, faithfully represent the underlying transactions and events in a manner that gives a true and fair view of or presents fairly, in all material respects, the information conveyed in the financial statements in the context of the financial reporting framework. Analytical procedures performed at or near the end of the audit help to corroborate conclusions formed during the audit and assist in arriving at the overall conclusion as to the fair presentation of the financial statements.

Extremely Rare Circumstances when Applying the Financial Reporting Framework Results in Misleading Financial Statements

15. As discussed in HKSA 210, the auditor considers the acceptability of the financial reporting framework when considering accepting the engagement.[8] Application of a financial reporting framework determined to be acceptable for general purpose financial statements will ordinarily result in financial statements that achieve fair presentation. In extremely rare circumstances, however, application of a specific requirement in a framework that has been determined to be acceptable for general purpose financial statements may result in financial statements that are misleading in the particular circumstances of the entity. Some financial reporting frameworks determined to be acceptable for general purpose financial statements acknowledge, implicitly or explicitly, that there are extremely rare circumstances when it is necessary for the financial statements to depart from a specific requirement in the framework in order to achieve the objective of fair presentation of the financial statements and provide guidance on the disclosures required. Other financial reporting frameworks may not provide any guidance on these circumstances even though they are acceptable frameworks for general purpose financial statements. If the auditor encounters circumstances that lead the auditor to conclude that compliance with a specific requirement results in financial statements that are misleading, the auditor considers the need to modify the auditor's report. The modifications, if any, that are appropriate to the auditor's report will depend on how management addresses the matter in the financial statements and how the financial reporting framework deals with these rare circumstances (see HKSA 701).

Elements of the Auditor's Report in an Audit Conducted in Accordance with Hong Kong Standards on Auditing[9]

16. Consistency in the auditor's report, when the audit has been conducted in accordance with HKSAs, promotes credibility in the marketplace by making more readily identifiable those audits that have been conducted in accordance with recognized standards. It also helps to promote the reader's understanding and to identify unusual circumstances when they occur.

17. Paragraphs 18-60 set out the requirements relating to the following elements of the auditor's report when the audit has been conducted in accordance with HKSAs:

    (a) Title;

    (b) Addressee;

    (c) Introductory paragraph;

    (d) Management's responsibility for the financial statements;

    (e) Auditor's responsibility;

    (f) Auditor's opinion;

    (g) Other reporting responsibilities;

    (h) Auditor's signature;

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8 See footnote 4.

9 Paragraphs 61-66 address the auditor's report when the audit has been conducted in accordance with both HKSAs and auditing standards of a specific jurisdiction or country (including International Standards on Auditing).

(i) Date of the auditor's report; and

(j) Auditor's address.

Title

18. **The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.**

19. A title indicating the report is the report of an independent auditor, for example, "Independent Auditor's Report," affirms that the auditor has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent auditor's report from reports issued by others.

Addressee

20. **The auditor's report should be addressed as required by the circumstances of the engagement.**

21. National laws or regulations often specify to whom the auditor's report on general purpose financial statements should be addressed in that particular jurisdiction. Ordinarily, the auditor's report on general purpose financial statements is addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.[9a]

Introductory Paragraph

22. **The introductory paragraph in the auditor's report should identify the entity whose financial statements have been audited and should state that the financial statements have been audited. The introductory paragraph should also:**

    (a) Identify the title of each of the financial statements that comprise the complete set of financial statements;

    (b) Refer to the summary of significant accounting policies and other explanatory notes; and

    (c) Specify the date and period covered by the financial statements.

23. This requirement is ordinarily met by stating that the auditor has audited the accompanying financial statements of the entity, which comprise [state the titles of the complete set of financial statements required by the applicable financial reporting framework, specifying the date and period covered by those financial statements] and referring to the summary of significant accounting policies and other explanatory notes. In addition, when the auditor is aware that the financial statements will be included in a document that contains other information, such as an annual report, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the financial statements are presented. This helps readers to identify the financial statements to which the auditor's report relates.

24. The auditor's opinion covers the complete set of financial statements as defined by the applicable financial reporting framework. In the case of financial statements prepared in accordance with HKFRSs, this includes: a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and a summary of significant accounting policies and other explanatory notes.[9b] In some jurisdictions additional information might also be considered to be an integral part of the financial statements.

25. In some circumstances, the entity may be required by law or regulation or standards, or may voluntarily choose, to present together with the financial statements supplementary information that is not required by the financial reporting framework. For example, supplementary information might be presented to enhance a user's understanding of the financial reporting framework or to provide further explanation of specific financial statement items. Such information is normally presented in either supplementary schedules or as additional notes. The auditor's opinion may or may not cover the supplementary information and it is therefore important for the auditor to be satisfied that any supplementary information

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[9a] In Hong Kong, auditors of a company incorporated under the Hong Kong Companies Ordinance have a statutory duty to make a report to the shareholders of the company on the company's financial statements.

[9b] Where relevant a statement of recognised income and expense may be prepared instead of a statement of changes in equity.

that is not covered by the auditor's opinion is clearly differentiated, as discussed in paragraphs 67-71.

26. In some circumstances, the supplementary information cannot be clearly differentiated from the financial statements because of its nature and how it is presented. Such supplementary information is covered by the auditor's opinion. For example, the auditor's opinion covers notes or supplementary schedules that are cross-referenced from the financial statements. This would also be the case when the notes to the financial statements include an explanation of the extent to which the financial statements comply with another financial reporting framework.

27. Supplementary information that is presented as an integral part of the financial statements does not need to be specifically referred to in the introductory paragraph of the auditor's report when the reference to the notes in the description of the components of the financial statements in the introductory paragraph is sufficient.

Management's Responsibility for the Financial Statements

28. **The auditor's report should state that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes:**

    (a) Designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;

    (b) Selecting and applying appropriate accounting policies; and

    (c) Making accounting estimates that are reasonable in the circumstances.

29. Financial statements are the representations of management. Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. For example, in the case of financial statements prepared in accordance with HKFRSs, management is responsible for preparing financial statements that fairly present the financial position, financial performance and cash flows of the entity in accordance with HKFRSs. To fulfill this responsibility, management designs and implements internal control[10] to prevent or to detect and correct misstatements, whether due to fraud or error, in order to ensure the reliability of the entity's financial reporting. The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

30. There may be circumstances when it is appropriate for the auditor to add to the description of management's responsibilities in paragraph 28 to reflect additional responsibilities that are relevant to the preparation and presentation of the financial statements in the context of the particular jurisdiction or the nature of the entity.

31. The term management has been used in this HKSA to describe those responsible for the preparation and fair presentation of the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction. For example, in some jurisdictions, the appropriate reference may be to those charged with governance (for example, the directors).[10a]

Auditor's Responsibility

32. **The auditor's report should state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.**

33. The auditor's report states that the auditor's responsibility is to express an opinion on the

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10 In some jurisdictions, law or regulation prescribing management's responsibilities may specifically refer to a responsibility for the adequacy of accounting books and records, or accounting system. As books, records and systems are an integral part of internal control (as defined in HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement"), no specific reference is made to them in paragraph 28 for the description of management's responsibilities.

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

financial statements based on the audit in order to contrast it to management's responsibility for the preparation and fair presentation of the financial statements.

34. **The auditor's report should state that the audit was conducted in accordance with Hong Kong Standards on Auditing. The auditor's report should also explain that those standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.**

35. The reference to the standards used conveys to the reader that the audit has been conducted in accordance with established standards.

36. HKSA 200 (Revised) specifies what is required in order to conduct an audit in accordance with the HKSAs. Paragraph 14 in that HKSA explains that the auditor cannot describe the audit as being conducted in accordance with the HKSAs unless the auditor has complied fully with all of the HKSAs relevant to the audit.

37. **The auditor's report should describe an audit by stating that:**

    (a) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements;

    (b) The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of internal control; and

    (c) An audit also includes evaluating the appropriateness of the accounting policies used, the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements.

38. **The auditor's report should state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.**

Auditor's Opinion

39. **An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.**

40. **When expressing an unqualified opinion, the opinion paragraph of the auditor's report should state the auditor's opinion that the financial statements give a true and fair view or present fairly, in all material respects, in accordance with the applicable financial reporting framework (unless the auditor is required by law or regulation to use different wording for the opinion, in which case the prescribed wording should be used).**

41. **When Hong Kong Financial Reporting Standards are not used as the financial reporting framework, the reference to the financial reporting framework in the wording of the opinion should identify the jurisdiction or country of origin of the financial reporting framework.**

42. The auditor's opinion states that the financial statements give a true and fair view of or present fairly, in all material respects, the information that the financial statements are designed to convey (which is determined by the financial reporting framework). For example, in the case of financial statements prepared in accordance with HKFRSs, the auditor expresses an opinion that the financial statements give a true and fair view of or present fairly, in all material respects, the financial position of the entity as at the end of the period and the entity's financial performance and cash flows for the period then ended.

43. To advise the reader of the context in which the auditor's opinion is expressed, the auditor's opinion identifies the applicable financial reporting framework on which the financial statements are based. When the applicable financial reporting framework is not HKFRSs, the auditor's opinion also identifies the jurisdiction or country of origin of the applicable financial reporting framework. The auditor identifies the applicable financial reporting framework in such terms as:

   - "… in accordance with Hong Kong Financial Reporting Standards" or
   - "… in accordance with accounting principles generally accepted in Country X …"

44. When the applicable financial reporting framework encompasses legal and regulatory requirements, the auditor identifies the applicable financial reporting framework in such terms as:

   "… in accordance with Hong Kong Financial Reporting Standards and the requirements of Country X Corporations Act."[10b]

Other Matters

45. Standards, laws or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. Such matters may be addressed in a separate paragraph following the auditor's opinion.

Other Reporting Responsibilities

46. In some jurisdictions, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility to express an opinion on the financial statements. For example, the auditor may be asked to report certain matters if they come to the auditor's attention during the course of the audit of the financial statements. Alternatively, the auditor may be asked to perform and report on additional specified procedures, or to express an opinion on specific matters, such as the adequacy of accounting books and records. Auditing standards in the specific jurisdiction or country often provide guidance on the auditor's responsibilities with respect to specific additional reporting responsibilities in that jurisdiction or country.

47. In some cases, the relevant standards or laws may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

48. **When the auditor addresses other reporting responsibilities within the auditor's report on the financial statements, these other reporting responsibilities should be addressed in a separate section in the auditor's report that follows the opinion paragraph.**[10c]

49. The auditor addresses these other reporting responsibilities in a separate section of the report in order to clearly distinguish them from the auditor's responsibilities for, and opinion on, the financial statements.

[10b] For companies incorporated in Hong Kong, the applicable Corporations Act is the Hong Kong Companies Ordinance.

[10c] For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

Auditor's Signature

50. **The auditor's report should be signed.**

51. The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction. In addition to the auditor's signature, in certain jurisdictions, the auditor may be required to declare the auditor's professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognized by the appropriate licensing authority in that jurisdiction.[10d]

Date of the Auditor's Report

52. **The auditor should date the report on the financial statements no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements. Sufficient appropriate audit evidence should include evidence that the entity's complete set of financial statements has been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.**

53. The date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in HKSA 560 (Revised), "Subsequent Events."

54. Since the auditor's opinion is provided on the financial statements and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until the auditor obtains evidence that a complete set of financial statements has been prepared and management has accepted responsibility for them.

55. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that a complete set of financial statements has been prepared, and specifies the necessary approval process. In such cases, the auditor obtains evidence of that approval before dating the report on the financial statements.[11] In other jurisdictions, however, the approval process is not prescribed in law or regulation. In such cases, the auditor takes into account the procedures the entity follows in preparing and finalizing its financial statements in view of its management and governance structures in order to identify the individuals or body with the authority to conclude that the entity's complete set of financial statements, including the related notes, has been prepared.

56. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of the HKSAs is the earlier date on which those with the recognized authority determine that a complete set of financial statements has been prepared. [11a]

[10d] In Hong Kong, the auditors' report is normally signed in the name of the firm because the firm as a whole assumes responsibility for the audit. To assist identification, the report will normally state the name of the firm of auditors and the location of the auditors' office.

For a corporate practice, the auditors' report is signed by a director of the practice, who must be a professional accountant holding a current practising certificate. The auditors' report states the name of the corporate practice and the location of its office and is signed in the name of the corporate practice. The auditors' report also identifies the director responsible for the performance of the audit engagement contemplated by such report, and states his/her full name as appearing in his/her practising certificate and the practising certificate number.

For certain purposes, a printed copy of the auditors' report may be required to state the name of the auditors and be signed by them (for example, the Hong Kong Inland Revenue Department normally requires a manuscript signed copy of the auditors' report). For published financial statements (e.g. those of listed companies) the auditors may sign their report in a form from which a final printed version is produced. In both these circumstances, they may sign copies for identification purposes in order to provide appropriately signed auditors' reports, however, no further active procedures need be undertaken after the initial auditors' report has been signed.

[11] In rare circumstances, law or regulation also identifies the point in the financial statement reporting process at which the audit is expected to be complete.

[11a] In Hong Kong, auditors would not date the audit report earlier than the date on which the financial statements are approved by the directors. In practice, the date of the audit report may be earlier than the date of physical signature of the auditors' report.

Auditor's Address

57. **The report should name the location in the country or jurisdiction where the auditor practices.**

Auditor's Report

58. **The auditor's report should be in writing.**

59. A written report encompasses both reports issued in hard copy format and those using an electronic medium.

60. The following is an illustration of the auditor's report incorporating the elements set forth above for an audit of financial statements prepared in accordance with HKFRSs expressing an unqualified opinion. In addition to the audit of the financial statements, the illustration assumes that the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR'S REPORT[11b]

[Appropriate Addressee]

Report on the Financial Statements[12]

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at 31 December 200X, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Hong Kong Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[13] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of *(or "present fairly, in all material respects,")* the financial position of ABC Company as at 31 December 200X, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

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

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

11b Illustrative examples of auditor's reports for use in Hong Kong are set out in Appendix 2.

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

13 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances."

Auditor's Report for Audits Conducted in Accordance with Both HKSAs and Auditing Standards of a Specific Jurisdiction or Country (including International Standards on Auditing)

61. The auditor may conduct the audit in accordance with both the HKSAs and the auditing standards of a specific jurisdiction or country (including International Standards on Auditing) (for purposes of this HKSA referred to as "national auditing standards").

62. **The auditor's report should refer to the audit having been conducted in accordance with the Hong Kong Standards on Auditing only when the auditor has complied fully with all of the Hong Kong Standards on Auditing relevant to the audit.**

63. The auditor may refer to the audit having been conducted in accordance with both HKSAs as well as national auditing standards when the auditor complies with each of the HKSAs relevant to the audit and performs any additional audit procedures necessary to comply with the relevant standards of that jurisdiction or country. A reference to both the HKSAs and national auditing standards is not appropriate if there is a conflict between the reporting requirements regarding the auditor's report in the HKSAs and in the national auditing standards that affects the auditor's opinion or the need to include an emphasis of matter paragraph in the particular circumstances. For example, some national auditing standards prohibit the auditor from including an emphasis of matter paragraph to highlight a going concern problem, whereas HKSA 701 requires the auditor to modify the auditor's report by adding an emphasis of matter paragraph in such circumstances. In case of such conflicts, the auditor's report refers only to the auditing standards (either HKSAs or the relevant national auditing standards) in accordance with which the auditor has complied with the reporting requirements.

64. **When the auditor's report refers to both Hong Kong Standards on Auditing and auditing standards of a specific jurisdiction or country, the auditor's report should identify the jurisdiction or country of origin of the auditing standards.**

65. **When the auditor prepares the auditor's report using the layout or wording specified by the law, regulation or auditing standards of the specific jurisdiction or country, the auditor's report should refer to the audit being conducted in accordance with both Hong Kong Standards on Auditing and the auditing standards of the specific jurisdiction or country only if the auditor's report includes, at a minimum, each of the following elements:**

    (a) A title;

    (b) An addressee, as required by the circumstances of the engagement;

    (c) An introductory paragraph that identifies the financial statements audited;

    (d) A description of management's responsibility for the preparation and fair presentation of the financial statements;

    (e) A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes:

    - **(i) A reference to the Hong Kong Standards on Auditing and the auditing standards of the specific jurisdiction or country, and**

    - **(ii) A description of the work an auditor performs in an audit.**

    (f) An opinion paragraph containing an expression of opinion on the financial statements[14] and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the country of origin of the financial reporting framework when Hong Kong Financial Reporting Standards are not used);

    (g) The auditor's signature;

[14] Circumstances when the auditor needs to modify the auditor's opinion are addressed in HKSA 701, "Modifications to the Independent Auditor's Report." In some circumstances, the auditor may not be able to express an opinion on the financial statements because the effect of a limitation on the scope of the audit is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence. In such circumstances, the auditor expresses a disclaimer of opinion.

(h) The date of the auditor's report; and

(i) The auditor's address.

66. The auditor may be obliged by national law or regulation to use a layout or wording in the auditor's report that differs from that described in this HKSA. When the differences only relate to the layout and wording of the auditor's report, the auditor will be considered to have complied with the reporting requirements of the HKSAs provided that the auditor's report includes, at a minimum, each of the elements identified in paragraph 65 – even if using the layout and wording specified by national laws or regulations. Where specific requirements in a particular jurisdiction do not conflict with HKSAs, the auditor adopts the layout and wording used in this HKSA so that users can more readily recognize the auditor's report as a report on an audit conducted in accordance with HKSAs.

Unaudited Supplementary Information Presented with Audited Financial Statements

67. **The auditor should be satisfied that any supplementary information presented together with the financial statements that is not covered by the auditor's opinion is clearly differentiated from the audited financial statements.**

68. As noted in paragraphs 25-26, the entity may be required to, or management may choose to, include supplementary information together with the financial statements. The auditor's opinion is considered to cover supplementary information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented. In other circumstances, however, law or regulation may not require the supplementary information to be audited and management may not ask the auditor to include the supplementary information within the scope of the audit of the financial statements. When the supplementary information is not intended to be audited, the auditor considers whether that supplementary information is presented in a manner that could be construed as being covered by the auditor's opinion and, if so, asks management to change how the information is presented. The auditor considers, for example, where the unaudited information is presented in relation to the financial statements and any audited supplementary information, and whether it is clearly labeled as "unaudited." The auditor asks management to remove any cross references from the financial statements to unaudited supplementary schedules or unaudited notes because the demarcation between the audited and unaudited information would not be sufficiently clear. Unaudited notes that are intermingled with the audited notes can also be misinterpreted as being audited. Therefore, the auditor asks the entity to place the unaudited information outside of the set of financial statements, or, if that is not possible in the circumstances, at a minimum, place the unaudited notes together at the end of the required notes to the financial statements and clearly label them as unaudited.

69. As noted in paragraph 23, when the auditor is aware that the financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented in the auditor's report. This helps readers differentiate the financial statements from other information not covered by the auditor's opinion.

70. **If the auditor concludes that the entity's presentation of any unaudited supplementary information does not differentiate it sufficiently from the audited financial statements, the auditor should explain in the auditor's report that that information has not been audited.**

71. The fact that supplementary information is unaudited does not relieve the auditor of the responsibility to read that information to identify material inconsistencies with the audited financial statements. The auditor's responsibilities with respect to unaudited supplementary information are consistent with those described in HKSA 720, "Other Information in Documents Containing Audited Financial Statements."

Effective Date

72. This HKSA is effective for auditor's reports dated on or after 31 December 2006.

Conformity and compliance with International Standards on Auditing

73. As of October 2006 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 700 (Revised), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements". Compliance with the requirements of this HKSA ensures compliance with ISA 700 (Revised).

74. Additional local explanations are provided in footnotes 2, 3a, 4, 9a, 9b, 10a, 10b, 10c, 10d, 11a and 11b.

75. Additional local guidance is provided in Appendices 1 and 2.

Public Sector Perspective

1. Some terms in this HKSA such as "firm" should be read as referring to their public sector equivalents.

2. In the public sector, legislation governing the audit mandate may specify the layout of or words to be used in the auditor's report. When the auditor prepares the auditor's report using the layout or wording specified in such legislation, the auditor's report should refer to the audit being conducted in accordance with HKSAs, and the legislation governing the audit mandate, only if the auditor's report includes, at a minimum, each of the elements specified in paragraph 65(a)-(i). As discussed in paragraph 66, where legislation governing the audit mandate does not conflict with HKSAs, the auditor adopts the layout and wording used in this HKSA so that users can more readily recognize the auditor's report as a report on an audit conducted in accordance with HKSAs.

3. In addition, such legislation may specify the responsibilities of management and auditors in relation to the audit. The descriptions of such responsibilities included in the auditor's report will need to reflect the requirements of the legislation.

