



MEMBERS' HANDBOOK

Update No. 166

(Issued 27 February 2015)

| Document Reference and Title | Instructions | Explanations |
|--|---|------------------------|
| VOLUME III | | |
| <u>Contents of Volume III</u> | Discard the existing pages i - iv and replace with the revised pages i - iv. | Revised contents pages |
| <u>Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services</u> | Discard the existing Glossary and replace with the revised Glossary. | Note 1 |
| HONG KONG STANDARDS ON QUALITY CONTROL | | |
| <u>HKSQC 1 (Clarified) Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements</u> | Replace cover page, pages 6, 7, 8 and 18 with revised cover page, pages 6, 7, 8 and 18. | - ditto - |
| HONG KONG STANDARDS ON AUDITING | | |
| <u>HKSA 200 (Clarified) Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing</u> | Replace cover page, pages 17, 19, 21, 24 and 25 with revised cover page, pages 17, 19, 21, 24 and 25. | - ditto - |
| <u>HKSA 220 (Clarified) Quality Control for an Audit of Financial Statements</u> | Replace cover page, pages 5, 9, 12 - 17 with revised cover page, pages 5, 9, 12 - 17. | - ditto - |
| <u>HKSA 230 (Clarified) Audit Documentation</u> | Replace cover page, pages 9, 11 and 13 with revised cover page, pages 9, 11 and 13. | - ditto - |
| <u>HKSA 240 (Clarified) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements</u> | Replace cover page, pages 5, 7, 8, 12, 17, 20 and 30 with revised cover page, pages 5, 7, 8, 12, 17, 20 and 30. | - ditto - |

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| <u>HKSA 260 (Clarified) Communication with Those Charged with Governance</u> | Replace cover page, pages 9, 11, 13, 15 - 19 with revised cover page, pages 9, 11, 13, 15 - 19. | - ditto - |
| <u>HKSA 265 (Clarified) Communicating Deficiencies in Internal Control to Those Charged with Governance and Management</u> | Replace cover page, pages 4, 8 and 11 with revised cover page, pages 4, 8 and 11. | - ditto - |
| <u>HKSA 300 (Clarified) Planning an Audit of Financial Statements</u> | Replace cover page, pages 5, 7 and 11 with revised cover page, pages 5, 7 and 11. | - ditto - |
| <u>HKSA 402 (Clarified) Audit Considerations Relating to an Entity Using a Service Organization</u> | Replace cover page, pages 4, 6, 7, 10 and 12 with revised cover page, pages 4, 6, 7, 10 and 12. | - ditto - |
| <u>HKSA 500 (Clarified) Audit Evidence</u> | Replace cover page, pages 4, 6, 7, 15 and 17 with revised cover page, pages 4, 6, 7, 15 and 17. | - ditto - |
| <u>HKSA 550 (Clarified) Related Parties</u> | Replace cover page, pages 5, 7 - 9, 13 - 16 and 18 with revised cover page, pages 5, 7 - 9, 13 - 16 and 18. | - ditto - |
| <u>HKSA 600 (Clarified) Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)</u> | Replace cover page, pages 8, 9, 17, 21, 22, 29, 37, 43 and 44 with revised cover page, pages 8, 9, 17, 21, 22, 29, 37, 43 and 44. | - ditto - |

HONG KONG STANDARDS ON ASSURANCE ENGAGEMENTS

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| <u>HKSAE 3000 (Revised) Assurance Engagements other than Audits or Reviews of Historical Financial Information</u> | Replace cover page, pages 7, 9, 11, 12, 15 - 17, 19 - 21, 24 - 26, 28, 34 - 36, 39 - 41, 45, 47, 51, 52 and 55 - 62 with revised cover page, pages 7, 9, 11, 12, 15 - 17, 19 - 21, 24 - 26, 28, 34 - 36, 39 - 41, 45, 47, 51, 52 and 55 - 62. | - ditto - |
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| <u>PN 810.2 (Revised) The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance</u> | Insert after PN 810.2 <i>The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance</i> revised in March 2014. | Note 2 |
|--|--|--------|

Notes:

1. In October 2014, the International Auditing and Assurance Standards Board (IAASB) published the 2014 edition of *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* (2014 Handbook) and made editorial and formatting changes in finalizing the 2014 Handbook. As part of the convergence with the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements, the changes have been made to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements.

In addition, conforming amendments as a result of HKSA 610 (Revised), *Using the Work of Internal Auditors* and HKSA 610 (Revised 2013), *Using the Work of Internal Auditors* have also been made to the relevant standards. The conforming amendments as a result of HKSA 610 (Revised) and HKSA 610 (Revised 2013) are effective for audits of financial statements for periods ended on or after 15 December 2013 and 2014 respectively.

To assist users, a Consolidated Table of Changes setting out these changes is posted at: http://www.hkicpa.org.hk/file/media/section6_standards/technical_resources/pdf-file/handbook/changes_update166.pdf

2. PN 810.2 (Revised) has been updated to align with the requirements of the new Hong Kong Companies Ordinance (Cap. 622) ("new CO") as well as the following housekeeping changes:
 - (a) Updated reporting requirements on financial information to be submitted by a Hong Kong Branch of an overseas insurance company in paragraph 16, Examples 4(a) and 4(b) of Appendix 2, with the relevant transition arrangements set out in Appendix 5;
 - (b) Aligned the wording in paragraph 28c with that in Example 4(a) of Appendix 2;
 - (c) Added guidance for annual return on employees' compensation gross premium in paragraph 59;
 - (d) Updated example audit and assurance reports in Appendices 2 and 4;
 - (e) Updated reporting requirement for an insurer to prepare a combined set of financial statements in accordance with the CO and financial information in accordance with the Insurance Companies Ordinance in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule in Example 4(a) of Appendix 2, with the relevant transition arrangement set out in Appendix 5;
 - (f) Inserted Appendix 5 to set out transition arrangements; and
 - (g) Other housekeeping amendments.