Appendix 1

Other local explanations

1. Paragraph 3 of ISA 700 "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" refers to ISA 800 "The Independent Auditors' Report on Special Purpose Audit Engagements". ISA 800 is currently under revision by the IAASB and, as a result, has not been adopted in Hong Kong. Accordingly paragraph 3 of ISA 700 has been removed from HKSA 700 and is shown below for reference:

   3. ISA 800, "The Independent Auditor's Report on Special Purpose Audit Engagements" establishes standards and provides guidance on the form and content of the auditor's report issued as a result of an audit of:

      (a) A complete set of financial statements prepared in accordance with an other comprehensive basis of accounting;

      (b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement;

      (c) Compliance with contractual agreements; and

      (d) Summarized financial statements.

2. As ISA 800 has not yet been adopted in Hong Kong, many of the principles of HKSA 700 can be applied to other forms of report provided by auditors after completing a full scope audit in accordance with HKSAs. An example of this is when an auditor is required to report on financial statements where a "properly prepared, in all material respects, in accordance with" opinion is to be given because the basis of preparation is other than Hong Kong Financial Reporting Standards.

Appendix 2

Examples of auditor's reports on financial statements

Unqualified opinions

Example 1 - company incorporated in Hong Kong

Example 2 - company incorporated in Hong Kong submitting group accounts

Example 3 - company incorporated overseas and reporting in Hong Kong

Example 1 - Company incorporated in Hong Kong

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)[1]

We have audited the financial statements of ABC Limited set out on pages .... to........ , which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit[2]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

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

2 Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

XYZ & Co.

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

[Address]

Date

Example 2 – Company incorporated in Hong Kong submitting group accounts

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)[1]

We have audited the consolidated financial statements of ABC Limited (the "company") set out on pages .... to........, which comprise the consolidated and company balance sheets as at 31 December 200X, and the consolidated income statement, the consolidated [statement of changes in equity or statement of recognised income and expense] and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit[2]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

---

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

[2] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 December 200X and of the group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

XYZ & Co.

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

[Address]

Date

Example 3 - Company incorporated overseas and reporting in Hong Kong

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in [country or place] with limited liability)[1]

We have audited the financial statements of ABC Limited set out on pages .... to........, which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants[2] and [the disclosure requirements of the Hong Kong Companies Ordinance[3]]. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit[4]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards [and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance].

---

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

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

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

4 Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

XYZ & Co.

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

[Address]

Date

HKSA 701
Issued October 2006

Effective for auditor's reports dated
on or after 31 December 2006

Hong Kong Standard on Auditing 701

Modifications to the Independent Auditor's Report

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

HONG KONG STANDARD ON AUDITING 701

MODIFICATIONS TO THE INDEPENDENT AUDITOR'S REPORT

(Effective for auditor's reports
dated on or after 31 December 2006)*

CONTENTS

Hong Kong Standard on Auditing (HKSA) 701, "Modifications to the Independent Auditor's Report" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

* This HKSA establishes standards and provides guidance to be applied when the independent auditor's report should be modified. HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" establishes standards and provides guidance to be applied when the auditor is able to express an unqualified opinion and no modification to the auditor's report is necessary. Both HKSAs are effective for auditor's reports dated on or after 31 December 2006.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the circumstances when the independent auditor's report should be modified and the form and the content of the modifications to the auditor's report in those circumstances.

2. HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" establishes standards and provides guidance on the form and content of the independent auditor's report on a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation when the auditor is able to express an unqualified opinion and no modification to the auditor's report is necessary. This HKSA describes how the auditor's report wording is modified in the following situations:

   Matters that Do Not Affect the Auditor's Opinion

   (a) Emphasis of matter

   Matters that Do Affect the Auditor's Opinion

   (a) Qualified opinion,

   (b) Disclaimer of opinion, or

   (c) Adverse opinion.

3. Uniformity in the form and content of each type of modified report will further the user's understanding of such reports. Accordingly, this HKSA includes suggested wording of modifying phrases for use when issuing modified reports.

4. The illustrative reports in this HKSA are based on the auditor's report on general purpose financial statements for a business enterprise. The principles relating to the circumstances when the auditor's report needs to be modified are, however, also applicable to reports on other engagements related to the audit of historical financial information, such as general purpose financial statements for entities of a different nature (for example, a not-for-profit organization).

Matters that Do Not Affect the Auditor's Opinion

5. In certain circumstances, an auditor's report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included after the paragraph containing the auditor's opinion but before the section on any other reporting responsibilities, if any. The emphasis of matter paragraph would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.

6. **The auditor should modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem.**

7. **The auditor should consider modifying the auditor's report by adding a paragraph if there is a significant uncertainty (other than a going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements.** An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

8. An illustration of an emphasis of matter paragraph for a significant uncertainty in an auditor's report follows:

   > *"Without qualifying our opinion we draw attention to Note X to the financial statements. The Company is the defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in*

progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements."

(An illustration of an emphasis of matter paragraph relating to going concern is set out in HKSA 570, "Going Concern.")

9. The addition of a paragraph emphasizing a going concern problem or significant uncertainty is ordinarily adequate to meet the auditor's reporting responsibilities regarding such matters. However, in extreme cases, such as situations involving multiple uncertainties that are significant to the financial statements, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.

10. In addition to the use of an emphasis of matter paragraph for matters that affect the financial statements, the auditor may also modify the auditor's report by using an emphasis of matter paragraph, preferably after the paragraph containing the auditor's opinion but before the section on any other reporting responsibilities, if any, to report on matters other than those affecting the financial statements. For example, if an amendment to other information in a document containing audited financial statements is necessary and the entity refuses to make the amendment, the auditor would consider including in the auditor's report an emphasis of matter paragraph describing the material inconsistency.

Matters that Do Affect the Auditor's Opinion

11. An auditor may not be able to express an unqualified opinion when either of the following circumstances exist and, in the auditor's judgment, the effect of the matter is or may be material to the financial statements:

    (a) There is a limitation on the scope of the auditor's work; or

    (b) There is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.

    The circumstances described in (a) could lead to a qualified opinion or a disclaimer of opinion. The circumstances described in (b) could lead to a qualified opinion or an adverse opinion. These circumstances are discussed more fully in paragraphs 16-21.

12. **A *qualified opinion* should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. A qualified opinion should be expressed as being 'except for' the effects of the matter to which the qualification relates.**

13. **A *disclaimer of opinion* should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.**

14. **An *adverse opinion* should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.**

15. **Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s) on the financial statements.** Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion on the financial statements and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

Circumstances that may Result in Other than an Unqualified Opinion

Limitation on Scope

16. A limitation on the scope of the auditor's work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). However, when the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists, the auditor would ordinarily not accept such a limited engagement as an audit engagement, unless required by statute. Also, a statutory auditor would not accept such an audit engagement when the limitation infringes on the auditor's statutory duties.

17. A scope limitation may be imposed by circumstances (for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion.

18. **When there is a limitation on the scope of the auditor's work that requires expression of a qualified opinion or a disclaimer of opinion, the auditor's report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.**

19. Illustrations of these matters are set out below.

Limitation on Scope—Qualified Opinion

> "We have audited ... (remaining words are the same as illustrated in the introductory paragraph – see paragraph 60 of HKSA 700).
>
> Management is responsible for … (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).
>
> Our responsibility is to express an opinion on these financial statements based on our audit. *Except as discussed in the following paragraph*, we conducted our audit in accordance with ... (remaining words are the same as illustrated in the auditor's responsibility paragraphs – see paragraph 60 of HKSA 700).
>
> *We did not observe the counting of the physical inventories as of 31 December 200X, since that date was prior to the time we were initially engaged as auditors for the Company. Owing to the nature of the Company's records, we were unable to satisfy ourselves as to inventory quantities by other audit procedures.*
>
> *In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to physical inventory quantities*, the financial statements give a true and fair view of ... (remaining words are the same as illustrated in the opinion paragraph – paragraph 60 of HKSA 700)."

Limitation on Scope—Disclaimer of Opinion

> *"We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as of 31 December 200X, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.*
>
> Management is responsible for … (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).

(Omit the sentence stating the responsibility of the auditor.) [(a)]

(The paragraph discussing the scope of the audit would either be omitted or amended according to the circumstances.)

(Add a paragraph discussing the scope limitation as follows:

We were not able to observe all physical inventories and confirm accounts receivable due to limitations placed on the scope of our work by the Company.)

Because of the significance of the matters discussed in the preceding paragraph, we do not express an opinion on the financial statements."

Disagreement with Management

20. The auditor may disagree with management about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosures in the financial statements. **If such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.**

21. Illustrations of these matters are set out below.

Disagreement on Accounting Policies—Inappropriate Accounting Method—Qualified Opinion

"We have audited ... (remaining words are the same as illustrated in the introductory paragraph – see paragraph 60 of HKSA 700).

Management is responsible for … (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).

Our responsibility is to … (remaining words are the same as illustrated in the auditor's responsibility paragraphs – see paragraph 60 of HKSA 700).

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which practice, in our opinion, is not in accordance with Hong Kong Financial Reporting Standards. The provision for the year ended 31 December 200X, should be xxx based on the straight-line method of depreciation using annual rates of 5% for the building and 20% for the equipment. Accordingly, the fixed assets should be reduced by accumulated depreciation of xxx and the loss for the year and accumulated deficit should be increased by xxx and xxx, respectively.

In our opinion, *except for the effect on the financial statements of the matter referred to in the preceding paragraph*, the financial statements give a true and fair view of ... (remaining words are the same as illustrated in the opinion paragraph – see paragraph 60 of HKSA 700)."

Disagreement on Accounting Policies—Inadequate Disclosure—Qualified Opinion

"We have audited ... (remaining words are the same as illustrated in the introductory paragraph – see paragraph 60 of HKSA 700).

Management is responsible for … (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700 (Revised)).

Our responsibility is to … (remaining words are the same as illustrated in the auditor's responsibility paragraphs – see paragraph 60 of HKSA 700 (Revised)).

(a) In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to make a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 32 and 34 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. An illustration is provided in Example 3 of the Appendix to reflect the auditor's duty under the Hong Kong Companies Ordinance.

On 15 January 2005, the Company issued debentures in the amount of xxx for the purpose of financing plant expansion. The debenture agreement restricts the payment of future cash dividends to earnings after 31 December 2000. In our opinion, disclosure of this information is required by ...[1]

In our opinion, *except for the omission of the information included in the preceding paragraph*, the financial statements give a true and fair view of ... (remaining words are the same as illustrated in the opinion paragraph–see paragraph 60 of HKSA 700)."

Disagreement on Accounting Policies—Inadequate Disclosure—Adverse Opinion

"We have audited ... (remaining words are the same as illustrated in the introductory paragraph – see paragraph 60 of HKSA 700).

Management is responsible for … (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).

Our responsibility is to … (remaining words are the same as illustrated in the auditor's responsibility paragraphs – see paragraph 60 of HKSA 700).

(Paragraph(s) discussing the disagreement.)

In our opinion, because of the effects of the matters discussed in the preceding paragraph(s), the financial statements do not give a true and fair view of (or 'do not present fairly, in all material respects,') the financial position of ABC Company as of 31 December 200X, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards."

Effective Date

22. This HKSA is effective for auditor's reports dated on or after 31 December 2006.

Conformity and compliance with International Standards on Auditing

23. As of October 2006 (date of issue) this HKSA conforms with International Standard on Auditing (ISA) 701, "Modifications to the Independent Auditor's Report" except that in paragraph 19, for a disclaimer of opinion, ISA 701 permits the omission of the paragraph stating the responsibility of the auditor. With the exception of the foregoing difference, as explained in footnote (a), compliance with the requirements of the HKSA ensures compliance with ISA 701.

24. Additional local guidance is provided in footnote (a) and the Appendix.

[1] Refer to relevant statutes or law.

Appendix

Examples of modified auditors' reports on financial statements

Matters that do affect the auditor's opinion

Example 1 – Qualified opinion – disagreement with management

Example 2 – Qualified opinion – limitation on the auditor's work

Example 3 – Disclaimer of opinion – limitation on the auditor's work

Example 4 – Adverse opinion – disagreement with management

Example 1 – Qualified opinion – disagreement with management

INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)[1]

We have audited the financial statements of ABC Limited set out on pages .... to ...., which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit[2]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Basis for qualified opinion

Included in debtors shown on the balance sheet is an amount of $X due from a debtor which has ceased trading. ABC Limited has no security for this debt. On the basis that no security has been obtained and no cash has been received on the debt, in our opinion the company should make a full provision for impairment of $X, reducing profit before taxation for the year and net assets at 31 December 200X by that amount.

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

2 Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Qualified opinion arising from disagreement about accounting treatment

In our opinion, except for the effect on the financial statements of the matter described in the basis for qualified opinion paragraph, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

XYZ & Co.

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

[Address]

Date

Example 2 – Qualified opinion - limitation on the auditors' work

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)[1]

Report on the Financial Statements

We have audited the financial statements of ABC Limited set out on pages .... to........, which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit[2]. Except as described in the basis for qualified opinion paragraph, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

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

[2] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Basis for qualified opinion

$X of the company's recorded turnover comprises cash sales, over which there was no system of internal control on which we could rely for the purpose of our audit. There were no other satisfactory audit procedures that we could adopt to satisfy ourselves that the recorded turnover was free from material misstatements.

Qualified opinion arising from limitation of audit scope

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to cash sales, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance[3]

In respect alone of the limitation on our work relating to cash sales:

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

XYZ & Co.

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

[Address]

Date

[3] For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

Example 3 – Disclaimer of opinion - limitation on the auditor's work

INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)[1]

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited set out on pages .... to........, which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit.[2] Except for the limitation in the scope of our work as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement. However, because of the matter described in the basis for disclaimer of opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

We were initially appointed auditors on (date) which was subsequent to the end of the company's financial year. In consequence we were unable to carry out auditing procedures necessary to obtain adequate assurance regarding the quantities and condition of inventories and work in progress, appearing in the balance sheet at $X. There were no other satisfactory audit procedures that we could adopt to obtain sufficient evidence regarding the existence of inventories and work in progress. Accordingly, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Any adjustment to the figure may have a consequential significant effect on the profit [loss] for the year and net assets at 31 December 200X.

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

[2] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Disclaimer of opinion: disclaimer on view given by financial statements[3]

Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, we do not express an opinion on the financial statements as to whether they give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance[4]

In respect alone of the limitation on our work relating to inventories and work in progress:

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

XYZ & Co.

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

[Address]

Date

[3] In this example, it is assumed that the counting of physical inventories is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. If the limitation of scope is not considered so material and pervasive, the auditor may express an "except for" opinion as illustrated in paragraph 19 of this HKSA.

[4] For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

Example 4 – Adverse opinion – disagreement with management

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)[1]

We have audited the financial statements of ABC Limited set out on pages .... to........, which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit[2]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Basis for adverse opinion

As more fully explained in note ... to the financial statements, losses expected to arise on certain long-term contracts currently in progress have not been recognised as expenses, as the directors consider that such losses should be off-set against amounts recoverable on other long-term contracts. In our opinion, the expected losses on individual contracts should be recognised as expenses immediately as required by Hong Kong Accounting Standard 11 "Construction Contracts". If losses had been so

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

[2] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

recognised the effect would have been to [reduce the profit/increase the loss] before taxation for the year and reduce the gross amounts due from customers at 31 December 200X by $X.

Adverse opinion

In our opinion, because of the significance of effects of the matters described in the basis for adverse opinion paragraph, the financial statements do not give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

XYZ & Co.

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

[Address]

Date

HKSA 200 (Revised)*
Issued October 2006

Effective for audits of financial statements
for periods beginning on or after 15 December 2005 and
where auditor's reports are dated on or after 31 December 2006*

Hong Kong Standard on Auditing 200 (Revised)

Objective and General Principles Governing an Audit of Financial Statements

* HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to HKSA 200, "Objective and General Principles Governing an Audit of Financial Statements". The conforming amendments are reflected in this HKSA 200 (Revised) and are effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor's reports are dated on or after 31 December 2006.

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

HONG KONG STANDARD ON AUDITING 200 (REVISED)

OBJECTIVE AND GENERAL PRINCIPLES GOVERNING AN AUDIT OF FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor's reports are dated on or after 31 December 2006)*

CONTENTS

Hong Kong Standard on Auditing (HKSA) 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

* HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement", HKSA 330, "The Auditor's Procedures in Response to Assessed Risks" and HKSA 500, "Audit Evidence" gave rise to conforming amendments to HKSA 200. These amendments are effective for audits of financial statements for periods beginning on or after 15 December 2004 and have been incorporated in the text of HKSA 200.

HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to HKSA 200. The conforming amendments are effective for audits of financial statements for periods beginning on or after 15 December 2005 where auditor's reports are dated on or after 31 December 2006 and have been incorporated in the text of this HKSA 200 (Revised). As implementation of the final sentence of paragraph 3 and paragraphs 37 to 48 of ISA 200 has been deferred, they have not been reflected in the body of this HKSA 200 (Revised). They are included in the Appendix to this HKSA 200 (Revised).

HKSA 230 (Revised), "Audit Documentation" gave rise to conforming amendments to HKSA 200 (Revised). These amendments are effective for audits of financial statements for periods beginning on or after 15 June 2006 and have been incorporated in the text of this HKSA 200 (Revised) (see footnote 1a).

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the objective and general principles governing an audit of financial statements. It also describes management's responsibility for the preparation and presentation of the financial statements and for identifying the financial reporting framework to be used in preparing the financial statements, referred to in the HKSAs as the "applicable financial reporting framework."

Objective of an Audit of Financial Statements

2. **The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.**

3. An audit of financial statements is an assurance engagement, as defined in the Hong Kong Framework for Assurance Engagements. The Framework defines and describes the elements and objectives of an assurance engagement. The HKSAs apply the Framework in the context of an audit of financial statements and contain the basic principles and essential procedures, together with related guidance, to be applied in such an audit. Paragraphs 34-35 in this HKSA discuss the meaning of the term "financial statements" and management's responsibility for such statements. As discussed in the Framework, a condition for acceptance of an assurance engagement is that the criteria referred to in the definition are "suitable criteria" and available to intended users.[1]

Ethical Requirements Relating to an Audit of Financial Statements

4. **The auditor should comply with relevant ethical requirements relating to audit engagements.**

5. As discussed in HKSA 220, "Quality Control for Audits of Historical Financial Information," ethical requirements relating to audits of financial statements ordinarily comprise HKICPA's *Code of Ethics for Professional Accountants* (the Code). HKSA 220 identifies the fundamental principles of professional ethics established by the Code and sets out the engagement partner's responsibilities with respect to ethical requirements. HKSA 220 recognizes that the engagement team is entitled to rely on a firm's systems in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement (for example, in relation to capabilities and competence of personnel through their recruitment and formal training; independence through the accumulation and communication of relevant independence information; maintenance of client relationships through acceptance and continuance systems; and adherence to regulatory and legal requirements through the monitoring process), unless information provided by the firm or other parties suggests otherwise. Accordingly, Hong Kong Standard on Quality Control (HKSQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

Conduct of an Audit of Financial Statements

6. **The auditor should conduct an audit in accordance with Hong Kong Standards on Auditing.**

7. HKSAs contain basic principles and essential procedures together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of explanatory and other material that provide guidance for their application. The text of a whole Standard is considered in order to understand and apply the basic principles and essential procedures.

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1 See Appendix to this HKSA in relation to paragraphs 37 to 48 of ISA 200 which discuss suitable criteria and their availability to intended users for an audit of financial statements through the auditor's consideration of the acceptability of the financial reporting framework. These paragraphs have been deferred by the IAASB (effective date yet to be determined).

8. In conducting an audit in accordance with HKSAs, the auditor is also aware of and considers Practice Notes and Auditing Guidelines (PNs and AGs) applicable to the audit engagement. PNs and AGs provide interpretive guidance and practical assistance to auditors in implementing HKSAs. An auditor who does not apply the guidance included in a relevant PN and AG needs to be prepared to explain how the basic principles and essential procedures in the Standard addressed by the PN and AG have been complied with.

9. The auditor may also conduct the audit in accordance with both HKSAs and auditing standards of a specific jurisdiction or country.

Scope of an Audit of Financial Statements

10. The term "scope of an audit" refers to the audit procedures that, in the auditor's judgment and based on the HKSAs, are deemed appropriate in the circumstances to achieve the objective of the audit.

11. **In determining the audit procedures to be performed in conducting an audit in accordance with Hong Kong Standards on Auditing, the auditor should comply with each of the Hong Kong Standards on Auditing relevant to the audit.**

12. In performing an audit, auditors may be required to comply with other professional, legal or regulatory requirements in addition to the HKSAs. The HKSAs do not override the local laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the HKSAs, an audit conducted in accordance with the local laws and regulations will not automatically comply with HKSAs.

13. When the auditor conducts the audit in accordance with HKSAs and auditing standards of a specific jurisdiction or country, in addition to complying with each of the HKSAs relevant to the audit, the auditor also performs any additional audit procedures necessary to comply with the relevant standards of that jurisdiction or country.

14. **The auditor should not represent compliance with Hong Kong Standards on Auditing unless the auditor has complied fully with all of the Hong Kong Standards on Auditing relevant to the audit.**

14A. The auditor may, in exceptional circumstances, judge it necessary to depart from a basic principle or an essential procedure that is relevant in the circumstances of the audit, in order to achieve the objective of the audit. In such a case, the auditor is not precluded from representing compliance with HKSAs, provided the departure is appropriately documented as required by HKSA 230, "Audit Documentation".[1a]

Professional Skepticism

15. **The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.**

16. An attitude of professional skepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. For example, an attitude of professional skepticism is necessary throughout the audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof. When making inquiries and performing other audit procedures, the auditor is not satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

[1a] These are conforming amendments arising from HKSA 230, "Audit Documentation" which are effective for audits of financial statements for periods beginning on or after 15 June 2006.

Reasonable Assurance

17. An auditor conducting an audit in accordance with HKSAs obtains reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.

18. An auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as the following:
    - The use of testing.
    - The inherent limitations of internal control (for example, the possibility of management override or collusion).
    - The fact that most audit evidence is persuasive rather than conclusive.

19. Also, the work undertaken by the auditor to form an audit opinion is permeated by judgment, in particular regarding:

    (a) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and

    (b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

20. Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions[2] (for example, transactions between related parties). In these cases certain HKSAs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:

    (a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or

    (b) Any indication that a material misstatement has occurred.

21. Accordingly, because of the factors described above, an audit is not a guarantee that the financial statements are free from material misstatement, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

Audit Risk and Materiality

22. Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks.[3] Management is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the financial statements. The auditor is ultimately concerned only with risks that may affect the financial statements.

23. The auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is known as "audit risk."[4]

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2 Paragraphs 15-18 of HKSA 500, "Audit Evidence," discuss the use of assertions in obtaining audit evidence.

3 Paragraphs 30-34 of HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement," discuss the concept of business risks and how they relate to risks of material misstatement.

4 This definition of audit risk does not include the risk that the auditor might erroneously express an opinion that the financial statements are materially misstated.

24. **The auditor should plan and perform the audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit.** The auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.

25. Audit risk is a function of the risk of material misstatement of the financial statements (or simply, the "risk of material misstatement") (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk"). The auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment (see HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" and HKSA 330, "The Auditor's Procedures in Response to Assessed Risks"). The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level (see HKSA 500, "Audit Evidence") and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.

26. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. The auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the financial statements taken as a whole. Materiality and audit risk are related (see HKSA 320, "Audit Materiality"). In order to design audit procedures to determine whether there are misstatements that are material to the financial statements taken as a whole, the auditor considers the risk of material misstatement at two levels: the overall financial statement level and in relation to classes of transactions, account balances, and disclosures and the related assertions.[5]

27. The auditor considers the risk of material misstatement at the overall financial statement level, which refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity's control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the auditor's consideration of the risk of material misstatement arising from fraud. The auditor's response to the assessed risk of material misstatement at the overall financial statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision; and whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

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5 HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" provides additional guidance on the auditor's requirement to assess risks of material misstatement at the financial statement level and at the assertion level.

28. The auditor also considers the risk of material misstatement at the class of transactions, account balance, and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level.[6] The auditor seeks to obtain sufficient appropriate audit evidence at the class of transactions, account balance, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish that objective.[7]

29. The discussion in the following paragraphs provides an explanation of the components of audit risk. The risk of material misstatement at the assertion level consists of two components as follows:

- "Inherent risk" is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, complex calculations are more likely to be misstated than simple calculations. Accounts consisting of amounts derived from accounting estimates that are subject to significant measurement uncertainty pose greater risks than do accounts consisting of relatively routine, factual data. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
- "Control risk" is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity's objectives relevant to preparation of the entity's financial statements. Some control risk will always exist because of the inherent limitations of internal control.

30. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor's assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. The HKSAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risk of material misstatement." Although the HKSAs ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

31. "Detection risk" is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other

6 HKSA 330, "The Auditor's Procedures in Response to Assessed Risks" provides additional guidance on the requirement for the auditor to design and perform further audit procedures in response to the assessed risks at the assertion level.

7 The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.

misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of a class of transactions, account balance, or disclosure and because of other factors. Such other factors include the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

32. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

Responsibility for the Financial Statements

33. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework is that of the management[8] of the entity, with oversight from those charged with governance.[9] The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

34. The term "financial statements" refers to a structured representation of the financial information, which ordinarily includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term can refer to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.

35. The requirements of the financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements. For certain financial reporting frameworks, a single financial statement such as a cash flow statement and the related explanatory notes constitutes a complete set of financial statements. For example, the International Public Sector Accounting Standard (IPSAS), "Financial Reporting Under the Cash Basis of Accounting," states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares and presents its financial statements in accordance with that IPSAS. Financial statements prepared by reference to Hong Kong Financial Reporting Standards (HKFRSs) or International Financial Reporting Standards (IFRSs), on the other hand, are intended to provide information about the financial position, performance and cash flows of an entity. A complete set of financial statements under HKFRSs or IFRSs includes a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and notes, comprising a summary of significant accounting policies and other explanatory notes.

36. Management is responsible for identifying the financial reporting framework to be used in the preparation and presentation of the financial statements. Management is also responsible for preparing and presenting the financial statements in accordance with that applicable financial reporting framework. This responsibility includes:

- Designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error;

8 The term "management" has been used in this HKSA to describe those responsible for the preparation and presentation of the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction.

9 The structures of governance vary from country to country, reflecting cultural and legal backgrounds. Therefore, the respective responsibilities of management and those charged with governance vary depending on the legal responsibilities in the particular jurisdiction.

- Selecting and applying appropriate accounting policies; and
- Making accounting estimates that are reasonable in the circumstances.

Determining the Acceptability of the Financial Reporting Framework[10]

37. – 48. *[See paragraph 1 of Appendix]*

Expressing an Opinion on the Financial Statements

49. When the auditor is expressing an opinion on a complete set of general purpose financial statements prepared in accordance with a financial reporting framework that is designed to achieve fair presentation, the auditor refers to HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," for standards and guidance on the matters the auditor considers in forming an opinion on such financial statements and on the form and content of the auditor's report. The auditor also refers to HKSA 701 when expressing a modified audit opinion, including an emphasis of matter, a qualified opinion, a disclaimer of opinion or an adverse opinion.

50. and 51. *[See paragraph 2 of Appendix]*

Effective Date

52. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor's reports are dated on or after 31 December 2006.

Conformity and Compliance with International Standards on Auditing

53. As of October 2006 (date of issue), this HKSA conforms with the version of International Standard on Auditing (ISA) 200, "Objective and General Principles Governing An Audit of Financial Statements" that is effective for audits of financial statements for period beginning on or after 15 December 2005. Compliance with the requirements of this HKSA ensures compliance with ISA 200.

54. Additional local explanations are provided in footnotes 1, 1a, 10 and the Appendix.

Public Sector Perspective

1. *Irrespective of whether an audit is being conducted in the private or public sector, the basic principles of auditing remain the same. What may differ for audits carried out in the public sector is the audit objective and scope. These factors are often attributable to differences in the audit mandate and legal requirements or the form of reporting (for example, public sector entities may be required to prepared additional financial reports).*

2. *When carrying out audits of public sector entities, the auditor will need to take into account the specific requirements of any other relevant regulations, ordinances or ministerial directives which affect the audit mandate and any special auditing requirements, including the need to have regard to issues of national security. Audit mandates may be more specific than those in the private sector, and often encompass a wider ranged of objectives and a broader scope than is ordinarily applicable for the audit of private sector financial statements. The mandates and requirements may also effect, for example, the extent of the auditor's discretion in establishing materiality, in reporting fraud and error, and in the form of the auditor's report. Differences in audit approach and style may also exist. However, these differences would not constitute a difference in the basic principles and essential procedures.*

[10] As the implementation of paragraphs 37 to 48 has been deferred by the IAASB, these paragraphs have not been reflected in the body of this HKSA 200 (Revised). These paragraphs are included in the Appendix to this HKSA 200 (Revised).

Appendix

Deferred Paragraphs

1. The application of the final sentence of paragraph 3 and paragraphs 37 to 48 of ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" have been deferred by the IAASB (effective date yet to be determined) pending the revision of ISA 800, "The Independent Auditor's Report on Special Purpose Audit Engagements". The sentence and paragraphs are shown below for reference and will be incorporated in this Standard when effective.

   3. Paragraphs 37 to 48 in this ISA discuss suitable criteria and their availability to intended users for an audit of financial statements through the auditor's consideration of the acceptability of the financial reporting framework

Determining the Acceptability of the Financial Reporting Framework

*37. **The auditor should determine whether the financial reporting framework adopted by management in preparing the financial statements is acceptable.** The auditor ordinarily makes this determination when considering whether to accept the audit engagement, as discussed in ISA 210, "Terms of Audit Engagements." An acceptable financial reporting framework is referred to in the ISAs as the "applicable financial reporting framework."*

38. The auditor determines whether the financial reporting framework adopted by management is acceptable in view of the nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not for profit organization) and the objective of the financial statements.

Financial Statements Designed to Meet the Financial Information Needs of Specific Users

39. In some cases, the objective of the financial statements will be to meet the financial information needs of specific users. The information needs of such users will determine the applicable financial reporting framework in these circumstances. Examples of financial reporting frameworks that address the needs of specific users are: a tax basis of accounting for a set of financial statements that accompany an entity's tax return; the financial reporting provisions of a government regulatory agency for a set of financial statements to meet the information needs of that agency; or a financial reporting framework established by the provisions of an agreement specifying the financial statements to be prepared. Financial statements prepared in accordance with such financial reporting frameworks may be the only financial statements prepared by an entity and, in such circumstances, are often used by users in addition to those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be designed to meet the financial information needs of specific users for purposes of the ISAs. ISA 800[11], "The Independent Auditor's Report on Special Purpose Audit Engagements" establishes standards and provides guidance on financial statements whose objective is to meet the financial information needs of specific users. Although specific users may not be identified, financial statements that are prepared in accordance with a framework that is not designed to achieve fair presentation are also addressed in ISA 800.

11 ISA 800 is currently under revision by the IAASB and revised ISA 800 will be considered for adoption by the HKICPA. .

Financial Statements Designed to Meet the Common Financial Information Needs of a Wide Range of Users

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

Financial Reporting Frameworks Established by Authorized or Recognized Organizations

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

- *IFRSs promulgated by the International Accounting Standards Board;*
- *IPSASs promulgated by the International Federation of Accountants – International Public Sector Accounting Standards Board; and*
- *Generally accepted accounting principles promulgated by a recognized standards setter in a particular jurisdiction.*

These financial reporting frameworks are often identified as the applicable financial reporting framework in legislative and regulatory requirements governing the preparation of general purpose financial statements. Refer to ISA 800 for financial reporting frameworks designed to meet the particular needs of a government regulatory agency.

Financial Reporting Frameworks Supplemented with Legislative and Regulatory Requirements

42. In some jurisdictions, legislative and regulatory requirements may supplement a financial reporting framework adopted by management with additional requirements relating to the preparation and presentation of financial statements. In these jurisdictions, the applicable financial reporting framework, for the purposes of applying the ISAs, encompasses both the identified financial reporting framework and such additional requirements, provided they do not conflict with the applicable financial reporting framework. This may, for example, be the case when additional requirements prescribe disclosures in addition to those required by the identified financial reporting framework or when they narrow the range of acceptable choices that can be made within the identified financial reporting framework. If the additional requirements conflict with the applicable financial reporting framework, the auditor discusses the nature of the requirements with management and whether the additional requirements can be met through additional disclosures. If this is not possible, the auditor considers whether it is necessary to modify the auditor's report, see ISA 701, "Modifications to the Independent Auditor's Report."

Jurisdictions that Do Not have an Authorized or Recognized Standards Setting Organization

43. When an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, the entity identifies an *applicable financial reporting framework. Practice in such jurisdictions is often to use a financial reporting framework established by one of the organizations described in paragraph 41. Alternatively, there may be established accounting conventions in a particular jurisdiction that are generally recognized as the applicable financial reporting framework for the general purpose financial statements prepared by certain specified entities operating in that jurisdiction. When such a financial reporting framework is adopted by the entity, the auditor determines whether the accounting conventions collectively can be considered to constitute an acceptable financial reporting framework for general purpose financial statements. When the accounting conventions are widely used in a particular jurisdiction, the accounting profession in that jurisdiction may have considered the acceptability of the financial reporting framework on behalf of the auditors. Alternatively, the auditor makes this determination by considering whether the accounting conventions exhibit attributes normally exhibited by acceptable financial reporting frameworks or by comparing the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable.*

44. Acceptable financial reporting frameworks for general purpose financial statements normally exhibit the following attributes that result in information provided in financial statements that is useful to users:

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

(b) Completeness, in that transactions and events, account balances and disclosures that could affect the fair presentation of the financial statements are not omitted.

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

Reflects the economic substance of events and transactions and not merely their legal form; and

Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances;

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

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

45. A conglomeration of accounting conventions devised to suit individual preferences is not an acceptable financial reporting framework for financial statements intended to address the common information needs of a wide range of users.

46. The description of the financial reporting framework in the financial statements includes information about the basis of preparation of the financial statements and the accounting policies selected and applied for significant transactions and other significant events.

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

48. When the auditor concludes that the financial reporting framework adopted by management is not acceptable, the auditor considers the implications in relation to engagement acceptance (see ISA 210) and the auditor's report (see ISA 701).

2. Paragraphs 50 and 51 of ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" have not been adopted in HKSA 200, and are shown below for reference

50. The auditor refers to ISA 800 when expressing an opinion on:

(a) A complete set of financial statements prepared in accordance with another comprehensive basis of accounting;

(b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement;

(c) Compliance with contractual agreements; and

(d) Summarized financial statements.

51. In addition to addressing reporting considerations, ISA 800 also addresses other matters the auditor considers in such engagements related to, for example, engagement acceptance and the conduct of the audit.

The HKICPA has not adopted the current ISA 800. The current ISA 800 allows a true and fair view opinion to be expressed by a practitioner in situations described in (a) and (b) above. ISA 800 is currently under revision by the IAASB and revised ISA 800 will be considered for adoption by the HKICPA.

HKSA 560 (Revised)*
Issued October 2006

Effective for auditor's reports dated
on or after 31 December 2006*

Hong Kong Standard on Auditing 560 (Revised)

Subsequent Events

* HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to HKSA 560, "Subsequent Events". The conforming amendments are reflected in this HKSA 560 (Revised). HKSA 700 and HKSA 560 (Revised) are effective for auditor's reports dated on or after 31 December 2006.

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

HONG KONG STANDARD ON AUDITING 560 (Revised)

SUBSEQUENT EVENTS

(Effective for auditor's reports dated
on or after 31 December 2006)*

CONTENTS

Hong Kong Standard on Auditing (HKSA) 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

* HKSA 700, "The Independent Auditor's Report On a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to HKSA 560, "Subsequent Events". The conforming amendments are reflected in this HKSA 560 (Revised). HKSA 700 and HKSA 560 (Revised) are effective for auditor's reports dated on or after 31 December 2006.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the auditor's responsibility regarding subsequent events. In this HKSA, the term "subsequent events" is used to refer to both events occurring between the date of the financial statements and the date of the auditor's report, and facts discovered after the date of the auditor's report.

2. **The auditor should consider the effect of subsequent events on the financial statements and on the auditor's report.**

3. Hong Kong Accounting Standard (HKAS) 10 "Events after the Balance Sheet Date" deals with the treatment in financial statements of events, both favorable and unfavorable, that occur between the date of the financial statements (referred to as the "balance sheet date" in the HKAS) and the date when the financial statements are authorized for issue and identifies two types of events:

   (a) Those that provide evidence of conditions that existed at the date of the financial statements; and

   (b) Those that are indicative of conditions that arose after the date of the financial statements.

Definitions

4. The following terms have the meanings attributed below:

   (a) "Date of the financial statements" is the date of the end of the latest period covered by the financial statements, which is normally the date of the most recent balance sheet in the financial statements subject to audit.

   (b) "Date of approval of the financial statements" is the date on which those with the recognized authority assert that they have prepared the entity's complete set of financial statements, including the related notes, and that they have taken responsibility for them. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that a complete set of financial statements has been prepared, and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalizing its financial statements in view of its management and governance structures. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of the HKSAs is the earlier date on which those with the recognized authority determine that a complete set of financial statements has been prepared.

   (c) "Date of the auditor's report" is the date selected by the auditor to date the report on the financial statements. The auditor's report is not dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements.[2] Sufficient appropriate audit evidence includes evidence that the entity's complete set of financial statements has been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

   (d) "Date the financial statements are issued" is the date that the auditor's report and audited financial statements are made available to third parties, which may be, in many circumstances, the date that they are filed with a regulatory authority.[2a]

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1 [not used].

2 In rare circumstances, law or regulation also identifies the point in the financial statement reporting process at which the audit is expected to be complete.

2a In Hong Kong, "Date the financial statements are issued" is the earliest date that the auditor's report and audited financial statements are made available to shareholders or other parties.

Events Occurring Up to the Date of the Auditor's Report

5. **The auditor should perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified.** These procedures are in addition to routine procedures which may be applied to specific transactions occurring after the date of the financial statements to obtain audit evidence as to account balances as at the date of the financial statements, for example, the testing of inventory cutoff and payments to creditors. The auditor is not, however, expected to conduct a continuing review of all matters to which previously applied procedures have provided satisfactory conclusions.

6. The procedures to identify events that may require adjustment of, or disclosure in, the financial statements would be performed as near as practicable to the date of the auditor's report and ordinarily include the following:

   - Reviewing procedures management has established to ensure that subsequent events are identified.
   - Reading minutes of the meetings of shareholders, the board of directors and audit and executive committees held after the date of the financial statements and inquiring about matters discussed at meetings for which minutes are not yet available.
   - Reading the entity's latest available interim financial statements and, as considered necessary and appropriate, budgets, cash flow forecasts and other related management reports.
   - Inquiring, or extending previous oral or written inquiries, of the entity's lawyers concerning litigation and claims.
   - Inquiring of management as to whether any subsequent events have occurred which might affect the financial statements. Examples of inquiries of management on specific matters are:
     - The current status of items that were accounted for on the basis of preliminary or inconclusive data.
     - Whether new commitments, borrowings or guarantees have been entered into.
     - Whether sales of assets have occurred or are planned.
     - Whether the issue of new shares or debentures or an agreement to merge or liquidate has been made or is planned.
     - Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
     - Whether there have been any developments regarding risk areas and contingencies.
     - Whether any unusual accounting adjustments have been made or are contemplated.
     - Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

7. When a component, such as a division, branch or subsidiary, is audited by another auditor, the auditor would consider the other auditor's procedures regarding events after the date of the financial statements and the need to inform the other auditor of the planned date of the auditor's report.

8. **When the auditor becomes aware of events which materially affect the financial statements, the auditor should consider whether such events are properly accounted for and adequately disclosed in the financial statements.**

Facts Discovered After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued

9. The auditor does not have any responsibility to perform procedures or make any inquiry regarding the financial statements after the date of the auditor's report. During the period from the date of the auditor's report to the date the financial statements are issued, the responsibility to inform the auditor of facts which may affect the financial statements rests with management.

10. **When, after the date of the auditor's report but before the date the financial statements are issued, the auditor becomes aware of a fact which may materially affect the financial statements, the auditor should consider whether the financial statements need amendment, should discuss the matter with management, and should take the action appropriate in the circumstances.**

11. When management amends the financial statements, the auditor would carry out the procedures necessary in the circumstances and would provide management with a new report on the amended financial statements. The new auditor's report would be dated not earlier than the date of approval of the amended financial statements and, accordingly, the procedures referred to in paragraph 5 would be extended to the date of the new auditor's report.

12. **When management does not amend the financial statements in circumstances where the auditor believes they need to be amended and the auditor's report has not been released to the entity, the auditor should express a qualified opinion or an adverse opinion, as described in HKSA 701, "Modifications to the Independent Auditor's Report."**

13. When the auditor's report has been released to the entity, the auditor would notify those persons ultimately responsible for the overall direction of the entity not to issue the financial statements and the auditor's report thereon to third parties. If the financial statements are subsequently released, the auditor needs to take action to prevent reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyer.

Facts Discovered After the Financial Statements have been Issued

14. After the financial statements have been issued, the auditor has no obligation to make any inquiry regarding such financial statements.