The changes with respect to the new CO are effective for financial statements which cover a period beginning on or after 3 March 2014. All other changes are effective upon issue. There are specific transition arrangements for reporting under Parts 8 and 9 of the Third Schedule to the Insurance Companies Ordinance (Examples 4(a) and (b) of Appendix 2 in this Practice Note), please refer to Appendix 5 of the Practice Note.



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Glossary
Issued September 2009; revised July 2010, December 2012,
February 2015

Effective as of 15 December 2009

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



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

(February 2015)

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

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

**Accounting estimate* - An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where HKSA 540 ² addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

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

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

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

* Denotes a term defined in the HKSAs.

† Denotes a term defined in HKSQC 1.

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

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

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

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

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

*Applicable criteria (in the context of HKSAE 3410)*³ - The criteria used by the entity to quantify and report its emissions in the GHG statement.

*Applicable criteria (in the context of HKSAE 3420)*⁴ - The criteria used by the responsible party when compiling the pro forma financial information. Criteria may be established by an authorized or recognized standard-setting organization or by law or regulation. Where established criteria do not exist, they will be developed by the responsible party.

**Applicable financial reporting framework* - The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. In the context of HKSRS 4410 (Revised),⁵ reference is to the financial information, rather than to the financial statements.

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

- (a) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- (b) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above.

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

**Applied criteria (in the context of HKSA 810)*⁶ - The criteria applied by management in the preparation of the summary financial statements.

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

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

³ HKSAE 3410, *Assurance Engagements on Greenhouse Gas Statements*

⁴ HKSAE 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*

⁵ HKSRS 4410 (Revised), *Compilation Engagements*

⁶ HKSA 810, *Engagements to Report on Summary Financial Statements*.

**Assertions* - Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur. In the context of HKSAE 3410, assertions are defined as representations by the entity, explicit or otherwise, that are embodied in the GHG statement, as used by the practitioner to consider the different types of potential misstatements that may occur.

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

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

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

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

Reasonable assurance engagement - The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement ⁷ as the basis for a positive form of expression of the practitioner's conclusion.

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

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

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

**Audit evidence* - Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. (See *Sufficiency of audit evidence* and *Appropriateness of audit evidence*.)

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

*[†]*Audit firm* - (see *Firm*)

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

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

⁷ Engagement circumstances include the terms of the engagement, including whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the subject matter, the criteria to be used, the needs of the intended users, relevant characteristics of the responsible party and its environment, and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.

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

**Audited financial statements (in the context of HKSA 810)* - Financial statements⁸ audited by the auditor in accordance with HKSAs, and from which the summary financial statements are derived.

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

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

**Auditor's expert* - An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an auditor's internal expert (who is a partner⁹ or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert.

**Auditor's point estimate or auditor's range* - The amount, or range of amounts, respectively, derived from audit evidence for use in evaluating management's point estimate.

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

Base year - A specific year or an average over multiple years against which an entity's emissions are compared over time.

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

Cap and trade - A system that sets overall emissions limits, allocates emissions allowances to participants, and allows them to trade allowances and emission credits with each other.

**Comparative financial statements* - Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

**Comparative information* - The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework. In the context of HKSAE 3410, comparative information is defined as the amounts and disclosures included in the GHG statement in respect of one or more prior periods.

Compilation engagement - An engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework, and reports as required by

⁸ HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraph 13(f) defines the term "financial statements."

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

this HKSRS. Throughout HKSRS 4410 (Revised), the words "compile", "compiling" and "compiled" are used in this context.

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

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

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

**Component auditor* - An auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit.

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

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

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

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

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

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

Corporate governance - (see *Governance*)

**Corresponding figures* - Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

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

Suitable criteria - Exhibit the following characteristics:

- (a) **Relevance:** relevant criteria contribute to conclusions that assist decision making by the intended users.
- (b) **Completeness:** criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.

- (c) Reliability: reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
- (d) Neutrality: neutral criteria contribute to conclusions that are free from bias.
- (e) Understandability: understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

**Date of approval of the financial statements* - The date on which all the statements that comprise the financial statements, including the related notes, have been prepared and those with the recognized authority have asserted that they have taken responsibility for those financial statements.

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

**Date of the auditor's report* - The date the auditor dates the report on the financial statements in accordance with HKSA 700.¹⁰

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

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

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

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

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

**Direct assistance* - The use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

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

**Element of a financial statement (in the context of HKSA 805¹¹)* - An element, account or item of a financial statement.

Emissions - The GHGs that, during the relevant period, have been emitted to the atmosphere or would have been emitted to the atmosphere had they not been captured and channeled to a sink. Emissions can be categorized as:

- Direct emissions (also known as Scope 1 emissions), which are emissions from sources that are owned or controlled by the entity.
- Indirect emissions, which are emissions that are a consequence of the activities of the entity, but which occur at sources that are owned or controlled by another entity. Indirect emissions can be further categorized as:

¹⁰ HKSA 700, *Forming an Opinion and Reporting on Financial Statements*.

¹¹ HKSA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*.

- Scope 2 emissions, which are emissions associated with energy that is transferred to and consumed by the entity.
- Scope 3 emissions, which are all other indirect emissions.

Emissions deduction - Any item included in the entity's GHG statement that is deducted from the total reported emissions, but which is not a removal; it commonly includes purchased offsets, but can also include a variety of other instruments or mechanisms such as performance credits and allowances that are recognized by a regulatory or other scheme of which the entity is a part.

Emissions factor - A mathematical factor or ratio for converting the measure of an activity (for example, liters of fuel consumed, kilometers travelled, the number of animals in husbandry, or tonnes of product produced) into an estimate of the quantity of GHGs associated with that activity.

Emissions trading scheme - A market-based approach used to control greenhouse gases by providing economic incentives for achieving reductions in the emissions of such gases.

**Emphasis of Matter paragraph* - A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

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

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

**†Engagement partner*¹² - The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

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

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

*Engagement risk (in the context of HKSRE 2400 (Revised))*¹³ - The risk that the practitioner expresses an inappropriate conclusion when the financial statements are materially misstated.

**†Engagement team* - All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes an auditor's external expert engaged by the firm or a network firm.¹⁴ The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of HKSA 610 (Revised 2013).¹⁵

Entity (in the context of HKSAE 3410) - The legal entity, economic entity, or the identifiable portion of a legal or economic entity (for example, a single factory or other form of facility, such as a land fill site),

¹² "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

¹³ HKSRE 2400 (Revised), *Engagements to Report on Historical Financial Statements*

¹⁴ HKSA 620, *Using the Work of an Auditor's Expert*, paragraph 6(a) defines the term "auditor's expert."

¹⁵ HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

or combination of legal or other entities or portions of those entities (for example, a joint venture) to which the emissions in the GHG statement relate.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Further procedures - Procedures performed in response to assessed risks of *material* misstatement, including tests of controls (if any), tests of details and analytical procedures.

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

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

**General purpose framework* - A financial reporting framework designed to meet the common financial information needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.

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

- (a) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- (b) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above.¹⁶

GHG statement - A statement setting out constituent elements and quantifying an entity's GHG emissions for a period (sometimes known as an emissions inventory) and, where applicable, comparative information and explanatory notes including a summary of significant quantification and reporting policies. An entity's GHG statement may also include a categorized listing of removals or emissions deductions. Where the engagement does not cover the entire GHG statement, the term "GHG statement" is to be read as that portion that is covered by the engagement. The GHG statement is the "subject matter information" of the engagement.¹⁷

Greenhouse gases (GHGs) - Carbon dioxide (CO₂) and any other gases required by the applicable criteria to be included in the GHG statement, such as: methane; nitrous oxide; sulfur hexafluoride;

¹⁶ HKSA 200, paragraph 13(a).

¹⁷ Assurance Framework, paragraph 8

hydrofluorocarbons; perfluorocarbons; and chlorofluorocarbons. Gases other than carbon dioxide are often expressed in terms of carbon dioxide equivalents (CO₂-e).

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

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

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

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

**Group engagement partner* - The partner or other person in the firm who is responsible for the group audit engagement and its performance, and for the auditor's report on the group financial statements that is issued on behalf of the firm. Where joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team.

**Group engagement team* - Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

**Group financial statements* - Financial statements that include the financial information of more than one component. The term "group financial statements" also refers to combined financial statements aggregating the financial information prepared by components that have no parent but are under common control.

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

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

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

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

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

*Independence*¹⁸ - Comprises:

- (a) Independence of mind - the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- (b) Independence in appearance - the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information,

¹⁸ As defined in the HKICPA *Code of Ethics for Professional Accountants*.

including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

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

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

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

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

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

Inquiry (in the context of HKSRE 2400 (Revised)) - Inquiry consists of seeking information of knowledgeable persons from within or outside the entity.

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

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

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

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

**Internal audit function* - A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

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

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

**International Financial Reporting Standards* - The International Financial Reporting Standards issued by the International Accounting Standards Board.

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

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

Limited assurance (in the context of HKSRE 2400 (Revised)) - The level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in accordance with this HKSRE. The combination of the nature, timing and extent of evidence gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the financial statements.

Limited assurance engagement - (see *Assurance engagement*)

*[†]*Listed entity* - An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

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

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

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

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

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

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

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

In the context of HKSRS 4410 (Revised), a misstatement is defined as a difference between the amount, classification, presentation, or disclosure of a reported item in the financial information, and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Where the financial information is prepared in accordance with a fair presentation framework, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the practitioner's judgment, are necessary for the financial information to be presented fairly, in all material respects, or to give a true and fair view.

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

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

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

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

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

*† *Network* - A larger structure:

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

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

* *Non-compliance (in the context of HKSA 250¹⁹)* - Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Noncompliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

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

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

Observation - Consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

* *Opening balances* - Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

Organizational boundary - The boundary that determines which operations to include in the entity's GHG statement.

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

* *Other Matter paragraph* - A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

¹⁹ HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

**Outcome of an accounting estimate* - The actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by the accounting estimate.

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

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

**Performance materiality* - The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures. In the context of HKSAE 3410, performance materiality is defined as the amount or amounts set by the practitioner at less than materiality for the GHG statement to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the GHG statement. If applicable, performance materiality also refers to the amount or amounts set by the practitioner at less than the materiality level or levels for particular types of emissions or disclosures.

*†*Personnel* - Partners and staff.

**Pervasive* - A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

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

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

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

Practitioner - A professional accountant in public practice.

Practitioner (in the context of HKSRE 2400 (Revised)) - A professional accountant in public practice. The term includes the engagement partner or other members of the engagement team, or, as applicable, the firm. Where HKSRE 2400 (Revised) expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.