15. **When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the auditor's report and which, if known at that date, may have caused the auditor to modify the auditor's report, the auditor should consider whether the financial statements need revision, should discuss the matter with management, and should take the action appropriate in the circumstances.**

16. When management revises the financial statements, the auditor would carry out the audit procedures necessary in the circumstances, would review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation, and would issue a new report on the revised financial statements.

17. **The new auditor's report should include an emphasis of a matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the revision of the previously issued financial statements and to the earlier report issued by the auditor.** The new auditor's report would be dated not earlier than the date of approval of the revised financial statements and, accordingly, the procedures referred to in paragraph 5 would ordinarily be extended to the date of the new auditor's report. Local regulations of some countries permit the auditor to restrict the audit procedures regarding the revised financial statements to the effects of the subsequent event that necessitated the revision. In such cases, the new auditor's report would contain a statement to that effect.

18. When management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation and does not revise the financial statements in circumstances where the auditor believes they need to be revised, the auditor would notify those persons ultimately responsible

for the overall direction of the entity that action will be taken by the auditor to prevent future reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyers.

19. It may not be necessary to revise the financial statements and issue a new auditor's report when issue of the financial statements for the following period is imminent, provided appropriate disclosures are to be made in such statements.

Offering of Securities to the Public

20. **In cases involving the offering of securities to the public, the auditor should consider any legal and related requirements applicable to the auditor in all jurisdictions in which the securities are being offered.** For example, the auditor may be required to carry out additional audit procedures to the date of the final offering document. These procedures would ordinarily include carrying out the procedures referred to in paragraphs 4, 5 and 6 up to a date at or near the effective date of the final offering document and reading the offering document to assess whether the other information in the offering document is consistent with the financial information with which the auditor is associated.

Effective Date

21. This HKSA is effective for auditor's reports dated on or after 31 December 2006.

Conformity and compliance with International Standards on Auditing

22. As of October 2006 (date of issue), this HKSA conforms with the version of International Standard on Auditing (ISA) 560, "Subsequent Events" that is effective for auditor's reports dated on or after 31 December 2006. Compliance with the requirements of this HKSA ensures compliance with ISA 560.

23. Additional local explanation is provided in footnote 2a.

HKSA 200
Issued November 2004

Effective for audits of financial statements
for periods beginning on or after 15 December 2004*

Hong Kong Standard on Auditing 200

Objectives and General Principles Governing an Audit of Financial Statements

* This HKSA 200 is effective for audits of financial statements for periods beginning on or after 15 December 2004. HKSA 200 (Revised) issued in October 2006 is effective for audits of financial statements for periods beginning on or after 15 December 2005 and where the auditor's report is dated on or after 31 December 2006 and supersedes this HKSA 200.

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HONG KONG STANDARD ON AUDITING 200

OBJECTIVE AND GENERAL PRINCIPLES GOVERNING AN AUDIT OF FINANCIAL STATEMENTS

(Effective for audits of financial statements
for periods beginning on or after 15 December 2004)

CONTENTS

Hong Kong Standard on Auditing (HKSA) 200, “Objective and General Principles Governing an Audit of Financial Statements” should be read in the context of the “Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services” which sets out the application and authority of HKSAs.

This Standard was first issued as SAS 100 (Revised), “Objective and General Principles Governing an Audit of Financial Statements” in January 2004 and reissued as HKSA 200 in November 2004.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the objective and general principles governing an audit of financial statements. This HKSA is to be read in conjunction with "Hong Kong Framework for Assurance Engagements".

Objective of an Audit

2. **The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.** The phrases used to express the auditor's opinion are "give a true and fair view" or "present fairly, in all material respects", which are equivalent terms.

3. Although the auditor's opinion enhances the credibility of the financial statements, the user cannot assume that the opinion is an assurance as to the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

General Principles of an Audit

4. **The auditor should comply with the HKICPA Statements of Professional Ethics/*Code of Ethics for Professional Accountants*.** Ethical principles governing the auditor's professional responsibilities are:

   (a) Independence;

   (b) Integrity;

   (c) Objectivity;

   (d) Professional competence and due care;

   (e) Confidentiality;

   (f) Professional behaviour; and

   (g) Technical standards.

5. **The auditor should conduct an audit in accordance with HKSAs.** These contain basic principles and essential procedures together with related guidance in the form of explanatory and other material.

6. **The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.** An attitude of professional skepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to audit evidence that contradicts or brings into question the reliability of documents or management representations. For example, an attitude of professional skepticism is necessary throughout the audit process for the auditor to reduce the risk of overlooking suspicious circumstances, of overgeneralizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof. In planning and performing an audit, the auditor neither assumes that management is dishonest nor assumes unquestioned honesty. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

Scope of an Audit

7. The term "scope of an audit" refers to the audit procedures deemed necessary in the circumstances to achieve the objective of the audit**. The procedures required to conduct an audit in accordance with HKSAs should be determined by the auditor having regard to the requirements of HKSAs, relevant professional bodies, legislation, regulations and, where appropriate, the terms of the audit engagement and reporting requirements.**

Reasonable Assurance

8. An audit in accordance with HKSAs is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.

9. An auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as:

   - The use of testing;
   - The inherent limitations of internal control (for example, the possibility of management override or collusion); and
   - The fact that most audit evidence is persuasive rather than conclusive.

10. Also, the work undertaken by the auditor to form an opinion is permeated by judgment, in particular regarding:

    (a) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and

    (b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management[2a] in preparing the financial statements.

11. Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions[1] (for example, transactions between related parties). In these cases certain HKSAs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:

    (a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or

    (b) Any indication that a material misstatement has occurred.

12. Accordingly, because of the factors described above, an audit is not a guarantee that the financial statements are free of material misstatement.

Audit Risk and Materiality

13. Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks[2]. Management[2a] is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the financial statements. The auditor is ultimately concerned only with risks that may affect the financial statements.

14. The auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the applicable financial reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The

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[1] Paragraphs 15-18 of HKSA 500, "Audit Evidence" discuss the use of assertions in obtaining audit evidence.

[2] Paragraphs 30-34 of HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" discuss the concept of business risks and how they relate to risks of material misstatement.

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

risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is known as "audit risk"[3].

15. **The auditor should plan and perform the audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit.** The auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.

16. Audit risk is a function of the risk of material misstatement of the financial statements (or simply, the "risk of material misstatement") (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk"). The auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment (see HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" and HKSA 330, "The Auditor's Procedures in Response to Assessed Risks"). The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level (see HKSA 500, "Audit Evidence") and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.

17. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. The auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the financial statements taken as a whole. Materiality and audit risk are related (see HKSA 320, "Audit Materiality"). In order to design audit procedures to determine whether there are misstatements that are material to the financial statements taken as a whole, the auditor considers the risk of material misstatement at two levels: the overall financial statement level and in relation to classes of transactions, account balances, and disclosures and the related assertions.[4]

18. The auditor considers the risk of material misstatement at the overall financial statement level, which refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity's control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the auditor's consideration of the risk of material misstatement arising from fraud. The auditor's response to the assessed risk of material misstatement at the overall financial statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision; and whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

19. The auditor also considers the risk of material misstatement at the class of transactions, account balance, and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level.[5]

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[3] This definition of audit risk does not include the risk that the auditor might erroneously express an opinion that the financial statements are materially misstated.

[4] HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" provides additional guidance on the auditor's requirement to assess risks of material misstatement at the financial statement level and at the assertion level.

[5] HKSA 330, "The Auditor's Procedures in Response to Assessed Risks" provides additional guidance on the requirement for the auditor to design and perform further audit procedures in response to the assessed risks at the assertion level.

The auditor seeks to obtain sufficient appropriate audit evidence at the class of transactions, account balance, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish that objective.[6]

20. The discussion in the following paragraphs provides an explanation of the components of audit risk. The risk of material misstatement at the assertion level consists of two components as follows:

- "Inherent risk" is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, complex calculations are more likely to be misstated than simple calculations. Accounts consisting of amounts derived from accounting estimates that are subject to significant measurement uncertainty pose greater risks than do accounts consisting of relatively routine, factual data. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
- "Control risk" is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity's objectives relevant to preparation of the entity's financial statements. Some control risk will always exist because of the inherent limitations of internal control.

21. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor's assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. HKSAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risk of material misstatement." Although HKSAs ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

22. "Detection risk" is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of a class of transactions, account balance, or disclosure and because of

[6] The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.

other factors. Such other factors include the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

23. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

Responsibility for the Financial Statements

24. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for preparing and fairly presenting the financial statements in accordance with the applicable financial reporting framework is that of the management of the entity, with oversight from those charged with governance.[7] The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Effective Date

25. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2004.

Conformity and Compliance with International Standards on Auditing

26. As of November 2004 *(date of issue)*, this HKSA conforms with International Standard on Auditing (ISA) 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements" except that a reference to IFAC Code of Ethics for Professional Accountants is replaced by HKICPA Statements of Professional Ethics/*Code of Ethics for Professional Accountants.* With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 200 (Revised).

27. Additional local explanation is provided in footnote 2a.

Public Sector Perspective

1. Irrespective of whether an audit is being conducted in the private or public sector, the basic principles of auditing remain the same. What may differ for audits carried out in the public sector is the audit objective and scope. These factors are often attributable to differences in the audit mandate and legal requirements or the form of reporting (for example, public sector entities may be required to prepare additional financial reports).

2. When carrying out audits of public sector entities, the auditor will need to take into account the specific requirements of any other relevant regulations, ordinances or ministerial directives which affect the audit mandate and any special auditing requirements, including the need to have regard to issues of national security. Audit mandates may be more specific than those in the private sector, and often encompass a wider range of objectives and a broader scope than is ordinarily applicable for the audit of private sector financial statements. The mandates and requirements may also effect, for example, the extent of the auditor's discretion in establishing materiality, in reporting fraud and error, and in the form of the auditor's report. Differences in audit approach and style may also exist. However, these differences would not constitute a difference in the basic principles and essential procedures.

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[7] The structures of governance vary from country to country reflecting cultural and legal backgrounds. Therefore, the respective responsibilities of management and those charged with governance vary depending on the legal responsibilities in the particular jurisdiction.

HKSA 210
Issued June 2005

Effective for audits of financial statements
for periods beginning on or after 15 December 2004*

Hong Kong Standard on Auditing 210

Terms of Audit Engagements

* HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" issued in October 2006 and effective for auditor's reports dated on or after 31 December 2006 gave rise to conforming amendments to HKSA 210. Implementation of these amendments in ISA 210 "Terms of Audit Engagements" (HKSA 210 equivalent) has been deferred by the IAASB (effective date yet to be determined). The conforming amendments are included in Appendix 3 of this HKSA for reference only.

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

HONG KONG STANDARD ON AUDITING 210

TERMS OF AUDIT ENGAGEMENTS

(Effective for audits of financial statements
for periods beginning on or after 15 December 2004)*

(Issued June 2005 and revised October 2006)

CONTENTS

Hong Kong Standard on Auditing (HKSA) 210, "Terms of Audit Engagements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

* HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" issued in October 2006 and effective for auditor's reports dated on or after 31 December 2006 gave rise to conforming amendments to HKSA 210. Implementation of these amendments in ISA 210 "Terms of Audit Engagements" (HKSA 210 equivalent) has been deferred by the IAASB (effective date yet to be determined). The conforming amendments are included in Appendix 3 of this HKSA for reference only.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on:

   (a) Agreeing the terms of the engagement with the client; and

   (b) The auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.

2. **The auditor and the client should agree on the terms of the engagement.** The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.

3. This HKSA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements. The guidance is also applicable to related services. When other services such as tax, accounting, or management advisory services are to be provided, separate letters may be appropriate.

4. In some countries, the objective and scope of an audit and the auditor's obligations are established by law. Even in those situations the auditor may still find audit engagement letters informative for their clients.

Audit Engagement Letters

5. It is in the interest of both client and auditor that the auditor sends an engagement letter[1], preferably before the commencement of the engagement, to help in avoiding misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.

Principal Contents

6. The form and content of audit engagement letters may vary for each client, but they would generally include reference to:

   - The objective of the audit of financial statements;
   - Management's responsibility for the financial statements[2];
   - The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres;
   - The form of any reports or other communication of results of the engagement;
   - The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatement may remain undiscovered; and
   - Unrestricted access to whatever records, documentation and other information requested in connection with the audit.

7. The auditor may also wish to include the following in the letter:

   - Arrangements regarding the planning and performance of the audit.
   - Expectation of receiving from management written confirmation concerning representations made in connection with the audit.

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

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

- Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.
- Description of any other letters or reports the auditor expects to issue to the client.
- Basis on which fees are computed and any billing arrangements.

8. When relevant, the following points could also be made:
   - Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.
   - Arrangements concerning the involvement of internal auditors and other client staff.
   - Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.
   - Any restriction of the auditor's liability when such possibility exists.
   - A reference to any further agreements between the auditor and the client.
   - An example of an audit engagement letter is set out in the Appendix.

Audits of Components

9. When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the decision whether to send a separate engagement letter to the component include the following:
   - Who appoints the auditor of the component.
   - Whether a separate auditor's report is to be issued on the component.
   - Legal requirements.
   - The extent of any work performed by other auditors.
   - Degree of ownership by parent.
   - Degree of independence of the component's management.

Recurring Audits

10. **On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.**
11. The auditor may decide not to send a new engagement letter each period. However, the following factors may make it appropriate to send a new letter:
    - Any indication that the client misunderstands the objective and scope of the audit.
    - Any revised or special terms of the engagement.
    - A recent change of senior management or those charged with governance.
    - A significant change in ownership.
    - A significant change in nature or size of the client's business.
    - Legal or regulatory requirements.

Acceptance of a Change in Engagement

12. **An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.**
13. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement,

whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.

14. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of service originally requested would ordinarily be considered a reasonable basis for requesting a change in the engagement. In contrast a change would not be considered reasonable if it appeared that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

15. Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with HKSAs would consider, in addition to the above matters, any legal or contractual implications of the change.

16. If the auditor concludes, that there is reasonable justification to change the engagement and if the audit work performed complies with the HKSAs applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusing the reader, the report would not include reference to:

    (a) The original engagement; or

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

17. **Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.**

18. **The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.** An example might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.

19. **If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as those charged with governance or shareholders, the circumstances necessitating the withdrawal.**

19-1. Auditor of a company incorporated under the Companies Ordinance who resigns from the office as auditor is required to comply with the requirements of section 140A of the Companies Ordinance regarding the statement to be made by him in relation to his resignation. If the auditor is removed from office, he may wish to exercise his rights under section 132(6) of the Companies Ordinance to attend and be heard at the general meeting.

Effective Date

20. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2004.

Conformity and Compliance with International Standards on Auditing

21. As of October 2006 (date of revision), this HKSA conforms with International Standard on Auditing (ISA) 210, "Terms of Audit Engagements". Compliance with the requirements of this HKSA ensures compliance with ISA 210.

22. Additional local guidance is provided in paragraph 19-1. Additional local explanations are provided in footnotes 1 and 2. Example audit engagement letter is provided in Appendix 1 and guidance on tax engagement letter and example tax engagement letter are provided in Appendix 2.

Public Sector Perspective

1. *The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement or recognizing an engagement not indicated in the legislative mandate may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagements letters when undertaking an audit.*

2. *Paragraphs 12 to 19-1 of this HKSA deal with the action a private sector auditor may take when there are attempts to change an audit engagement to one which provides a lower level of assurance. In the public sector specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if management (including the department head) attempts to limit the scope of the audit.*

APPENDIX 1

Example of an Audit Engagement Letter

This form of letter has been drafted to apply to limited company clients which are incorporated in Hong Kong under the Companies Ordinance. It is not necessarily comprehensive or appropriate to be used in relation to every entity, and it must be tailored to specific circumstances - for example to the special reporting requirement of regulated entities.

To the directors of ______________________________:

The purpose of this letter is to set out the basis on which we (are to)* act as auditors of the company (and its subsidiaries)* and the respective areas of responsibility of the directors and of ourselves.

Responsibilities of directors and auditors

1.1 As directors of the above company, you are responsible for ensuring that the company maintains proper books of account and for preparing financial statements which give a true and fair view and have been prepared in accordance with the Companies Ordinance. You are also responsible for making available to us, as and when required, all the company's books of account and all other relevant records and related information, including minutes of all management and shareholders' meetings.

1.2 We have a statutory responsibility to report to the members whether in our opinion the financial statements give a true and fair view and whether they have been properly prepared in accordance with the Companies Ordinance. In arriving at our opinion, we are required to consider the following matters, and to report on any in respect of which we are not satisfied:

a. whether proper books of account have been kept by the company and proper returns adequate for our audit have been received from branches not visited by us;

b. whether the company's balance sheet and profit and loss account are in agreement with the books of account and returns; and

c. whether we have obtained all the information and explanations which we consider necessary for the purposes of our audit.

In addition, there are certain other matters which, according to the circumstances, may need to be dealt with in our report. For example, where the financial statements do not give details of directors' remuneration or of loans to officers, the Companies Ordinance requires us to disclose such matters in our report.

1.3 We have a professional responsibility to report if the financial statements do not comply in any material respect with applicable accounting standards, unless in our opinion the non-compliance is justified in the circumstances. In determining whether or not the departure is justified, we consider:

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

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

Scope of audit

2.1 Our audit will be conducted in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants, and will include such tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting and internal control systems in order to assess their adequacy as a basis for the preparation of the financial statements and to establish whether proper books of account have been maintained by the company. We shall expect to obtain such appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom.

2.2 The nature and extent of our procedures will vary according to our assessment of the company's accounting system and, where we wish to place reliance on it, the internal control system, and may cover any aspect of the business's operations that we consider appropriate. Our audit is not designed to identify all significant weaknesses in the company's systems but, if such weaknesses come to our notice during the course of our audit which we think should be brought to your attention, we shall report them to you. Any such report may not be provided to third parties without our prior written consent. Such consent will be granted only on the basis that such reports are not prepared with the interests of anyone other than the company in mind and that we accept no duty or responsibility to any other party as concerns the reports.

2.3 As part of our normal audit procedures, we may request you to provide written confirmation of certain oral representations which we have received from you during the course of the audit on matters having a material effect on the financial statements. In connection with representations and the supply of information to us generally, we draw your attention to section 134 of the Companies Ordinance under which it is an offence for an officer of the company to mislead the auditors.

2.4 In order to assist us with the examination of your financial statements, we shall request sight of all documents or statements, including the chairman's statement, operating and financial review and the directors' report, which are due to be issued with the financial statements. We are also entitled to attend all general meetings of the company and to receive notice of all such meetings.

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

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

2.7 Once we have issued our report we have no further direct responsibility in relation to the financial statements for that period. However, we expect that you will inform us of any material event occurring between the date of our report and that of the Annual General Meeting which may affect the financial statements.

(Group accounts

3. As auditors of the holding company we are required to report, in similar terms to those outlined in paragraph 1.2 above, on the group accounts, which comprise the financial statements of the holding company and its subsidiaries. In order to express an opinion on group accounts which include the financial information of subsidiaries, joint ventures or associated companies of which we are not the auditors, it will be necessary for us to communicate directly with the other auditors concerned to satisfy ourselves that:

   a. so far as is practicable, there is uniformity within the group in the application of accounting policies;

   b. the group accounts give the information required by the Companies Ordinance, applicable accounting standards and any other legislation or non-statutory requirements affecting the presentation of financial statements; and

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

(Other services

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

Fees

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

Agreement of terms

6.1 Once it has been agreed, this letter will remain effective, from one audit appointment to another, until it is replaced. We shall be grateful if you could confirm in writing your agreement to these terms by signing and returning the enclosed copy of this letter, or let us know if they are not in accordance with your understanding of our terms of engagement.

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

Yours faithfully,

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Date

We agree to the terms of this letter.

(Signed)
....
Director, for and on behalf of the board of ______________________________

Date

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* Delete where not applicable.

Note

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

附件 一

核數應聘書樣本

此應聘書格式適合在公司條例下在香港註冊成立之客戶公司之用。惟此應聘書並非全面或適合應用於所有公司，必須配合特有情況所需而作出修改，例如受管轄機構的特別報告要求。

致____________________各董事：

此應聘書旨在闡釋本所出任(將出任)*為　貴公司 (及附屬公司)*核數師之基準、與及　貴董事和本所之各自職責範圍。

董事和核數師之職責

1.1 閣下作為上述公司董事，應負責確保公司記錄及妥善保存帳簿 、編製財務報表。該等財務報表須作出真實與公平之反映，並已遵照公司條例編製。　閣下亦應按照需要，負責為本所提供　貴公司之所有帳簿、 記錄及有關資料，包括所有行政人員會議及股東會議記錄。

1.2 本所有法定責任向股東報告，根據本所之意見，該等財務報表是否已作出真實與公平之反映，及是否已遵照公司條例妥善編製。本所作出審核意見時，將考慮以下事項，並報告其中未感滿意之處：

i. 貴公司是否已妥善記錄及保存帳簿；與及自本所未能親身視察之　貴公司分處接獲足以使本所進行審核之適當報表；

ii. 貴公司之資產負債表及損益表所載，是否與帳簿及報表相符；及

iii. 本所是否已取得全部認為對進行核數所需之資料及解釋。

此外，本所之核數報告內可能按照實際情況所需，論及若干其他事項。例如，財務報表內未有提供董事酬金或高級職員借貸詳情，根據公司條例規定，本所須於核數報告內透露 該等事項。

1.3 倘財務報表於任何重要事項上未有遵守適用會計準則之規定，本所有專業責任就此作出報告，除非本所認為在實際情況下有適當理由不遵守該等會計準則。在作出決定該等不遵守會計準則是否有適當理由時，本所會考慮：

i. 該等不遵守會計準則是否需要從而令到財務報表作出真實與公平之反映；和

ii. 該等不遵守會計準則是否已作出足夠之披露。

核數之範圍

2.1 本所將按照香港會計師公會發出之核數準則進行核數工作。倘本所認為有需要，核數工作將包括查核各項交易，和檢定資產與債務之存在、其所有權及估值等情形。本所須對會計與內部管制系統取得瞭解，目的是為評估其是否足以作為編製財務報表之根據，並為證實帳簿有否妥為記錄與保存。本所預期取得足夠有關和可靠之證據，以便從中作出合理之結論。

2.2 本所進行核數之性質與範圍，會根據本所對 貴公司會計系統與內部管制系統之評估(倘本所擬信賴內部管制系統)而作適當調整，並可能包括本所認爲適合之業務經營之各方面。本所之核數工作不是爲發覺 貴公司各系統之重大缺點而編排，惟本所在核數工作過程中發覺這些缺 點，而認爲閣下應獲得知會，本所會向 閣下報告。在未得到本所書面許可前， 閣下不可向第三者提供這些報告。只會是基於這些報告並非爲 貴公司以外的任何人等之利益所編製和本所不會就這些報告而對其他人士負上任何職責或責任的原則下，本所才會給予上述的許可。

2.3 本所或會就對財務報表有重大影響之事項，要求 閣下爲某些在核數過程中提供給本所之口頭陳詞作出書面確認，此舉乃本所進行核數之正常步驟。就 閣下之陳詞和提供之資料，本所謹此提醒 閣下注意公司條例第 134 條的條文。該條文列明若公司之高級人員誤導核數師，會構成罪行。

2.4 爲協助本所審核 貴公司之財務報表起見，本所須要求查閱與財務報表一併發表之所有文件或報告書，其中包括主席報告書、經營和財務檢討與董事局報告書。本所亦有權出席 貴公司的股東大會，並有權收到所有該等會議之開會通告。

2.5 保護 貴公司之資產與防範和查明詐騙行爲、錯誤和違規行爲乃 閣下之責任；惟本所將盡力策劃核數工作，冀能合理地期望可察覺到財務報表或帳簿之重要錯誤陳述(包括被詐騙行爲、錯誤或違規行爲所引致的重要錯誤陳述)。但是此類審核工作不應被依賴用以揭發所有可能存在之詐騙行爲、錯誤和違規行爲。

2.6 (如適用—見附註)就本所之核數責任而言，對本所非負責核數工作人員提供之資料(例如：有關會計、稅務與其他服務之資料)，不得作爲已對本所提供核數資料論。

2.7 當本所已提供核數報告後，本所對該年度之財務報表已沒有任何直接責任。惟本所仍然期望 貴公司會通知本所任何在核數報告簽發日期和股東週年大會日期之期間發生而有可能會影響財務報表之重大事件。

(集團帳目

3. 按照上文 1.2 段列出之類似條款，本所作爲控股公司之核數師須負責就 貴集團帳目作出報告，而 貴集團帳目乃由控股公司與其附屬公司各自之財務資料組成。倘本所並非 貴集團的附屬公司、合營企業或聯營公司之核數師，則本所爲表達對 貴集團帳目之意見，將須直接與其他有關之核數師聯絡，令本所確信：

   i. 貴集團應用的會計政策在可能的情況下是一致的；

   ii. 貴集團帳目提供的資料符合公司條例、適用之會計準則與其他對財務報告書陳述方面有影響之法例或非法定要求；和

   iii. 貴集團帳目內之所有重要帳目審核，均已按本所認爲足夠和合理之性質及範圍進行，以便本所能歸納對 貴集團帳目之意見。)*

(其他服務

4. 貴公司要求本所提供其他服務，包括・・・。提供以上服務之條款已另函載述。)*

收費

5. 本所之收費計算標準，乃根據本所合夥人及職員在處理 貴公司事務上所花費之時間、與涉及之技巧及責任程度而定。除非另有協議，本所之收費將按照上述各主要工作種類分別徵收及包括有關之費用；帳單將於工作期間按時寄上， 貴公司於接獲帳單後應即時繳付。

條款協議

6.1 此應聘書一經　貴公司及本所同意，會對以後各次核數任命維持有效，直至此應聘書被取代爲止。本所謹請　閣下簽署附上之文本及交回本所，以作爲　閣下贊同此應聘書之條款。倘此應聘書條款與　閣下理解之委任條件不符，則請告知本所。

(6.2 由於本所應聘爲附錄內所列的附屬公司之核數師之應聘條款與此應聘書所載相同，因此本所將不再另行向各附屬公司董事局呈遞應聘書。本所謹請　閣下向　貴公司屬下各附屬公司董事局轉達此應聘書複本，並請　閣下確認各董事局均已贊同及確認接受此應聘書條款。)*

謹此

______________________________謹上

承____________________________董事局命，由以下董事簽署以示贊同及接受此應聘書條款。

______________________________(簽署)

______________________________(日期)

---

*若不適用，可刪除。

附註

如核數師同時提供會計、稅務或其他服務時，資料可能提供給予核數師非負責核數工作的職員。在這情況下，核數應聘書應包括這段或類似的文字以顯示核數師就核數責任而言，該等資料不得作爲已對核數師提供核數資料論，以清楚地表示公司不可以避免知會核數師重大事項。

APPENDIX 2

Tax Engagement Letter

The need for a tax engagement letter

1. A tax engagement letter provides written confirmation of a member's acceptance and scope of his appointment as a client's tax representative to provide taxation services (tax practitioner). If a tax engagement letter is not sent to clients, both new and existing, there is scope for uncertainty about the precise extent of the respective obligations of the client and the tax practitioner in relation to the client's tax affairs.

Contents and form of a tax engagement letter

2. When a tax practitioner prepares tax returns or tax computations for a client, he is acting in an agency capacity. This has an important bearing on his responsibilities.

3. A tax practitioner ensures that every client understands that work can only be undertaken on the basis that the client will supply all relevant information. This is usually best dealt with in a tax engagement letter.

4. A member may undertake services for clients in addition to carrying out his responsibilities as auditor. Some appointments may only require the handling of client's tax affairs and/or the preparation of financial statements. It is recommended that the nature and scope of taxation services should be adequately recorded in a separate tax engagement letter rather than as an add-on to the audit engagement letter.

5. The letter should explain the respective responsibilities of the client and of the tax practitioner in connection with returns of information to the Inland Revenue Department (IRD) in relation to employees, the preparation of taxation computations and the submission of returns of the business, dealing with enquiries from the IRD and agreeing the tax liability with the IRD.

Procedures

6. The agreement of a tax engagement letter is in the interests of both the tax practitioner and the client. Therefore the contents of a tax engagement letter should be discussed and agreed with management (the sole trader, partners or directors as the case may be) before it is sent and preferably before or at the same time as he accepts his appointment.

7. A tax practitioner also considers sending a tax engagement letter to existing clients to whom no similar letter has previously been sent.

8. Where a tax practitioner is engaged by a client that has subsidiaries, it is preferable that a separate letter is sent to the board of directors of each company for which he is acting.

9. A tax practitioner cannot normally treat his client's failure to respond to a tax engagement letter as a binding acceptance of its terms. Accordingly, the letter should include a request to management that they confirm in writing their agreement to the terms of the tax engagement by counter-signing and returning a copy of the letter and every effort should be made to ensure that the client responds. It should be clearly understood that when agreed the tax engagement letter will give rise to contractual obligations and its precise content must therefore be carefully considered. In the case of a company, the tax practitioner requests that the letter of acknowledgement be signed on behalf of the board.

10. Once it has been agreed by the client, a tax engagement letter will, if it so provides, remain effective until it is replaced. However, the tax engagement letter should be reviewed regularly to ensure that it continues to reflect the actual circumstances of the client. If a change has taken place, including a significant change in management, which materially affects the scope or understanding of the appointment, the tax practitioner discusses the matter with management and where appropriate sends a revised tax engagement letter.

11. The following is an example of a tax engagement letter.

An example of a tax engagement letter

Below is an example of a tax engagement letter where a member has been instructed to undertake tax work in addition to his audit appointment. It is not intended to be used in relation to every client, as tax engagement letters must be tailored to specific circumstances.

To the [proprietor/partners/directors]* of

....

The purpose of this letter is to set out the basis on which we are to act as tax representatives of the [business/partnership/company]* and the respective areas of responsibility of the [business/partners/company]* and of ourselves.

Taxation services

1.1 As the taxpayer, you have the primary responsibility to submit a correct and complete tax return, profits tax computation and supporting schedules. Similarly, when any additional information is provided, whether arising out of correspondence with the Inland Revenue Department or otherwise, you are ultimately responsible for ensuring that to the best of your knowledge and belief, after making appropriate enquiries, such information is correct and complete.

1.2 We shall be responsible for preparing on your behalf for your consideration and agreement, [your/the firm's/the company's]* tax computation and tax returns and for the proper presentation and disclosure therein of all known relevant facts. We shall then submit the computation and signed returns to the Inland Revenue Department and deal with the agreement thereof [and the allocation of the adjusted profit/loss amongst the partners]** on your behalf. In cases where additional correspondence or information is required this may result in additional fees being charged.

1.3 We shall base our computation on the general interpretation and application of the relevant provisions of the Inland Revenue Ordinance prevailing at the time of preparation of the returns. It must be emphasised that in some cases a position has to be taken as regards deductibility or chargeability of particular transactions. These will be fully discussed and decided with you.

1.4 In carrying out the above work, we must stress that we shall be dealing with your tax affairs on your behalf as your agent, and on the basis that you make full disclosure to us of all relevant information. There is no requirement for us to, and therefore we shall not, perform any audit or independent verification work on any information provided by you to us for the purposes of preparing the tax return and forwarding it to the Inland Revenue Department [except to the extent required for the statutory audit. Our responsibilities as your auditors are already clearly set out in the audit engagement letter. Our roles as your auditors and your tax representatives are different. Therefore, the appointments should be treated as separate engagements]***. You are responsible for ensuring that the accounting records faithfully reflect the nature of transactions.

[Other assignment eg. tax planning, employer's returns, etc.]**

1.5 We shall be pleased to advise on any other taxation matters if requested. These will be regarded as separate assignments.

1.6 The Inland Revenue Department has special procedures for the examination of business accounts. Cases which exhibit certain characteristics may trigger a field audit examination or a full investigation by the Inland Revenue Department. These examinations may not be restricted to the books and records of the business.

1.7 You will appreciate therefore the necessity of maintaining accurate and complete records of all your business transactions. Once a taxpayer is selected for this in-depth examination a considerable amount of information will be requested by the Inland Revenue Department which may involve us, and you, in substantial additional time and cost, unless the information is readily available.

1.8 We should also emphasise that the due date for the submission for your Profits Tax Returns is [1 May/31 July/31 October]**. If the returns are not submitted by this due date, penalties up to three times the tax unpaid may be charged. Therefore, we urge that [the books and records of the business, duly completed to include all transactions of the accounting year/draft financial statements/audited financial statements]*, be made available to us at least months [period to be agreed with the client]** before this due date.

Fees

2. Our fees are computed on the basis of the time spent on your affairs by the partners and our staff, and on the levels of skill and responsibility involved plus out-of-pocket expenses. Unless otherwise agreed, our fees will be charged separately for the basic taxation services described above and any other assignments [each of the main classes of work described above]**, will be billed at appropriate intervals during the course of the year and will be due on presentation.

Agreement of terms

3. Once it has been agreed, this letter will remain effective, from one tax year to another, until it is replaced. We shall be grateful if you could confirm in writing your agreement to the terms of this letter by signing and returning the attached copy, or let us know if they are not in accordance with your understanding of our terms of appointment.

Yours faithfully,

______________________________ (signed)

Agreed and accepted by

______________________________ (signed)
______________________________ (Date)

Footnotes:

* Delete as appropriate.

** Insert as appropriate.

*** Only applicable where the member acts as both auditor and tax representative.

稅務應聘書樣本

以下爲一間會計師事務所受客戶委託核數任命外，並負責處理稅務工作時的稅務應聘書樣本。由於稅務應聘書必須配合特有情況所需，因此並不擬用於所有客戶。

致__________________________(公司東主／合夥人／董事)*：

此應聘書旨在闡釋本會計師事務所(以下簡稱“本所”)出任爲　貴(商行／合夥公司／公司)*稅務代表的基準，與及　貴(商行／合夥公司／公司)*和本所各自的職責範圍。

稅務服務

1.1 作爲納稅人，　貴公司的基本責任是向稅務局呈報一份正確及完整的報稅表、利得 稅的計算表及有關附表。同時，倘呈報後因稅務局要求或其他原因，還需提交補充資料，　貴公司有絕對責任根據所知所信及查證，確保此等資料是正確和完整的。

1.2 本所將以　貴公司的稅務代表身份，負責編製(閣下／貴商號／貴公司)*的應課稅計算表及報稅表，並將一切所知的有關事實在該等計算表及報稅表內適當地列報及披露，以供　貴公司參詳和確定。然後本所將代表　貴公司把該計算表和已簽署的報稅表呈交稅務局，並代表　貴公司處理有關往後與稅務局商討應課稅溢利或虧損(及按經調整後的溢利／虧損分配給各合夥人)**的計算事宜。倘在此過程中需提供額外資料，或導致本所需提供額外服務，本所可能需要收取額外的費用。

1.3 在編製報稅表和計算稅項時，本所將依據當時稅務條例的一般解釋及應用準則來辦理。本所必須強調，在某些情況下，　貴公司需就某些交易是否可獲稅務減免或需要課稅採取立場，本所會就這些事項與　貴公司詳細討論及決定。

1.4 本所必須指出，在進行上述工作時，本所是以　貴公司的代理人身份處理　貴公司的稅務事宜，以及在　貴公司向本所提供一 切有關的資料的基礎上進行。對於任何由　貴公司提供而用作報稅的資料，本所無須進行任何核數或獨立的審查工作(屬於法定核數範圍者除外，本所作爲核數師的責任已詳列於核數應聘書內。核數師和稅務代表各有職責，故此聘任的程序需分別進行)***。貴公司是有責任確保　貴公司的會計記錄能如實反映各項交易的狀況。

(其他聘任工作，如稅務策劃、僱主塡報的報稅表等。)**

1.5 如有需要，本所樂意爲　貴公司提供其他有關稅務的服務，但這服務需視爲另外聘任的工作。

1.6 稅務局有特別的程序去審查企業的帳目。過去的事例顯示，某些特別的徵象是會導致稅務局向企業進行實地審查或全面的稅務調查。這些審查的範圍可能並不局限於調查企業的帳簿及記錄。

1.7 由此可見，爲　貴公司的所有商業交易編製正確和完整的記錄是必須的。納稅人一旦被稅務局選中作深入審查時，該公司便要提供相當詳盡的資料。除非資料已準備妥當，否則可能會耗用　貴公司及本所頗多時間和費用。

1.8 本所必須同時指出，　貴公司最後呈交利得稅報稅表的日期爲(五月一日／七月三十一日／十月三十一日)*。如到期仍未呈報，稅務局便可以徵收高達應繳稅款三倍的罰款。因此，本所敦促　貴公司及早完成編製(企業的帳簿及紀錄，包括本會計年度的全部交易／財務報表草稿／已審核的財務報表)*，並需於呈交限期前的____個月(與客戶議定)**交給本所辦理。

收費

2. 本所的收費是根據本所的合夥人及職員在處理　貴公司稅務上所花費的時間、與涉及的技巧及責任程度來釐定。除非另有協議，本所的收費將按照上述基本稅務服務和其他聘任的工作(其他聘任服務的類別如上所述)** 分別徵收及包括有關之費用，帳單於年內寄上，　貴公司於接獲帳單後應即時繳付。

條款協議

3. 此應聘書一經　貴公司及本所同意，即爲聘任本所爲每課稅年度的稅務代表，直至此聘任書被取代爲止。本所謹請　閣下簽署附上的文本及交回本所，以作爲　貴公司贊同此應聘書的條款。倘此應聘書條款與　貴公司 理解的聘任條件不符，則請告知本所。

謹此

__________________________謹上

贊同及接受此應聘書條款：

__________________________(簽署)

__________________________(日期)

備註：

* 請將不適用的部份刪去。

** 衹於適當時載入此應聘書內。

*** 衹適用於兼任核數師的稅務代表。

Appendix 3

HKSA 210 Amended as a Result of HKSA 700—Effective Date to be Determined

HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" issued in October 2006 and effective for auditor's reports dated on or after 31 December 2006 gave rise to conforming amendments to HKSA 210. Implementation of these amendments in ISA 210 "Terms of Audit Engagements (HKSA 210 equivalent) has been deferred by the IAASB (effective date yet to be determined) pending the revision of ISA 800 "The Independent Auditor's Report on Special Purpose Audit Engagements". It is shown below for reference and will be issued as a revised standard with illustrative Hong Kong examples when effective.

Introduction

1. *The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on:*

   (a) *Agreeing the terms of the engagement with the client; and*

   (b) *The auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.*

2. ***The auditor and the client should agree on the terms of the engagement.*** *The agreed terms would need to be recorded in an audit engagement letter or other suitable form of contract.*

3. *This HKSA is intended to assist the auditor in the preparation of engagement letters relating to audits of financial statements.*

4. *In some countries, the objective and scope of an audit and the auditor's obligations are established by law. Even in those situations the auditor may still find audit engagement letters informative for their clients.*

Audit Engagement Letters

5. *It is in the interest of both client and auditor that the auditor sends an engagement letter, preferably before the commencement of the engagement, to help in avoiding misunderstandings with respect to the engagement. The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.*

Principal Contents

6. *The form and content of audit engagement letters may vary for each client, but they would generally include reference to:*

   - *The objective of the audit of financial statements.*
   - *Management's responsibility for the financial statements as described in HKSA 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements."*
   - *The financial reporting framework adopted by management in preparing the financial statements, i.e., the applicable financial reporting framework.*
   - *The scope of the audit, including reference to applicable legislation, regulations, or pronouncements of professional bodies to which the auditor adheres.*
   - *The form of any reports or other communication of results of the engagement.*
   - *The fact that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatement may remain undiscovered.*
   - *Unrestricted access to whatever records, documentation and other information requested in connection with the audit.*

7. *The auditor may also wish to include in the letter:*
   - *Arrangements regarding the planning of the audit.*
   - *Expectation of receiving from management written confirmation concerning representations made in connection with the audit.*
   - *Request for the client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.*
   - *Description of any other letters or reports the auditor expects to issue to the client.*
   - *Basis on which fees are computed and any billing arrangements.*
8. *When relevant, the following points could also be made:*
   - *Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.*
   - *Arrangements concerning the involvement of internal auditors and other client staff.*
   - *Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.*
   - *Any restriction of the auditor's liability when such possibility exists.*
   - *A reference to any further agreements between the auditor and the client.*

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

Audits of Components

9. *When the auditor of a parent entity is also the auditor of its subsidiary, branch or division (component), the factors that influence the decision whether to send a separate engagement letter to the component include the following:*
   - *Who appoints the auditor of the component.*
   - *Whether a separate auditor's report is to be issued on the component.*
   - *Legal requirements.*
   - *The extent of any work performed by other auditors.*
   - *Degree of ownership by parent.*
   - *Degree of independence of the component's management.*

Agreement on the Applicable Financial Reporting Framework

10. ***The terms of the engagement should identify the applicable financial reporting framework***.
11. *As stated in HKSA 200 (Revised) the acceptability of the financial reporting framework adopted by management in preparing the financial statements will depend on the nature of the entity and on the objective of the financial statements. In some cases, the objective of the financial statements will be to meet the common information needs of a wide range of users; in others, to meet the needs of specific users.*
12. *HKSA 200 (Revised) describes the financial reporting frameworks that are presumed to be acceptable for general purpose financial statements. Legislative and regulatory requirements often identify the applicable financial reporting framework for general purpose financial statements. In most cases, the applicable financial reporting framework will be established by a standards setting organization that is authorized or recognized to promulgate standards in the jurisdiction in which the entity is registered or operates.*
13. ***The auditor should accept an engagement for an audit of financial statements only when the auditor concludes that the financial reporting framework adopted by management is acceptable or when it is required by law or regulation. When law or regulation requires use of a financial reporting framework for general purpose financial statements that the***

auditor considers to be unacceptable, the auditor should accept the engagement only if the deficiencies in the framework can be adequately explained to avoid misleading users.