Practitioner (in the context of HKSRS 4410 (Revised)) - A professional accountant in public practice who conducts the compilation engagement. The term includes the engagement partner or other members of the engagement team, or, as applicable, the firm. Where HKSRS 4410 (Revised) expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.

**Preconditions for an audit* - The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise²⁰ on which an audit is conducted.

**Predecessor auditor* - The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

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

- (a) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
- (b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (c) To provide the auditor with:
 - (i) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - (ii) Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and
 - (iii) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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

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

Pro forma adjustments - In relation to unadjusted financial information, these include:

- (a) Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction ("event" or "transaction") as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration; and
- (b) Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity ("entity") and its accounting policies under that framework.

Pro forma adjustments include the relevant financial information of a business that has been, or is to be, acquired ("acquiree"), or a business that has been, or is to be, divested ("divestee"), to the extent that such information is used in compiling the pro forma financial information ("acquiree or divestee financial information").

²⁰ HKSA 200, paragraph 13.

Pro forma financial information - Financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information as if the event had occurred or the transaction had been *undertaken* at an earlier date selected for purposes of the illustration. In this HKSAE, it is presumed that pro forma financial information is presented in columnar format consisting of (a) the unadjusted financial information; (b) the pro forma adjustments; and (c) the resulting pro forma column.

*Professional accountant*²¹ - An individual who is a member of the Hong Kong Institute of Certified Public Accountants.

*Professional accountant in public practice*²² - A professional accountant, irrespective of functional classification (for example, audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.

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

Professional judgment (in the context of HKSRE 2400 (Revised)) - The application of relevant training, knowledge and experience, within the context provided by assurance, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the review engagement.

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

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

†*Professional standards (in the context of HKSQC 1*²³*)* - Hong Kong Engagement Standards, as defined in the *Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, and relevant ethical requirements.

Projection - Prospective financial information prepared on the basis of:

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

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

Prospectus - A document issued pursuant to legal or regulatory requirements relating to the entity's securities on which it is intended that a third party should make an investment decision.

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

Published financial information - Financial information of the entity or of an acquiree or a divestee that is made available publicly.

²¹ As defined in the HKICPA *Code of Ethics for Professional Accountants*.

²² As defined in the HKICPA *Code of Ethics for Professional Accountants*.

²³ HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*.

Purchased offset - An emissions deduction in which the entity pays for the lowering of another entity's emissions (emissions reductions) or the increasing of another entity's removals (removal enhancements), compared to a hypothetical baseline.

Quantification - The process of determining the quantity of GHGs that relate to the entity, either directly or indirectly, as emitted (or removed) by particular sources (or sinks).

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

Reasonable assurance engagement - (see *Assurance engagement*)

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

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

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

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

Related services - Comprise agreed-upon procedures and compilations.

*[†]*Relevant ethical requirements* - Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) together with national requirements that are more restrictive. In the context of HKSRE 2400 (Revised), relevant ethical requirements are defined as the ethical requirements the engagement team is subject to when undertaking review engagements. These requirements ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code), together with national requirements that are more restrictive. In the context of HKSRS 4410 (Revised), relevant ethical requirements are defined as the ethical requirements the engagement team is subject to when undertaking compilation engagements. These requirements ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) (excluding Section 290, *Independence - Audit and Review Engagements*, and Section 291, *Independence - Other Assurance Engagements* in Part B), together with national requirements that are more restrictive.

Removal - The GHGs that the entity has, during the period, removed from the atmosphere, or that would have been emitted to the atmosphere had they not been captured and channeled to a sink.

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

**Report on the description and design of controls at a service organization (referred to in HKSA 402²⁴ as a type 1 report)* - A report that comprises:

- (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date; and
- (b) A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organization's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

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

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

Responsible party - The person (or persons) who:

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

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

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

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

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

²⁴ HKSA 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

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

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

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

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

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

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

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

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

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

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

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

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

**Significant component* - A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements.

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

Significant facility - A facility that is of individual significance due to the size of its emissions relative to the aggregate emissions included in the GHG statement or its specific nature or circumstances which give rise to particular risks of material misstatement.

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

Sink - A physical unit or process that removes GHGs from the atmosphere.

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

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

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

Source - A physical unit or process that releases GHGs into the atmosphere.

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

**Special purpose framework* - A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.²⁵

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

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

- (a) Random selection of the sample items; and

²⁵ HKSA 200, paragraph 13(a).

- (b) The use of probability theory to evaluate sample results, including measurement of sampling risk.

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

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

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

**Subsequent events* - Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

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

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

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

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

Suitable criteria - (see *Criteria*)

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

**Summary financial statements (in the context of HKSA 810)* - Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time.²⁶ Different jurisdictions may use different terminology to describe such historical financial information.

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

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

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

²⁶ HKSA 200, paragraph 13(f).

**Those charged with governance* - The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.²⁷

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

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

Type of emission - A grouping of emissions based on, for example, source of emission, type of gas, region, or facility.

Unadjusted financial information - Financial information of the entity to which pro forma adjustments are applied by the responsible party.

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

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

**Unmodified opinion* - The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.²⁸

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

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

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

**Written representation* - A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

²⁷ For discussion of the diversity of governance structures, see paragraphs A1-A8 of HKSA 260, *Communication with Those Charged with Governance*.

²⁸ HKSA 700, paragraphs 35-36 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

Effective as of 15 December 2009

Hong Kong Standard on Quality Control 1

Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

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



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- (e) Engagement quality control reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report.
- (f) Engagement team – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes an auditor's external expert engaged by the firm or by a network firm. The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of HKSA 610 (Revised 2013).³
- (g) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants.
- (h) Inspection – In relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.
- (i) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
- (j) Monitoring – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively.
- (k) Network firm – A firm or entity that belongs to a network.
- (l) Network – A larger structure:
 - (i) That is aimed at cooperation, and
 - (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (m) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (n) Personnel – Partners and staff.
- (o) Professional standards – Hong Kong Engagement Standards, as defined in the *Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, and relevant ethical requirements.
- (p) Reasonable assurance – In the context of this HKSQC, a high, but not absolute, level of assurance.

³ HKSA 610 (Revised 2013), "Using the Work of Internal Auditors," establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

- (q) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) together with national requirements that are more restrictive.
- (r) Staff – Professionals, other than partners, including any experts the firm employs.
- (s) Suitably qualified external person – An individual outside the firm with the competence and capabilities to act as an engagement partner, for example, a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

Requirements

Applying, and Complying with, Relevant Requirements

- 13. Personnel within the firm responsible for establishing and maintaining the firm's system of quality control shall have an understanding of the entire text of this HKSQC, including its application and other explanatory material, to understand its objective and to apply its requirements properly.
- 14. The firm shall comply with each requirement of this HKSQC unless, in the circumstances of the firm, the requirement is not relevant to the services provided in respect of audits and reviews of financial statements, and other assurance and related services engagements. (Ref: Para. A1)
- 15. The requirements are designed to enable the firm to achieve the objective stated in this HKSQC. The proper application of the requirements is therefore expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm shall consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this HKSQC to meet the stated objective.

Elements of a System of Quality Control

- 16. The firm shall establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:
 - (a) Leadership responsibilities for quality within the firm.
 - (b) Relevant ethical requirements.
 - (c) Acceptance and continuance of client relationships and specific engagements.
 - (d) Human resources.
 - (e) Engagement performance.
 - (f) Monitoring.
- 17. The firm shall document its policies and procedures and communicate them to the firm's personnel. (Ref: Para. A2-A3)

Leadership Responsibilities for Quality within the Firm

18. The firm shall establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements. Such policies and procedures shall require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control. (Ref: Para. A4-A5)
19. The firm shall establish policies and procedures such that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's chief executive officer or managing board of partners has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: Para. A6)

Relevant Ethical Requirements

20. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: Para. A7-A10)

Independence

21. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including network firm personnel) maintain independence where required by relevant ethical requirements. Such policies and procedures shall enable the firm to: (Ref: Para. A10)
 - (a) Communicate its independence requirements to its personnel and, where applicable, others subject to them; and
 - (b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement, where withdrawal is possible under applicable law or regulation.
22. Such policies and procedures shall require: (Ref: Para. A10)
 - (a) Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;
 - (b) Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
 - (c) The accumulation and communication of relevant information to appropriate personnel so that:
 - (i) The firm and its personnel can readily determine whether they satisfy independence requirements;
 - (ii) The firm can maintain and update its records relating to independence; and
 - (iii) The firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.
23. The firm shall establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures shall include requirements for: (Ref: Para. A10)
 - (a) Personnel to promptly notify the firm of independence breaches of which they become aware;

Definition of "Firm," "Network" and "Network Firm" (Ref: Para. 20-25)

- A10. The definitions of "firm," "network" or "network firm" in relevant ethical requirements may differ from those set out in this HKSQC. For example, the Code⁴ defines the "firm" as:
- (a) A sole practitioner, partnership or corporation of professional accountants;
 - (b) An entity that controls such parties through ownership, management or other means; and
 - (c) An entity controlled by such parties through ownership, management or other means.

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

In complying with the requirements in paragraphs 20-25, the definitions used in the relevant ethical requirements apply in so far as is necessary to interpret those ethical requirements.

Written Confirmation (Ref: Para. 24)

- A11. Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the firm demonstrates the importance that it attaches to independence and makes the issue current for, and visible to, its personnel.

Familiarity Threat (Ref: Para. 25)

- A12. The Code discusses the familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such threats.
- A13. Determining appropriate criteria to address familiarity threat may include matters such as:
- The nature of the engagement, including the extent to which it involves a matter of public interest; and
 - The length of service of the senior personnel on the engagement.

Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.

- A14. The Code recognizes that the familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the Code requires the rotation of the key audit partner⁵ after a pre-defined period, normally no more than seven years, and provides related standards and guidance. National requirements may establish shorter rotation periods.

⁴ "HKICPA Code of Ethics for Professional Accountants."

⁵ As defined in the HKICPA Code.

HKSA 200
Issued June 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 200

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

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



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Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 5 and 17)

Sufficiency and Appropriateness of Audit Evidence

- A28. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit¹⁷) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.
- A29. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.
- A30. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
- A31. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. HKSA 500 and other relevant HKSAs establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence.

Audit Risk

- A32. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.
- A33. For purposes of the HKSAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

¹⁷ HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 9.

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.

A41. HKSA 315 (Revised) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

Detection Risk

A42. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

A43. 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. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

- adequate planning;
- proper assignment of personnel to the engagement team;
- the application of professional skepticism; and
- supervision and review of the audit work performed,

assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

A44. HKSA 300¹⁹ and HKSA 330 establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

Inherent Limitations of an Audit

A45. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; and
- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

¹⁹ HKSA 300, "Planning an Audit of Financial Statements."

A49. Consequently, it is necessary for the auditor to:

- Plan the audit so that it will be performed in an effective manner;
- Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- Use testing and other means of examining populations for misstatements.