14. *Without an acceptable financial reporting framework management does not have an appropriate basis for preparing the financial statements and the auditor does not have suitable criteria for evaluating the entity's financial statements. In these circumstances, unless use of the financial reporting framework is required by law or regulation, the auditor encourages management to address the deficiencies in the financial reporting framework or to adopt another financial reporting framework that is acceptable. When the financial reporting framework is required by law or regulation and management has no choice but to adopt this framework, the auditor accepts the engagement only if the deficiencies can be adequately explained to avoid misleading users, see HKSA 701, "Modifications to the Independent Auditor's Report," paragraph 5 and, unless required by law or regulation to do so, does not express the opinion on the financial statements using the terms "give a true and fair view" or "are presented fairly, in all material respects," in accordance with the applicable financial reporting framework.*

15. *When the auditor accepts an engagement involving an applicable financial reporting framework that is not established by an organization that is authorized or recognized to promulgate standards for general purpose financial statements of certain types of entities, the auditor may encounter deficiencies in that framework that were not anticipated when the engagement was initially accepted and that indicate that the framework is not acceptable for general purpose financial statements. In these circumstances, the auditor discusses the deficiencies with management and the ways in which such deficiencies may be addressed. If the deficiencies result in financial statements that are misleading and there is agreement that management will adopt another financial reporting framework that is acceptable, the auditor refers to the change in the financial reporting framework in a new engagement letter. If management refuses to adopt another financial reporting framework, the auditor considers the impact of the deficiencies on the auditor's report, see HKSA 701.*

Recurring Audits

16. ***On recurring audits, the auditor should consider whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the client of the existing terms of the engagement.***

17. *The auditor may decide not to send a new engagement letter each period. However, the following factors may make it appropriate to send a new letter:*
    - *Any indication that the client misunderstands the objective and scope of the audit.*
    - *Any revised or special terms of the engagement.*
    - *A recent change of senior management, board of directors or ownership.*
    - *A significant change in nature or size of the client's business.*
    - *Legal requirements.*
    - *A change in the financial reporting framework adopted by management in preparing the financial statements (as discussed in paragraph 15).*

Acceptance of a Change in Engagement

18. ***An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.***

19. *A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.*

20. *A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of service originally requested would ordinarily be considered a reasonable basis for requesting a change in the engagement. In contrast a change would not be considered reasonable if it appeared that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory.*

21. *Before agreeing to change an audit engagement to a related service, an auditor who was engaged to perform an audit in accordance with the HKSAs would consider, in addition to the above matters, any legal or contractual implications of the change.*

22. *If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complies with the HKSAs applicable to the changed engagement, the report issued would be that appropriate for the revised terms of engagement. In order to avoid confusing the reader, the report would not include reference to:*

    (a) *The original engagement; or*

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

23. ***Where the terms of the engagement are changed, the auditor and the client should agree on the new terms.***

24. ***The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.*** *An example might be an audit engagement where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the client asks for the engagement to be changed to a review engagement to avoid a qualified audit opinion or a disclaimer of opinion.*

25. ***If the auditor is unable to agree to a change of the engagement and is not permitted to continue the original engagement, the auditor should withdraw and consider whether there is any obligation, either contractual or otherwise, to report to other parties, such as the board of directors or shareholders, the circumstances necessitating the withdrawal.***

Effective Date

26. *This HKSA is effective for audits of financial statements for periods beginning on or after [date].*

Public Sector Perspective

1. *The purpose of the engagement letter is to inform the auditee of the nature of the engagement and to clarify the responsibilities of the parties involved. The legislation and regulations governing the operations of public sector audits generally mandate the appointment of a public sector auditor and the use of audit engagement letters may not be a widespread practice. Nevertheless, a letter setting out the nature of the engagement or recognizing an engagement not indicated in the legislative mandate may be useful to both parties. Public sector auditors have to give serious consideration to issuing audit engagement letters when undertaking an audit.*

2. *Paragraphs 18-25 of this HKSA deal with the action a private sector auditor may take when there are attempts to change an audit engagement to one which provides a lower level of assurance. In the public sector specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if management (including the department head) attempts to limit the scope of the audit.*

Appendix: Example of an Engagement Letter

The following is an example of an engagement letter for an audit of general purpose financial statements prepared in accordance with Hong Kong Financial Reporting Standards. This letter is to be used as a guide in conjunction with the considerations outlined in this HKSA and will need to be varied according to individual requirements and circumstances.

To the Board of Directors or the appropriate representative of senior management:

You have requested that we audit the financial statements of ………., which comprise the balance sheet as at ...., and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the financial statements.

We will conduct our audit in accordance with Hong Kong Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In making our risk assessments, we consider internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we expect to provide you with a separate letter concerning any material weaknesses in the design or implementation of internal control over financial reporting that come to our attention during the audit of the financial statements.[*]

We remind you that the responsibility for the preparation of financial statements that present fairly the financial position, financial performance and cash flows of the company in accordance with Hong Kong Financial Reporting Standards is that of the management of the company. Our auditors' report will explain that management is responsible for the preparation and the fair presentation of the financial statements in accordance with the applicable financial reporting framework and this responsibility includes:

- *Designing, implementing and maintaining internal control relevant to the preparation of financial statements that are free from misstatement, whether due to fraud or error;*
- *Selecting and applying appropriate accounting policies; and*
- *Making accounting estimates that are appropriate in the circumstances.*

As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff and we trust that they will make available to us whatever records, documentation and other information are requested in connection with our audit.

[Insert additional information here regarding fee arrangements and billings, as appropriate.]

[*] In some jurisdictions, the auditor may have responsibilities to report separately on the entity's internal control. In such circumstances, the auditor reports on that responsibility as required in that jurisdiction. The reference in the auditor's report on the financial statements to the fact that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control may not be appropriate in such circumstances.

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our audit of the financial statements.

XYZ & Co.

Acknowledged on behalf of ABC Company by

(signed)
....
Name and Title
Date

HKSA 560
Issued June 2005

Effective for audits of financial statements
for periods beginning on or after 15 December 2004*

Hong Kong Standard on Auditing 560

Subsequent Events

* This HKSA 560 is effective for audits of financial statements for periods beginning on or after 15 December 2004. HKSA 560 (Revised) issued in October 2006 is effective for auditor's report dated on or after 31 December 2006 and supersedes this HKSA 560.

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

INTERNATIONAL STANDARD ON AUDITING 560

SUBSEQUENT EVENTS

(Effective for audits of financial statements
for periods beginning on or after 15 December 2004)

CONTENTS

Hong Kong Standard on Auditing (HKSA) 560, "Subsequent Events" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the auditor's responsibility regarding subsequent events. In this HKSA, the term "subsequent events" is used to refer to both events occurring between period end and the date of the auditor's report, and facts discovered after the date of the auditor's report.

2. **The auditor should consider the effect of subsequent events on the financial statements and on the auditor's report.**

3. Hong Kong Accounting Standard 10, "Events after the Balance Sheet Date" deals with the treatment in financial statements of events, both favourable and unfavourable, occurring after period end and identifies two types of events:

   (a) Those that provide evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date); and

   (b) Those that are indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date).

Events Occurring Up to the Date of the Auditor's Report

4. **The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor's report that may require adjustment of, or disclosure in, the financial statements have been identified.** These procedures are in addition to procedures which may be applied to specific transactions occurring after period end to obtain audit evidence as to account balances as at period end, for example, the testing of inventory cutoff and payments to creditors. The auditor is not, however, expected to conduct a continuing review of all matters to which previously applied audit procedures have provided satisfactory conclusions.

5. The audit procedures to identify events that may require adjustment of, or disclosure in, the financial statements would be performed as near as practicable to the date of the auditor's report. Such audit procedures take into account the auditor's risk assessment and ordinarily include the following:

   - Reviewing procedures management[2] has established to ensure that subsequent events are identified.
   - Reading minutes of the meetings of shareholders, those charged with governance, including established committees such as relevant executive committees and the audit committee, held after period end and inquiring about matters discussed at meetings for which minutes are not yet available.
   - Reading the entity's latest available interim financial statements and, as considered necessary and appropriate, budgets, cash flow forecasts and other related management reports.
   - Inquiring, or extending previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims.
   - Inquiring of management as to whether any subsequent events have occurred which might affect the financial statements. Examples of inquiries of management on specific matters are:
     - ➢ The current status of items that were accounted for on the basis of preliminary or inconclusive data.
     - ➢ Whether new commitments, borrowings or guarantees have been entered into.

---

1 Not used.

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

- Whether sales or acquisition of assets have occurred or are planned.
- Whether the issue of new shares or debentures or an agreement to merge or liquidate has been made or is planned.
- Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
- Whether there have been any developments regarding risk areas and contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
- Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

6. When a component, such as a division, branch or subsidiary, is audited by another auditor, the auditor would consider the other auditor's procedures regarding events after period end and the need to inform the other auditor of the planned date of the auditor's report.

7. **When the auditor becomes aware of events which materially affect the financial statements, the auditor should consider whether such events are properly accounted for and adequately disclosed in the financial statements.**

Facts Discovered After the Date of the Auditor's Report But Before the Financial Statements are Issued

8. The auditor does not have any responsibility to perform audit procedures or make any inquiry regarding the financial statements after the date of the auditor's report. During the period from the date of the auditor's report to the date the financial statements are issued, the responsibility to inform the auditor of facts which may affect the financial statements rests with management.

9. **When, after the date of the auditor's report but before the financial statements are issued, the auditor becomes aware of a fact which may materially affect the financial statements, the auditor should consider whether the financial statements need amendment, should discuss the matter with management, and should take the action appropriate in the circumstances.**

10. When management amends the financial statements, the auditor would carry out the audit procedures necessary in the circumstances and would provide management with a new report on the amended financial statements. The new auditor's report would be dated not earlier than the date the amended financial statements are signed or approved and, accordingly, the audit procedures referred to in paragraphs 4 and 5 would be extended to the date of the new auditor's report.

11. **When management does not amend the financial statements in circumstances where the auditor believes they need to be amended and the auditor's report has not been released to the entity, the auditor should express a qualified opinion or an adverse opinion.**

12. When the auditor's report has been released to the entity, the auditor would notify those charged with governance not to issue the financial statements and the auditor's report thereon to third parties. If the financial statements are subsequently released, the auditor needs to take action to prevent reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyer.

Facts Discovered After the Financial Statements Have Been Issued[3]

13. After the financial statements have been issued, the auditor has no obligation to make any inquiry regarding such financial statements.

14. **When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the auditor's report and which, if known at that date, may have caused the auditor to modify the auditor's report, the auditor should consider whether the financial statements need revision, should discuss the matter with management, and should take the action appropriate in the circumstances.**

15. When management revises the financial statements, the auditor would carry out the audit procedures necessary in the circumstances, would review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation, and would issue a new report on the revised financial statements.

16. **The new auditor's report should include an emphasis of a matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the revision of the previously issued financial statements and to the earlier report issued by the auditor.** The new auditor's report would be dated not earlier than the date the revised financial statements are approved and, accordingly, the audit procedures referred to in paragraphs 4 and 5 would ordinarily be extended to the date of the new auditor's report. Local regulations of some countries permit the auditor to restrict the audit procedures regarding the revised financial statements to the effects of the subsequent event that necessitated the revision. In such cases, the new auditor's report would contain a statement to that effect.

17. When management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation and does not revise the financial statements in circumstances where the auditor believes they need to be revised, the auditor would notify those charged with governance of the entity that action will be taken by the auditor to prevent future reliance on the auditor's report. The action taken will depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyers.

18. It may not be necessary to revise the financial statements and issue a new auditor's report when issue of the financial statements for the following period is imminent, provided appropriate disclosures are to be made in such statements.

Offering of Securities to the Public

19. **In cases involving the offering of securities to the public, the auditor should consider any legal and related requirements applicable to the auditor in all jurisdictions in which the securities are being offered.** For example, the auditor may be required to carry out additional audit procedures to the date of the final offering document. These procedures would ordinarily include carrying out the audit procedures referred to in paragraphs 4 and 5 up to a date at or near the effective date of the final offering document and reading the offering document to assess whether the other information in the offering document is consistent with the financial information with which the auditor is associated.

Effective Date

20. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2004.

3 Additional local guidance is provided in the appendix to this HKSA on "facts discovered after the financial statements are laid before the shareholders or equivalent".

Conformity and Compliance with International Standards on Auditing

21. As of June 2005 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 560 “Subsequent Events”. Compliance with the requirements of this HKSA ensures compliance with ISA 560.

22. Additional local explanations are provided in footnotes 2 and 3. Additional local guidance is provided in the Appendix to this HKSA.

Appendix

Additional local guidance on "facts discovered after the financial statements are laid before the shareholders or equivalent"

1. Because of the variety of conditions which might be encountered, some of the procedures set out in paragraphs 2 to 7 below are necessarily set out only in general terms; the specific actions to be taken in a particular case may vary somewhat in the light of the circumstances. The auditors would be well advised to consult with their lawyers when they encounter such circumstances.

2. The auditors' appointment expires at the annual general meeting. If after the annual general meeting, the auditors become aware of information which may materially affect financial statements previously reported on by them which were laid before the shareholders or equivalent at that meeting, they would, as soon as practicable, consider undertaking steps to determine whether the information is reliable. These steps would need to be performed even when the auditors have resigned, retired, not been re-appointed or have been discharged. In this connection, the auditors would discuss the matter with the directors and request cooperation with whatever investigation may be necessary.

3. When such subsequently discovered information is found to be reliable and relates to facts which may materially affect the financial statements, the auditors would take the action set out in paragraphs 4 to 6 below.

   However, the auditors may take the view that such action is not necessary after discussing with the directors and giving consideration to all the circumstances including, amongst other things:

   a. the time elapsed since the financial statements were issued;

   b. the materiality of the facts discovered; and

   c. whether the audited financial statements for a subsequent period report or will report a correction of a fundamental error in respect of the facts discovered.

4. When the auditors have concluded that action would need to be taken to prevent future reliance on the auditors' report, they would advise the directors to make appropriate disclosure of the newly discovered facts and their effect on the financial statements to shareholders or equivalent. When the directors undertake to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances.

   a. If the effect on the financial statements or auditors' report of the subsequently discovered facts can promptly be determined, disclosure would consist of issuing, as soon as practicable, revised financial statements and auditors' report. The reasons for the revision would be described in a note to the financial statements and referred to in the auditors' report.

   b. When the issuance of the audited financial statements for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision could be made in such financial statements instead of reissuing the earlier financial statements pursuant to subparagraph (a).

c. When the effect on the financial statements of subsequently discovered facts cannot be determined without a prolonged investigation, the steps set out in paragraphs 4(a) and (b) above may be delayed. In these circumstances the auditors would advise the directors of the facts discovered and of the possibility that the facts may require the financial statements and/or auditors' report to be re-issued or may need to be disclosed in the financial statements for a subsequent period. The directors would be advised to make appropriate disclosure to the shareholders or equivalent and, where appropriate, the relevant regulatory authorities.

d. In addition to taking the actions as set out in paragraphs 4(a), (b) and (c) above, the auditors would also consider whether notification or disclosure needs to be made to any other party who may be relying on the previously issued auditors' report.

5. If the directors refuse to make the disclosure recommended in paragraph 4 above, the auditors would notify each member of the board of directors of such refusal and that, in the absence of disclosure being made, the auditors may take steps to prevent future reliance upon the auditors' report. The steps which the auditors would consider taking may include:

   a. Notification to the directors that the auditors' report must no longer be associated with the financial statements; and

   b. Notification to shareholders or equivalent that the financial statements and the auditors' report should no longer be relied upon; and/or

   c. Notification to the appropriate regulatory authorities that the financial statements and the auditors' report should no longer be relied upon; and/or

   d. Resignation.

   However, such steps would only be taken after seeking legal advice and after considering the auditors' duty of confidentiality as set out in Statement 1.204A "Confidentiality" and any relevant legislation.

6. The following provides guidance on the content of any disclosure made by the auditors in accordance with paragraph 5:

   a. The disclosure would describe the effect the subsequently discovered facts would have had on the auditors' report if they had been known to the auditors at the date of the auditors' report and had not been reflected in the financial statements. The disclosure would include a description of the nature of the subsequently discovered facts and of their effect on the financial statements.

   b. The disclosure would be as precise and factual as possible and would not go beyond that which is reasonably necessary to accomplish the purpose mentioned in the preceding subparagraph (a). Comments concerning the conduct or motives of any person would be avoided.

7. There may be circumstances in which the auditors are unable satisfactorily to investigate the information discovered, for example because the directors refuse to co-operate or to provide information or explanations. In these circumstances the auditors would for example consider taking the following steps:

   a. Requesting the directors to make an appropriate disclosure as soon as practicable to the shareholders or equivalent and, where appropriate, the appropriate regulatory authorities.

The contents of such disclosure would normally include:

i. the nature of the subsequently discovered information;

ii. where these can be identified, the items in the financial statements which may be materially affected by the information;

iii. the fact that the auditors have been unable satisfactorily to obtain all the information and explanations which they consider necessary for the purposes of investigating the information;

iv. a statement that, as a result of the scope limitation stated in (iii) above, the auditors have been unable to establish the effect of the discovered information on the financial statements. It may also be indicated that there is an uncertainty as to whether further reliance on the previous auditors' report would be appropriate;

v. if known, the reason or reasons why the auditors have been unable satisfactorily to investigate the information.

b. Should the directors fail or refuse to make the appropriate disclosure as set out in (a) above, the auditors would consider notifying the shareholders or equivalent and the appropriate regulatory authorities. The contents of this notification would be as set out in paragraphs (a)(i) - (v) above.

c. Particularly in circumstances where the directors refuse to co-operate in allowing the auditors to investigate the information discovered or refuse to make the disclosure set out in paragraph (a) above, the auditors would also consider resigning.

Such steps would only be taken after seeking legal advice and after considering the auditors' duty of confidentiality as set out in Statement 1.204A "Confidentiality" and any relevant legislation.

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AUDITORS' REPORTS ON FINANCIAL STATEMENTS

(Issued August 1994; revised April 2000, June 2001; February 2004, September 2004 (name change), December 2005 and October 2006)

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AUDITORS' REPORTS ON FINANCIAL STATEMENTS

Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures (auditing standards), indicated by paragraphs in ***bold italic type****, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

Introduction

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance on the form and content of auditors' reports issued as a result of an audit of the financial statements of a corporate or non-corporate enterprise (the reporting entity). Much of the guidance provided can be adapted to auditors' reports on financial information other than financial statements.

2. Auditors' reports on financial statements should contain a clear expression of opinion, based on review and assessment of the conclusions drawn from evidence obtained in the course of the audit. (SAS 600.1)

3. An appreciation of the inter-relationship between the responsibilities of those who prepare financial statements and those who audit them is also necessary to achieve an understanding of the nature and context of the opinion expressed by the auditors. Readers need to be aware that it is the directors (or equivalent persons) of the reporting entity and not the auditors who determine the accounting policies followed. Auditors' reports therefore also set out the respective responsibilities of directors and auditors.

4. It will aid communication with the reader if the auditors' report is placed before the financial statements.

5. The requirements of this SAS are intended to achieve informative reporting by auditors within the reporting obligations current at its date of issue (as revised). Further developments may in the future alter the matters on which auditors are required to report or the manner in which they are required to report: such changes will be reflected in amendments to the requirements in this SAS when appropriate.

Nature of assurance provided

6. The view given in financial statements is derived from a combination of fact and judgement, and consequently cannot be characterised as "absolute". When reporting on financial statements, therefore, auditors provide a level of assurance which is reasonable in that context but, equally, cannot be absolute. Consequently it is important that the users of financial statements are made aware of the context in which the auditors' report is given.

Scope

7. This SAS applies to all reports issued by auditors which express an opinion in terms of whether financial statements give a true and fair view, or where statutory or other specific requirements prescribe the use of a term such as "present fairly", "exhibit a true and correct view" or "properly prepared in accordance with". Although this SAS is not primarily intended to apply to other forms of report provided by auditors, many of the principles of this SAS will normally be applicable to such reports.

8. Auditors may be requested to report separately on one or more primary statements. When making such a separate report, auditors need to ensure that in doing so no impression is given that the primary statement(s) referred to is other than integral to the financial statements as a whole and it is clear to a reader that in order to obtain a true and fair view of the state of affairs and profit or loss for statutory purposes it is necessary for the full set of financial statements to be considered.