A50. In light of the approaches described in paragraph A49, the HKSAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities,²¹ and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.²²

Other Matters that Affect the Inherent Limitations of an Audit

A51. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion. See HKSA 240 for further discussion.
- The existence and completeness of related party relationships and transactions. See HKSA 550²³ for further discussion.
- The occurrence of non-compliance with laws and regulations. See HKSA 250²⁴ for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See HKSA 570²⁵ for further discussion.

Relevant HKSAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

A52. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with HKSAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with HKSAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in

²¹ HKSA 315 (Revised), paragraphs 5-10.

²² HKSA 330; HKSA 500; HKSA 520, "Analytical Procedures;" HKSA 530, "Audit Sampling."

²³ HKSA 550, "Related Parties."

²⁴ HKSA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements."

²⁵ HKSA 570, "Going Concern."

- (vi) Few personnel, many having a wide range of duties.

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

A65. The considerations specific to smaller entities included in the HKSAs have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities.

A66. The HKSAs refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the "owner-manager."

Objectives Stated in Individual HKSAs (Ref: Para. 21)

A67. Each HKSA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual HKSAs serve to focus the auditor on the desired outcome of the HKSA, while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding whether more needs to be done to achieve them in the particular circumstances of the audit.

A68. Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this HKSA. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

A69. In using the objectives, the auditor is required to have regard to the interrelationships among the HKSAs. This is because, as indicated in paragraph A53, the HKSAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this HKSA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each HKSA. At a more detailed level, HKSA 315 (Revised) and HKSA 330 contain, among other things, objectives and requirements that deal with the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An HKSA dealing with specific aspects of the audit (for example, HKSA 540) may expand on how the objectives and requirements of such HKSAs as HKSA 315 (Revised) and HKSA 330 are to be applied in relation to the subject of the HKSA but does not repeat them. Thus, in achieving the objective stated in HKSA 540, the auditor has regard to the objectives and requirements of other relevant HKSAs.

Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

A70. The requirements of the HKSAs are designed to enable the auditor to achieve the objectives specified in the HKSAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the HKSAs by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the HKSAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the HKSAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the HKSAs to meet the objectives specified in the HKSAs.

Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained
(Ref: Para. 21(b))

A71. The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 21(b):

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other HKSAs;
- Extend the work performed in applying one or more requirements; or
- Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the HKSAs to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

Complying with Relevant Requirements

Relevant Requirements (Ref: Para. 22)

A72. In some cases, an HKSA (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in HKSA 610 (Revised 2013)²⁶ is relevant.

A73. Within a relevant HKSA, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

- The requirement to modify the auditor's opinion if there is a limitation of scope²⁷ represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies in internal control identified during the audit to those charged with governance,²⁸ which depends on the existence of such identified significant deficiencies; and the requirement to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework,²⁹ which depends on that framework requiring or permitting such disclosure, represent implicit conditional requirements.

In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the auditor may be required to withdraw from the audit engagement, *where withdrawal is possible under applicable law or regulation*, or the auditor may be

²⁶ HKSA 610 (Revised 2013), "Using the Work of Internal Auditors," paragraph 2.

²⁷ HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report," paragraph 13.

²⁸ HKSA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management," paragraph 9.

²⁹ HKSA 501, "Audit Evidence—Specific Considerations for Selected Items," paragraph 13.

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

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

Hong Kong Standard on Auditing 220

Quality Control for an Audit of Financial Statements

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



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Definitions

7. For purposes of the HKSAs, the following terms have the meanings attributed below:
- (a) Engagement partner² – The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
 - (b) Engagement quality control review – A process designed to provide an objective evaluation, on or before the date of the auditor's report, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report. The engagement quality control review process is for audits of financial statements of listed entities and those other audit engagements, if any, for which the firm has determined an engagement quality control review is required.
 - (c) Engagement quality control reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report.
 - (d) Engagement team – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external expert engaged by the firm or a network firm.³ The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of HKSA 610 (Revised 2013).⁴
 - (e) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants.
 - (f) Inspection – In relation to completed audit engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.
 - (g) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
 - (h) Monitoring – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively.
 - (i) Network firm – A firm or entity that belongs to a network.
 - (j) Network – A larger structure:
 - (i) That is aimed at cooperation, and

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

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

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

- (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and
- (c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached. (Ref: Para. A28-A31)

Differences of Opinion

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

Monitoring

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

Documentation

- 24. The auditor shall include in the audit documentation:⁵
 - (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
 - (b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
 - (c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
 - (d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement. (Ref: Para. A35)
- 25. The engagement quality control reviewer shall document, for the audit engagement reviewed, that:
 - (a) The procedures required by the firm's policies on engagement quality control review have been performed;
 - (b) The engagement quality control review has been completed on or before the date of the auditor's report; and
 - (c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate.

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

Considerations Specific to Public Sector Entities

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

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

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

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

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

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

Assignment of Engagement Teams (Ref: Para. 14)

- A10. An engagement team includes a person using expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm, if any, who performs audit procedures on the engagement. However, a person with such expertise is not a member of the engagement team if that person's involvement with the engagement is only consultation. Consultations are addressed in paragraphs 18, A21 and A22.
- A11. When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:
- Understanding of, and practical experience with, audit engagements of a similar nature

⁶ HKSQC 1, paragraph 27(a).

and complexity through appropriate training and participation.