Basic elements of the auditors' report

9. Auditors' reports on financial statements should include the following matters:

- ***a. a title identifying the person or persons to whom the report is addressed;***
- ***b. where applicable, the country or place of incorporation of the reporting entity;***
- ***c. an introductory paragraph identifying the financial statements audited and the accounting principles adopted;***
- ***d. separate sections, appropriately headed, dealing with:***
  - ***i. respective responsibilities of directors (or equivalent persons) and auditors,***
  - ***ii. the basis of the auditors' opinion,***
  - ***iii. the auditors' opinion on the financial statements;***
- ***e. the signature of the auditors; and***
- ***f. the date of the auditors' report. (SAS 600.2)***

10. The use of a standard format for auditors' reports on financial statements assists the reader to follow the report's contents. The section headings indicate to the reader the nature of the matters contained in the section concerned: for example, where a qualified opinion is expressed, the heading "Qualified opinion" is used.

11. Auditors draft each section of their report on financial statements to reflect the requirements which apply to the particular audit engagement. However, the use of common language in auditors' reports assists the reader's understanding. Accordingly, Appendix 2 includes examples of auditors' reports on financial statements to illustrate wording which meets the auditing standards contained in this SAS.

Title and addressee

12. An appropriate title is used to distinguish clearly the auditors' report from other information relating to the reporting entity with which it may be published.

13. The auditors' report on the financial statements of a company is addressed to its members (normally the shareholders) because the audit is undertaken on their behalf. The auditors' report on financial statements of other types of reporting entity is addressed to the appropriate person or persons, as defined by statute or by the terms of the individual engagement.

Identification of financial statements audited and accounting principles adopted

14. The purpose of the introductory section of the auditors' report, identifying the financial statements that have been audited, is to ensure that there is no ambiguity regarding the information to which the auditors' opinion relates.

15. Frequently one or more of the following accompany the financial statements in a company's annual report:

    a. directors' report;

    b. chairman's statement;

    c. management discussion and analyses; and

    d. information supplementary to the financial statements.

    To indicate that the auditors are neither responsible for nor reporting on such statements, it is considered good practice for the auditors to be specific as to the actual financial statements on which they are reporting by identifying the page numbers containing the audited financial statements as follows:

    "We have audited the financial statements on pages .... to ...."

16. Although the auditors are not responsible for the additional statements/information referred to in paragraph 15 above, there could be a belief on the part of the reader that the auditors have in fact satisfied themselves that the information is accurate or at least not misleading. The auditors would therefore consider whether the additional information is materially inconsistent or misleading (see [Auditing Guideline 3.255 "Financial information issued with audited financial statements"]/[SAS 160 "Other information in documents containing audited financial statements"]).

17. The introductory section refers to accounting principles, comprising the accounting standards and accounting policies, which have been adopted in the preparation of the financial statements.

Statements of responsibility

18. Auditors should distinguish between their responsibilities and those of the directors by including in their report:

a. a statement that the financial statements are the responsibility of the reporting entity's directors; and

b. a statement that the auditors' responsibility is to express an opinion on the financial statements. (SAS 600.3)

19. In view of the importance of the accounting principles adopted in the preparation of the financial statements, auditors may wish to include a description of the directors' responsibilities in a representation letter which reflects the specific requirements applicable to the reporting entity. A description of the responsibilities of a company's directors is normally considered adequate when it includes the following points:

    a. the Companies Ordinance requires directors to prepare financial statements for each financial year which give a true and fair view of the company's (or group's) state of affairs at the end of the year and profit or loss for the year then ended;

    b. in preparing those financial statements, the directors need to:

        i. select suitable accounting policies and then apply them on a consistent basis, making judgements and estimates that are prudent and reasonable,

        ii. state the reasons for any significant departure from applicable accounting standards,

iii. (where no separate statement on going concern is made by the directors) prepare the financial statements on the going concern basis unless it is not appropriate to presume that the company will continue in business; and

c. the directors are responsible for keeping proper accounting records, for safeguarding the assets of the company (or group) and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

20. Much of the guidance provided in paragraph 19 can be adapted for different requirements applicable to different categories of reporting entity, for example to reflect special legal requirements relating to securities or commodities dealers or specific requirements applicable to a non-corporate enterprise.

21. In the case of reporting entities other than companies, auditors assess the adequacy of the description in the representation letter by reference to statutory or any other specific requirements with which the reporting entity's management is required to comply.

22. Standards and guidance on representation letters are set out in SAS 440 "Representations by management".

Basis of opinion

23. Auditors should explain the basis of their opinion by including in their report:

a. a statement as to their compliance or otherwise with Statements of Auditing Standards, together with the reasons for any departure therefrom;

b. a statement that the audit process includes:

i. examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements,

ii. assessing the significant estimates and judgements made by the reporting entity's directors in preparing the financial statements,

iii. considering whether the accounting policies are appropriate to the reporting entity's circumstances, consistently applied and adequately disclosed;

c. a statement that they planned and performed the audit so as to obtain reasonable assurance as to whether the financial statements are free from material misstatement and that they have evaluated the overall presentation of the financial statements; and

d. a statement that the audit provides a reasonable basis for the opinion. (SAS 600.4)

24. A reference to compliance with Statements of Auditing Standards is necessary in order to provide assurance that the audit has been carried out in accordance with established standards.

25. Guidance on reporting considerations in relation to reliance placed on the work of other auditors in a group audit situation, or of an expert such as actuaries is provided in SAS 510 "Principal auditors and other auditors" and SAS 520 "Using the work of an expert" respectively.

26. In some exceptional circumstances, a departure from Statements of Auditing Standards may be appropriate to fulfil the objectives of a specific audit more effectively. If this is the case, the auditors explain the reasons for that departure in their report. Other than in such exceptional and justifiable circumstances, a departure from a Statement of Auditing Standard is a limitation on the scope of work undertaken by the auditors. In such circumstances the auditors assess whether a qualified (except for limitation) opinion or disclaimer of opinion is required, as set out in SAS 600.6.

27. In certain circumstances, auditors may be required by statute to follow other comparable standards. Where this is the case, auditors would refer to these standards.

28. In some circumstances, auditors may be required to report whether the financial statements have been properly prepared in accordance with regulations or other requirements, but are not required to report on whether they give a true and fair view. Where the special circumstances of the reporting entity require or permit the adoption of policies or accounting bases which would not normally permit a true and fair view to be given, auditors would refer to those circumstances in the paragraphs dealing with the respective responsibilities of directors and auditors (unless the matter is included in a separate statement given by the directors) and may draw attention to them in the basis of opinion section of the report.

Expression of opinion

29. An auditors' report should contain a clear expression of opinion on the financial statements and on any further matters required by statute or other requirements applicable to the particular engagement. (SAS 600.5)

30. The auditors would use their best endeavour to obtain sufficient, relevant and reliable audit evidence to enable them to express an unqualified opinion. Failing that, the auditors would include a qualified opinion in the auditors' report. The circumstances giving rise to each type of opinion are set out below and example reports illustrating each form of opinion are contained in Appendix 2.

31. When expressing a qualified opinion in their report, the auditors would refer to all material matters about which they have reservations. Thus, a qualification on one matter cannot be regarded as a reason for omitting other unrelated qualifications which otherwise would have been reported.

32. If there is a scope limitation or disagreement concerning the income statement, but the auditors are able to conclude that the balance sheet does give a true and fair view and satisfies the relevant requirements, then they would express a qualified opinion on the income statement and an unqualified opinion on the balance sheet. Similarly, it may sometimes be appropriate to express an unqualified opinion on the income statement and a qualified opinion on the balance sheet. Furthermore, even though the auditors may decide to disclaim their opinion as to whether the financial statements give a true and fair view, or to issue an adverse opinion stating that they do not give a true and fair view, it does not necessarily follow that such an extreme opinion may be appropriate for other matters on which they are required to report (for example, as to whether the financial statements are properly prepared in accordance with the Companies Ordinance). In such cases the wording of the opinion would be modified accordingly to accurately reflect the auditors' opinion.

Unqualified opinion

33. An unqualified opinion on financial statements is expressed when in the auditors' judgement they give a true and fair view (where relevant) and have been prepared in accordance with relevant accounting and other requirements. This judgement entails concluding whether inter alia:

   a. the financial statements have been prepared using appropriate accounting policies, which have been consistently applied;

   b. the financial statements have been prepared in accordance with relevant legislation, regulations or applicable accounting standards (and that any departures are justified and adequately explained in the financial statements); and

   c. there is adequate disclosure of all information relevant to the proper understanding of the financial statements.

Modified report

34. The auditors' report can be modified to take account of the following:

    a. Matters that do not affect the auditors' opinion.

    b. Matters that do affect the auditors' opinion - qualified opinion.

Matters that do not affect the auditors' opinion

35. The auditors would modify the auditors' report to highlight a significant level of concern about the validity of the going concern basis. The auditors would also consider modifying the auditors' report by adding a paragraph if there is a significant uncertainty (other than a going concern problem), the resolution of which is dependent upon future events and whose potential effect on the financial statements is unusually great. A more detailed discussion of fundamental uncertainties and the reporting considerations is set out in paragraphs 52 to 65 below.

36. In addition to the use of an explanatory paragraph to refer to a fundamental uncertainty in the basis of opinion section of their report, auditors are not precluded in the following limited circumstances from modifying their report by including a paragraph after the audit opinion to draw attention to or emphasise a matter that is relevant to the readers of the auditors' report but is not of such a nature that it affects the audit opinion:

    a. if an amendment is necessary to the other information in a document containing audited financial statements and the directors refuse to make the amendment, the auditors would consider including in the auditors' report a paragraph describing the material inconsistency in accordance with [Auditing Guideline 3.255] / [SAS 160];

    b. if there is an actual or possible material misstatement in the corresponding amounts but that misstatement does not directly affect the current period's figures, the auditors would consider including in the auditors' report a paragraph describing the material misstatement in accordance with [paragraph 13 of Auditing Guideline 3.253 "Amounts derived from the preceding financial statements"]/[SAS 450 "Opening balances and comparatives"];

    c. if the financial statements have been issued but before their laying before the shareholders, or equivalent, and a fact is discovered that leads management to revise the financial statements, the new audit report on the revised financial statements would include a paragraph referring to a note to the financial statements that more extensively discusses the reason for the revision of the previously issued financial statements or setting out such reason, and referring to the earlier report issued by them on the financial statements in accordance with [SAS 150 "Subsequent events and subsequent discovery of facts existing at the date of the auditors' report"];

    d. if, as a result of the report or findings of an expert, the auditors consider it necessary to include a paragraph in the auditors' report emphasising a matter regarding the financial statements in accordance with paragraph 26 of SAS 520 "Using the work of an expert".

    The inclusion of such a paragraph after the audit opinion in the auditors' report is not a qualification and care needs to be taken to ensure that this is clear to the readers of the auditors' report when describing the matter, for example by use of words such as "Without qualifying the opinion above, attention is drawn to ...".

Matters that do affect the auditors' opinion - qualified opinion

37. Circumstances giving rise to the issue of a qualified opinion by the auditors can occur when there is either:

a. a limitation on the scope of the auditors' work;

b. the auditors disagree with the treatment or disclosure of a matter in the financial statements; or

c. in extreme cases where the financial statements are affected by fundamental uncertainties (see paragraph 64 below).

38. For the auditors' report to be qualified, the effect of the matter must either be material or be likely to be material to the financial statements. If the matter is material, the financial statements either may not or do not show a true and fair view of the reporting entity's profit or loss and state of affairs, or may not or do not comply with other relevant accounting requirements (see paragraphs 47 to 51 below).

Qualified opinions in respect of limitation of audit scope

39. When there has been a limitation on the scope of the auditors' work that prevents them from obtaining sufficient evidence to express an unqualified opinion:

a. the auditors should include a description of the factors leading to the limitation in the section of their report setting out the basis of their opinion;

b. the auditors should issue a disclaimer of opinion when the possible effect of a limitation on scope is so material or pervasive that they are unable to express an opinion on the financial statements;

c. the auditors should issue a qualified (except for limitation) opinion when the effect of the limitation is not so material or pervasive as to require a disclaimer, and the wording of the opinion should indicate that it is qualified as to the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed. (SAS 600.6)

40. In considering whether a limitation results in a lack of evidence necessary to form an opinion, auditors assess:

a. the quantity and type of evidence which may reasonably be expected to be available to support the particular figure or disclosure in the financial statements; and

b. the possible effect on the financial statements of the matter for which insufficient evidence is available. When the possible effect is, in the opinion of the auditors, material to the financial statements, there will be insufficient evidence to support an unqualified opinion.

41. Inherent uncertainties do not arise from, or give rise to, a limitation on the auditors' work and are considered under SAS 600.8 below.

42. A description of the factors leading to a limitation of audit scope enables the readers to understand the reasons for the limitation and to distinguish between:

a. limitations imposed on the auditors (for example, where not all the accounting records are made available to the auditors or where the directors prevent a particular procedure considered necessary by the auditors from being carried out); and

b. limitations outside the control of the auditors or the directors (for example, when the timing of the auditors' appointment is such that attendance at the reporting entity's stocktake is not possible and there is no alternative form of evidence regarding the existence of inventories).

43. A limitation on the scope of the auditors' work may sometimes be imposed by the reporting entity. When the proposed terms of an audit engagement include a scope limitation such that the auditors believe the need to issue a disclaimer of opinion exists, they would normally not accept such a limited engagement as an audit engagement, unless required by statute to do so. Also, statutory auditors would not accept such an audit engagement when the limitation infringes on their statutory duties.

44. Where a scope limitation is imposed by circumstances, auditors would normally attempt to carry out reasonable alternative procedures to obtain sufficient audit evidence to support an unqualified opinion.

Qualified opinions in respect of disagreement

45. Where the auditors disagree with the accounting treatment or disclosure of a matter in the financial statements, and in the auditors' opinion the effect of that disagreement is material to the financial statements:

a. the auditors should include in the opinion section of their report:

i. a description of all substantive factors giving rise to the disagreement,

ii. their implications for the financial statements, and

iii. whenever practicable, a quantification of the effect on the financial statements;

b. when the auditors conclude that the effect of the matter giving rise to disagreement is so material or pervasive that the financial statements are seriously misleading, they should issue an adverse opinion; and

c. in the case of other material disagreements, the auditors should issue a qualified (except for disagreement) opinion indicating that it is expressed except for the effects of the matter giving rise to the disagreement. (SAS 600.7)

46. An auditors' report including a qualified opinion arising from disagreement includes a description of the reasons for qualification and the effects on the financial statements. Whilst reference may be made to relevant notes in the financial statements, such reference is not a substitute for sufficient description of the circumstances in the auditors' report so that a reader can appreciate the principal points at issue and their implications for an understanding of the financial statements.

Non-compliance with accounting standards

47. Financial statements are normally required to contain particulars of any material departure from an accounting standard which applies to the reporting entity, together with the financial effects of the departure unless this would be inpracticable or misleading in the context of giving a true and fair view.

48. When the auditors conclude that the financial statements do not comply with accounting standards, they assess:

a. whether there are sound reasons for the departure;

b. whether adequate disclosure has been made concerning the departure from accounting standards; and

c. whether the departure is such that the financial statements do not give a true and fair view of the state of affairs, profit or loss and cash flows.

49. In normal cases, a departure from accounting standards will result in the issue of a qualified (except for disagreement) or adverse opinion on the view given by the financial statements.

50. In the extremely rare circumstances, the auditors may determine that there are sound reasons for the departure, that they concur with the directors that compliance with a requirement in an accounting standard would be misleading, and therefore that departure from an accounting standard is necessary for the financial statements to give a true and fair view, and that there is adequate disclosure of the departure. In these circumstances, the auditors do not qualify their opinion.

51. Where no explanation is given for a departure from accounting standards, its absence may of itself impair the ability of the financial statements to give a true and fair view of the reporting entity's state of affairs, profit or loss and cash flows. When auditors conclude that this is so, a qualified (except for disagreement) or adverse opinion on the view given by the financial statements is appropriate.

Fundamental uncertainty

52. a. In forming their opinion on financial statements, auditors should consider whether the view given by the financial statements could be affected by inherent uncertainties which, in their opinion, are fundamental.

b. When an inherent uncertainty exists which:

i. in the auditors' opinion is fundamental, and

ii. is adequately accounted for and disclosed in the financial statements,

the auditors should include an explanatory paragraph referring to the fundamental uncertainty in the section of their report setting out the basis of their opinion.

c. When adding an explanatory paragraph, auditors should use words which clearly indicate that their opinion on the financial statements is not qualified in respect of its contents. (SAS 600.8)

Inherent uncertainties

53. Inherent uncertainties about the outcome of future events frequently affect, to some degree, a wide range of components of the financial statements at the date they are approved. It is not possible for the directors to remove the uncertainties by obtaining more information at the date they approve the financial statements: the statements can reflect only the working assumptions of directors as to their financial outcome and, where material, describe the circumstances giving rise to the uncertainties and their potential financial effect.

54. In forming an opinion, auditors take into account the adequacy of the accounting treatment, estimates and disclosures of inherent uncertainties in the light of evidence available at the date they express that opinion.

55. Auditors recognise that, in preparing financial statements, directors are required to analyse relevant existing conditions, including uncertainties about future events and their effect on financial statements. An audit includes assessment of whether there is sufficient evidence to support the directors' analyses and resulting estimates and disclosures given in the financial statements. Usually auditors are able to obtain sufficient evidence concerning the directors' assessment of the outcome of inherent uncertainties by considering various types of evidence, including the historical experience of the reporting entity.

56. Forming an opinion on the adequacy of the accounting treatment of inherent uncertainties involves consideration of:

a. the appropriateness of accounting policies dealing with uncertain matters;

b. the reasonableness of the estimates included in the financial statements in respect of inherent uncertainties; and

c. the adequacy of disclosure.

57. Auditors distinguish between circumstances in which an unqualified opinion is appropriate and those in which a qualified (except for limitation) opinion or disclaimer of opinion is required due to a limitation on the scope of their work. An inherent uncertainty can be expected to be resolved at a future date, at which time sufficient evidence concerning its outcome would be expected to become available. When evidence does or did exist (or reasonably could be expected to exist) but that evidence is not available to the auditors, the scope of their work is limited and a qualified (except for limitation) opinion or disclaimer of opinion is appropriate as required by SAS 600.6.

58. Where auditors conclude that the accounting policies followed lead to material misstatements in the financial statements, or that the estimates included in the financial statements are materially misstated, or that disclosures relating to the uncertainty are inadequate, a qualified (except for disagreement) or adverse opinion is required by SAS 600.7.

Fundamental uncertainties

59. In some circumstances, the degree of uncertainty about the outcome of a future event and its potential impact on the view given by the financial statements may be very great. Where resolution of an inherent uncertainty could affect the view given by the financial statements to the degree that the auditors conclude that it is to be regarded as fundamental, they include an explanatory paragraph when setting out the basis of their opinion describing the matter giving rise to the fundamental uncertainty and its possible effects on the financial statements, including (where practicable) quantification. Where it is not possible to quantify the potential effects of the resolution of the uncertainty, the auditors include a statement to that effect. Reference may be made to notes in the financial statements but such a reference is not a substitute for sufficient description of the fundamental uncertainty so that a reader can appreciate the principal points at issue and their implications.

60. Communication with the reader is enhanced by the use of an appropriate sub-heading differentiating the explanatory paragraph from other matters included in the section describing the basis of the auditors' opinion.

61. In determining whether an inherent uncertainty is fundamental, auditors consider:

    a. the risk that the estimate included in financial statements may be subject to change;

    b. the range of possible outcomes; and

    c. the consequences of those outcomes on the view shown in the financial statements.

62. Inherent uncertainties are regarded as fundamental when they involve a significant level of concern about the validity of the going concern basis or other matters whose potential effect on the financial statements is unusually great, a common example of which is the outcome of major litigation.

Opinions expressed

63. An unqualified opinion indicates that the auditors consider that the fundamental uncertainty has been adequately accounted for and disclosed in the financial statements. It remains unqualified notwithstanding the inclusion of an explanatory paragraph describing a fundamental uncertainty. The explanatory paragraph is included as part of the basis for the auditors' opinion so as to make clear that it describes a matter which the auditors have taken into account in forming their opinion, but that it does not qualify that opinion.

64. When the auditors decide to add an explanatory paragraph describing a fundamental uncertainty involving the validity of the going concern basis, this will normally adequately serve users of the financial statements. However, in extreme cases, such as situations involving multiple uncertainties that are fundamental to the financial statements, the auditors may consider it appropriate to express a disclaimer of opinion.

65. When the auditors conclude that the estimate of the outcome of a fundamental uncertainty is materially misstated or that the disclosure relating to it is inadequate, they issue a qualified (except for disagreement) or adverse opinion. On the other hand, where the auditors encounter a limitation on the scope of their work which would preclude them from making an assessment of the adequacy of the accounting treatment and disclosure in respect of an inherent uncertainty, they would issue a qualified (except for limitation) opinion or a disclaimer of opinion.