- Understanding of professional standards and applicable legal and regulatory requirements.
- Technical expertise, including expertise with relevant information technology and specialized areas of accounting or auditing.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Considerations Specific to Public Sector Entities

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

Engagement Performance

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

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

- Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with professional skepticism as required by HKSA 200.⁷
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- The objectives of the work to be performed.
- The nature of the entity's business.
- Risk-related issues.
- Problems that may arise.
- The detailed approach to the performance of the engagement.

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

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

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

A15. Supervision includes matters such as:

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

Reviews

Review Responsibilities (Ref: Para. 16)

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

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

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

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

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

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

⁸ HKSQC 1, paragraph 33.

- Significant risks; and
- Other areas the engagement partner considers important.

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

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

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

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

- Agreeing with that member the nature, scope and objectives of that member's work; and the respective roles of, and the nature, timing and extent of communication between that member and other members of the engagement team.
- Evaluating the adequacy of that member's work including the relevance and reasonableness of that member's findings or conclusions and their consistency with other audit evidence.

Consultation (Ref: Para. 18)

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

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

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

Engagement Quality Control Review

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

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

⁹ HKSA 230, paragraph 9(c).

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

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

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

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

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

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

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

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

- Significant risks identified during the engagement in accordance with HKSA 315 (Revised),¹² and the responses to those risks in accordance with HKSA 330,¹³ including the engagement team's assessment of, and response to, the risk of fraud in accordance with HKSA 240.¹⁴
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the audit.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

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

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

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

¹¹ HKSA 230, paragraphs 14-16.

¹² HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

¹³ HKSA 330, "The Auditor's Responses to Assessed Risks."

¹⁴ HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

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

- A30. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General), may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.
- A31. Listed entities as referred to in paragraphs 21 and A28 are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

Monitoring (Ref: Para. 23)

- A32. HKSQC 1 requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively.¹⁵
- A33. In considering deficiencies that may affect the audit engagement, the engagement partner may have regard to measures the firm took to rectify the situation that the engagement partner considers are sufficient in the context of that audit.
- A34. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the auditor's report was not appropriate.

Documentation

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

- A35. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:
- The issue on which consultation was sought; and
 - The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

¹⁵ HKSQC 1, paragraph 48.

HKSA 230
Issued June 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 230

Audit Documentation

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- Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the HKSAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussions required by HKSA 315 (Revised).⁵

Documentation of Significant Matters and Related Significant Professional Judgments (Ref: Para. 8(c))

- A8. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:
- Matters that give rise to significant risks (as defined in HKSA 315 (Revised)).⁶
 - Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
 - Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
 - Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.
- A9. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).
- A10. Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:
- The rationale for the auditor's conclusion when a requirement provides that the auditor "shall consider" certain information or factors, and that consideration is significant in the context of the particular engagement.
 - The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
 - The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

⁵ HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 10.

⁶ HKSA 315 (Revised), paragraph 4(e).

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

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

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

- A16. The audit documentation for the audit of a smaller entity is generally less extensive than that for the audit of a larger entity. Further, in the case of an audit where the engagement partner performs all the audit work, the documentation will not include matters that might have to be documented solely to inform or instruct members of an engagement team, or to provide evidence of review by other members of the team (for example, there will be no matters to document relating to team discussions or supervision). Nevertheless, the engagement partner complies with the overriding requirement in paragraph 8 to prepare audit documentation that can be understood by an experienced auditor, as the audit documentation may be subject to review by external parties for regulatory or other purposes.
- A17. When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its internal control, the overall audit strategy and audit plan, materiality determined in accordance with HKSA 320,⁸ assessed risks, significant matters noted during the audit, and conclusions reached.

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

- A18. The requirements of the HKSAs are designed to enable the auditor to achieve the objectives specified in the HKSAs, and thereby the overall objectives of the auditor. Accordingly, other than in exceptional circumstances, the HKSAs call for compliance with each requirement that is relevant in the circumstances of the audit.
- A19. The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant⁹ only in the cases where:
- (a) The entire HKSA is not relevant (for example, if an entity does not have an internal audit function, nothing in HKSA 610 (Revised 2013)¹⁰ is relevant); or
 - (b) The requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor's opinion where there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability).

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

- A20. Examples of exceptional circumstances include facts which become known to the auditor after the date of the auditor's report but which existed at that date and which, if known at that date, might have caused the financial statements to be amended or the auditor to modify the opinion in the auditor's report.¹¹ The resulting changes to the audit documentation are reviewed in accordance with the review responsibilities set out in HKSA 220,¹² with the engagement partner taking final responsibility for the changes.

⁸ HKSA 320, "Materiality in Planning and Performing an Audit."

⁹ HKSA 200, paragraph 22.

¹⁰ HKSA 610 (Revised 2013), "Using the Work of Internal Auditors", paragraph 2.

¹¹ HKSA 560, "Subsequent Events," paragraph 14.

¹² HKSA 220, paragraph 16.

Appendix

(Ref: Para. 1)

Specific Audit Documentation Requirements in Other HKSAs

This appendix identifies paragraphs in other HKSAs in effect for audits of financial statements for periods beginning on or after 15 December 2009 that contain specific documentation requirements. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

- HKSA 210, "Agreeing the Terms of Audit Engagements" – paragraphs 10-12
- HKSA 220, "Quality Control for an Audit of Financial Statements" – paragraphs 24-25
- HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" – paragraphs 44-47
- HKSA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements" – paragraph 29
- HKSA 260, "Communication with Those Charged with Governance" – paragraph 23
- HKSA 300, "Planning an Audit of Financial Statements" – paragraph 12
- HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment" – paragraph 32
- HKSA 320, "Materiality in Planning and Performing an Audit" – paragraph 14
- HKSA 330, "The Auditor's Responses to Assessed Risks" – paragraphs 28-30
- HKSA 450, "Evaluation of Misstatements Identified during the Audit" – paragraph 15
- HKSA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures" – paragraph 23
- HKSA 550, "Related Parties" – paragraph 28
- HKSA 600, "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)" – paragraph 50
- HKSA 610 (Revised 2013), "Using the Work of Internal Auditors" – paragraphs 36-37

HKSA 240
Issued July 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 240

The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

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



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

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how HKSA 315 (Revised)¹ and HKSA 330² are to be applied in relation to risks of material misstatement due to fraud.