Further matters required by statute or other regulations

66. Further opinions or information to be included in the auditors' report may be determined by specific statutory requirements applicable to the reporting entity, or, in some circumstances, by the terms of the auditors' engagement. Such matters may be required to be dealt with by a positive statement in the auditors' report or only by exception.

67. For the requirements under the Companies Ordinance, reference should be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance" and PN 600.2 "Audit approach to companies applying section 141D of the Companies Ordinance".

68. Reporting entities operating in the securities dealing, commodities trading or foreign exchange trading industries are subject to the Securities Ordinance, the Commodities Trading Ordinance and the Leveraged Foreign Exchange Trading Ordinance respectively, which impose certain reporting requirements on their auditors. Example auditors' reports on these reporting entities are set out in Appendix 2.

Signature of the auditors' report

69. The auditors' report should be signed in the name of the auditors' firm, the personal name of the auditor, or both, as appropriate. (SAS 600.9)

70. The auditors' report is normally signed in the name of the firm because the firm as a whole assumes responsibility for the audit. To assist identification, the report will normally state the name of the firm of auditors and the location of the auditors' office.

71. For a corporate practice, the auditors' report is signed by a director of the practice, who must be a professional accountant holding a current practising certificate. The auditors' report states the name of the corporate practice and the location of its office and is signed in the name of the corporate practice. The auditors' report also identifies the director responsible for the performance of the audit engagement contemplated by such report, and states his/her full name as appearing in his/her practising certificate and the practising certificate number. An example auditors' report issued by a corporate practice is included in Appendix 2.

72. For certain purposes, a printed copy of the auditors' report may be required to state the name of the auditors and be signed by them (for example, the Inland Revenue Department normally requires a manuscript signed copy of the auditors' report). For published financial statements (e.g. those of listed companies) the auditors may sign their report in a form from which a final printed version is produced. In both these circumstances, they may sign copies for identification purposes in order to provide appropriately signed auditors' reports, however, no further active procedures need be undertaken after the initial auditors' report has been signed.

Date of the auditors' report

73. The auditors should date the auditors' report as of the completion date of the audit. (SAS 600.10)

74. Dating the auditors' report as of the completion date of the audit informs the reader that the auditors have considered the effect on the financial statements and on the report of events and transactions of which the auditors became aware and that occurred up to that date. In practice, the completion date of the audit may be earlier than the date of physical signature of the auditors' report.

75. Since the auditors' responsibility is to report on the financial statements as prepared and presented by the directors, the auditors should not date the report earlier than the date on which the financial statements are approved by the directors. (SAS 600.11)

76. The auditors are in a position to form their opinion when the financial statements have been approved by the directors and the auditors have completed their assessment of all the evidence and procedures they consider necessary for the opinion or opinions to be given in their report.

77. If the date of completion of the audit is later than that on which the directors approved the financial statements, the auditors take such steps as are appropriate to ensure that their procedures for reviewing subsequent events in accordance with SAS 150 covered the period up to that date.

Compliance with International Standards on Auditing

78. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 700 "The Auditor's Report on Financial Statements".

Effective date

79. Auditors are required to comply with the requirements of this SAS for auditors' reports dated on or after 1 May 2000 but before 31 December 2006.

APPENDIX 1

Forming an opinion on financial statements

1. This Appendix sets out in the form of a flowchart the steps involved in forming an opinion as to whether a set of financial statements gives a true and fair view of the reporting entity's state of affairs and profit or loss. The flowchart is intended to provide guidance to readers in understanding the Statement of Auditing Standards. It does not form part of the standards themselves.

2. The flowchart is drawn up on the basis that the directors make no further amendments to the financial statements following the audit. In practice, directors may make amendments in response to comments by the auditors: any amendment of the financial statements (for example, to provide additional disclosure in order to give a true and fair view) would require auditors to begin the sequence of questions afresh.

3. In applying the logic in the flowchart, auditors may find it necessary to address the questions for discrete sections of the financial statements as well as for the financial statements as a whole.

4. The principal matters which auditors consider in forming an opinion may be expressed in three questions:

   a. have they completed all procedures necessary to meet auditing standards and to obtain all the information and explanations necessary for their audit? This question is considered in paragraphs 39 to 44 of the SAS.

   b. have the financial statements been prepared in accordance with the accounting standards? This question is considered in paragraphs 47 to 51 of the SAS.

   The flowchart refers to these requirements as GAAP (generally accepted accounting principles) as a convenient shorthand to indicate those accounting and other requirements which apply in the case of the particular financial statements concerned. In the case of a company subject to company legislation in Hong Kong this will normally mean that the financial statements have been properly prepared in accordance with the Companies Ordinance and with accounting principles generally accepted in Hong Kong.

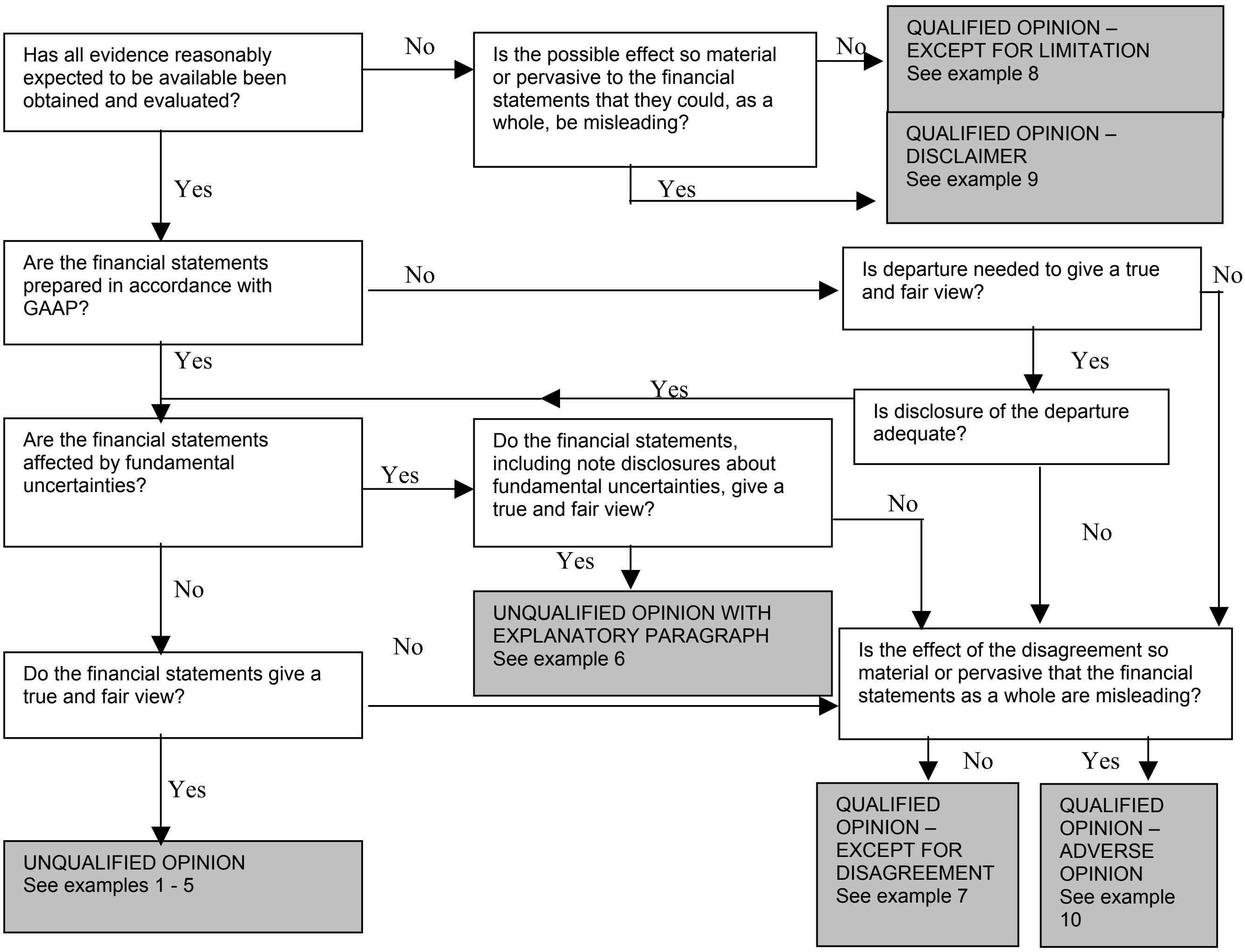
   As a starting point, compliance with applicable accounting standards is likely to result in financial statements giving a true and fair view.

   However, although usually a breach of the rules, whether by omission or substitution of an alternative accounting treatment, may mean that a true and fair view is not given, in exceptional cases departures from the rules are needed so that a true and fair view can be given.

   Hence the third question:

   c. do the financial statements, as prepared by the directors, give a true and fair view?

Forming an opinion on financial statements



Questions concerning limitation and disagreement are presumed to involve matters considered to be material.

APPENDIX 2

Examples of auditors' reports on financial statements

Unqualified opinions

1. company incorporated in Hong Kong

2. company incorporated in Hong Kong submitting group accounts

3. company incorporated in Hong Kong applying section 141D of the Companies Ordinance

4. unincorporated enterprise operating in Hong Kong

5. company incorporated overseas

6. company incorporated in Hong Kong submitting group accounts - with an explanatory paragraph dealing with a fundamental uncertainty

Qualified opinions

7. disagreement

8. limitation on the auditors' work

9. disclaimer of opinion

10. adverse opinion

11. disagreement arising from departure from Accounting Standards and explanatory paragraph dealing with a fundamental uncertainty

12. disagreement arising from omission of a cash flow statement

Specialised industries - unqualified opinions

13. company carrying on banking/insurance business

14 - 17. [Withdrawn; example auditors' reports on licensed corporations and associated entities of intermediaries are now included in PN 820 "The audit of licensed corporations and associated entities of intermediaries"]

19. owners' corporation of building

Issued by a corporate practice

18. unqualified opinion - company incorporated in Hong Kong

Example 1 - Company incorporated in Hong Kong

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 2 – Company incorporated in Hong Kong submitting group accounts

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's and the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 December 19.. and of the group's profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 3[*] - Company incorporated in Hong Kong applying section 141D of the Companies Ordinance

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the balance sheet together with the notes thereon on pages .... to .... which has been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare a profit and loss account and a balance sheet. Pursuant to section 141D of the Companies Ordinance, the balance sheet together with the notes thereon should be prepared in accordance with the requirements of the Eleventh Schedule to the Companies Ordinance. In preparing those statements it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on the balance sheet together with the notes thereon and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. The audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the balance sheet and the notes thereon. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the balance sheet and the notes thereon, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the balance sheet together with the notes thereon is free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the balance sheet together with the notes thereon. We believe that our audit provides a reasonable basis for our opinion.

Opinion

We report that we have obtained all the information and explanations which we have required.

In our opinion the balance sheet together with the notes thereon is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as at 31 December 19.. according to the best of our information and explanations given to us, and as shown by the books of the company.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

[*] The example report is applicable to an audit of a company applying section 141D of the Companies Ordinance for periods beginning before 1 January 2005. For periods beginning on or after 1 January 2005, the applicable example report is that in the Appendix to PN 900 “Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard”. Where such a company early adopts the Small and Medium-sized Entity Financial Reporting Standard for a period beginning before 1 January 2005, the example report in PN 900 is applicable.

Example 4 - Unincorporated enterprise operating in Hong Kong

AUDITORS' REPORT
TO THE MEMBERS OF XYZ COMPANY

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of the governing council and auditors

The company's constitution and by-laws require the governing council to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

We are engaged to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the governing council in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its surplus [deficit] and cash flows for the year then ended and have been properly prepared in accordance with the constitution and by-laws of the company.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 5 - Company incorporated overseas

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in [country or place] with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with [accounting principles generally accepted in Hong Kong (or International Accounting Standards)]*.

Respective responsibilities of directors and auditors

The company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] and cash flows for the year then ended [and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance (and/or other legal requirements)]*.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

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* It may be necessary to refer to International Accounting Standards or other national accounting standards and/or other national legal requirements according to the jurisdiction in which the company is incorporated.

Example 6 - Company incorporated in Hong Kong submitting group accounts - with an explanatory paragraph dealing with a fundamental uncertainty

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's and the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of the disclosures made in the financial statements concerning the possible outcome to litigation against B Limited, a subsidiary of the company, for an alleged breach of environmental regulations. The future settlement of this litigation could result in additional liabilities and the closure of B Limited's business, whose net assets included in the consolidated balance sheet total $X and whose profit before taxation for the year is $Y. Details of the circumstances relating to this fundamental uncertainty are described in note .... We consider that the fundamental uncertainty has been adequately accounted for and disclosed in the financial statements and our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 December 19.. and of the group's profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 7 - Disagreement

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong, other than as set out below.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Qualified opinion arising from disagreement about accounting treatment

Included in debtors shown on the balance sheet is an amount of $X due from a debtor which has ceased trading. XYZ Limited has no security for this debt. In our opinion the company is unlikely to receive any payment and full provision of $X should have been made, reducing profit before taxation for the year and net assets at 31 December 19.. by that amount.

Except for the absence of this provision, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 8 - Limitation on the auditors' work

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants, except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. However, the evidence available to us was limited because $X of the company's recorded turnover comprises cash sales, over which there was no system of control on which we could rely for the purpose of our audit. There were no other satisfactory audit procedures that we could adopt to confirm that all cash sales were properly recorded.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Qualified opinion arising from limitation of audit scope

Except for any adjustments that might have been found to be necessary had we been able to obtain sufficient evidence concerning cash sales, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

In respect alone of the limitation on our work relating to cash sales:

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

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 9 - Disclaimer of opinion

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants, except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. However, the evidence available to us was limited because we were initially appointed auditors on (date) which was subsequent to the end of the company's financial year. In consequence we were unable to carry out auditing procedures necessary to obtain adequate assurance regarding the quantities and condition of inventories and work in progress, appearing in the balance sheet at $X. There were no other satisfactory audit procedures that we could adopt to obtain sufficient evidence regarding the existence of inventories and work in progress. Any adjustment to the figure may have a consequential significant effect on the profit [loss] for the year and net assets at 31 December 19...

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Qualified opinion: Disclaimer on view given by financial statements

Because of the significance of the possible effect of the limitation in evidence available to us, we are unable to form an opinion as to whether the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. or of its profit [loss] and cash flows for the year then ended. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Companies Ordinance.

In respect alone of the limitation on our work relating to inventories and work in progress:

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

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 10 - Adverse opinion

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong, other than as set out below.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Qualified opinion: Adverse opinion

As more fully explained in note ... losses expected to arise on certain long-term contracts currently in progress have not been recognised as expenses, as the directors consider that such losses should be off-set against amounts recoverable on other long-term contracts. In our opinion, the expected losses on individual contracts should be recognised as expenses immediately as required by HKICPA Statement 2.123 "Construction contracts". If losses had been so recognised the effect would have been to [reduce the profit/increase the loss] before taxation for the year and reduce the gross amounts due from customers at 31 December 19.. by $X.

In view of the effect of the failure to provide for the losses referred to above, in our opinion the financial statements do not give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] for the year then ended. In our opinion the financial statements give a true and fair view of the company's cash flows for the year ended 31 December 19 ... In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 11 - Disagreement arising from departure from Accounting Standards and explanatory paragraph dealing with a fundamental uncertainty

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong, other than as set out below.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of the disclosures made in the financial statements concerning the possible outcome of negotiations for additional finance being made available to replace an existing loan of $X which is repayable on 30 June 19... The financial statements have been prepared on a going concern basis, the validity of which depends upon future funding being available. The financial statements do not include any adjustments that would result from a failure to obtain such funding. Details of the circumstances relating to this fundamental uncertainty are described in note ... We consider that the fundamental uncertainty has been adequately accounted for and disclosed in the financial statements and our opinion is not qualified in this respect.

Qualified opinion arising from disagreement about accounting treatment

The company leases plant and equipment which have been accounted for in the financial statements as operating leases. In our opinion, these leases should be accounted for as finance leases as required by HKICPA Statement 2.114 "Accounting for leases and hire purchase contracts" (SSAP 14). If this accounting treatment were followed, the fixed assets held under finance leases and the finance lease obligations would be reflected in the company's balance sheet at 31 December 19.. at $X and $Y respectively and the profit [loss] before taxation for the year would have been reduced [increased] by $Z. The financial statements do not include an explanation for this departure from an applicable Accounting Standard.

Except for the failure to account for the leases referred to above as required by SSAP 14, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 12 -Disagreement arising from omission of a cash flow statement

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to........ which have been prepared in accordance with accounting principles generally accepted in Hong Kong, other than as set out below.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Qualified opinion arising from omission of cash flow statement

As explained in note .. the financial statements do not contain a cash flow statement as required by HKICPA Statement 2.115 "Cash flow statements". The increase [decrease] in cash and cash equivalents for the year ended 31 December 19.. amounted to $X and in our opinion information about the company's cash flows is necessary for a proper understanding of the company's state of affairs and profit [loss].

Except for the failure to provide information about the company's cash flows, in our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 13 - Company carrying on banking/insurance business

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to .... which have been prepared in accordance with the provisions of the Companies Ordinance applicable to banking/insurance companies and accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements on the basis of the provisions of the Companies Ordinance applicable to banking/insurance companies. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements have been properly prepared in accordance with the provisions of the Companies Ordinance applicable to banking/insurance companies and, on that basis, give a true and fair view of the state of the company's affairs as at 31 December 19.. and of its profit [loss] and cash flows for the year then ended.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Examples 14 – 17 have been withdrawn

Example 18 - An auditors' report issued by a corporate practice expressing an unqualified opinion on the financial statements of a company incorporated in Hong Kong

AUDITORS' REPORT
TO THE SHAREHOLDERS OF XYZ LIMITED
(incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages .... to .... which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 20.. and of its profit [loss] and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

[Note 1]
ABC CPA (Practising) Co. Ltd.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

[Note 2]
Albert Norman Chan
Practising Certificate number xxxx

Notes:

1. *The report states the name of the corporate practice and the location of its office and is signed in the name of the corporate practice.*

2. *The report identifies the director responsible for the performance of the audit engagement contemplated by such report, and states his/her full name as appearing in his/her practising certificate and his/her practising certificate number.*

Example 19 - Owners' corporation of building

AUDITORS' REPORT
TO THE MEMBERS OF THE OWNERS' CORPORATION OF XYZ BUILDING ("CORPORATION")
(incorporated in Hong Kong and registered in the Land Registry under section 8 of the Building Management Ordinance)

We have audited the income and expenditure account and balance sheet ("accounts") of the Corporation on pages___to___which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of the Management Committee and auditors

The Building Management Ordinance requires the Management Committee to prepare accounts which present fairly the financial transactions and financial position of the Corporation. In preparing these accounts it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on the accounts and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the Management Committee in the preparation of the accounts, and of whether the accounting policies are appropriate to the Corporation's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the accounts present fairly the financial transactions of the Corporation during the [year/period] ended______to which the accounts relate, and the financial position of the Corporation at the end of that [year/period].

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date

Example 19 - Owners' corporation of building

核數師報告書

致ＸＹＺ大廈業主立案法團(「法團」) (根據《建築物管理條例》第８條於香港成立，並已以在土地註冊處註冊) **各業主**

我們已完成審核刊於第 ____ 頁至第 ____ 頁按照香港公認會計原則編製的法團收支表與資產負表(「帳目」)。

管理委員會與核數師各自的責任

《建築物管理條例》規定管理委員會須編製中肯地映法團之財務往來情況和財務狀況的帳目。在編製該等帳目時，管理委員會必須貫徹採用合適的會計政策。

我們的責任是根據我們審核工作的結果，對帳目發表獨立意見，並向業主報告。

意見基礎

我們已按照香港會計師公會頒布的《核數準則》進行審核工作。審核範圍包括以抽查方式查核與帳目內所載數額和披露事項有關的憑證，亦包括評估管理委員會於編製該等帳目時所作的重大估計和判斷、所釐定的會計政策是否適合法團的具體情況、並有否貫徹運用和足夠披露該等會計政策。

我們在策劃和進行審核工作時，均以取得一切我們認爲必需的資料和解釋爲目標，使我們能獲得充份的憑證，就該等帳目是不存有重大的錯誤陳述，作合理的確定。在作出意見時，我們亦已衡量該等帳目所載資料在整體上是否足夠。我們相信，我們的審核工作已爲下列意見建立合理的基礎。

意見

我們認爲，上述的帳目中肯地反映在截至 __________ 之〔年／季〕內法團之財務往來情況，與及在該〔年／季〕結束時法團的財務狀況。

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香港執業會計師
香港
日期