Characteristics of Fraud

2. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
3. Although fraud is a broad legal concept, for the purposes of the HKSAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. (Ref: Para. A1-A6)

Responsibility for the Prevention and Detection of Fraud

4. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability.

Responsibilities of the Auditor

5. An auditor conducting an audit in accordance with HKSAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the HKSAs.³

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

² HKSA 330, "The Auditor's Responses to Assessed Risks."

³ HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraphs A51-A52.

- (b) Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Requirements

Professional Skepticism

- 12. In accordance with HKSA 200⁵, the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A7- A8)
- 13. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A9)
- 14. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

Discussion among the Engagement Team

- 15. HKSA 315 (Revised) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.⁶ This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A10-A11)

Risk Assessment Procedures and Related Activities

- 16. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by HKSA 315 (Revised),⁷ the auditor shall perform the procedures in paragraphs 17-24 to obtain information for use in identifying the risks of material misstatement due to fraud.

Management and Others within the Entity

- 17. The auditor shall make inquiries of management regarding:
 - (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments; (Ref: Para. A12-A13)
 - (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: Para. A14)
 - (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and

⁵ HKSA 200, paragraph 15.

⁶ HKSA 315 (Revised), paragraph 10.

⁷ HKSA 315 (Revised), paragraphs 5-24.

- (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior.
- 18. The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. (Ref: Para. A15-A17)
- 19. For those entities that have an internal audit function, the auditor shall make inquiries of appropriate individuals within the function to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. (Ref: Para. A18)

Those Charged with Governance

- 20. Unless all of those charged with governance are involved in managing the entity,⁸ the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. (Ref: Para. A19-A21)
- 21. Unless all of those charged with governance are involved in managing the entity, the auditor shall make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management.

Unusual or Unexpected Relationships Identified

- 22. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.

Other Information

- 23. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: Para. A22)

Evaluation of Fraud Risk Factors

- 24. The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. (Ref: Para. A23-A27)

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

- 25. In accordance with HKSA 315 (Revised), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.⁹

⁸ HKSA 260, "Communication with Those Charged with Governance," paragraph 13.

⁹ HKSA 315 (Revised), paragraph 25.

- (d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (Ref: Para. A58-A59)

Communications to Management and with Those Charged with Governance

- 40. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. A60)
- 41. Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:
 - (a) management;
 - (b) employees who have significant roles in internal control; or
 - (c) others where the fraud results in a material misstatement in the financial statements,the auditor shall communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit. (Ref: Para. A61-A63)
- 42. The auditor shall communicate with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities. (Ref: Para. A64)

Communications to Regulatory and Enforcement Authorities^{11a}

- 43. If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor's professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor's legal responsibilities may override the duty of confidentiality in some circumstances. (Ref: Para. A65-A67)

Documentation

- 44. The auditor shall include the following in the audit documentation¹² of the auditor's understanding of the entity and its environment and the assessment of the risks of material misstatement required by HKSA 315 (Revised):¹³
 - (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; and
 - (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level.
- 45. The auditor shall include the following in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by HKSA 330:¹⁴

^{11a} Additional local guidance is provided in Appendix 4.

¹² HKSA 230, "Audit Documentation," paragraphs 8-11, and paragraph A6.

¹³ HKSA 315 (Revised), paragraph 32.

¹⁴ HKSA 330, paragraph 28.

Considerations specific to smaller entities

- A13. In some entities, particularly smaller entities, the focus of management's assessment may be on the risks of employee fraud or misappropriation of assets.

Management's Process for Identifying and Responding to the Risks of Fraud (Ref: Para. 17(b))

- A14. In the case of entities with multiple locations management's processes may include different levels of monitoring of operating locations, or business segments. Management may also have identified particular operating locations or business segments for which a risk of fraud may be more likely to exist.

Inquiry of Management and Others within the Entity (Ref: Para. 18)

- A15. The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated.

- A16. Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

- Operating personnel not directly involved in the financial reporting process.
- Employees with different levels of authority.
- Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
- In-house legal counsel.
- Chief ethics officer or equivalent person.
- The person or persons charged with dealing with allegations of fraud.

- A17. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.

Inquiries of the Internal Audit Function (Ref: Para. 19)

- A18. HKSA 315 (Revised) and HKSA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.¹⁶ In carrying out the requirements of those HKSAs in the context of fraud, the auditor may inquire about specific activities of the function including, for example:

- The procedures performed, if any, by the internal audit function during the year to detect fraud.
- Whether management has satisfactorily responded to any findings resulting from those procedures.

¹⁶ HKSA 315 (Revised), paragraphs 6(a) and 23, and HKSA 610 (Revised 2013), "Using the Work of Internal Auditors."

- A29. The risks of fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks of fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales.
- A30. The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property.

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: Para. 27)

- A31. Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.¹⁸ In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.
- A32. It is therefore important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. In doing so, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from obtaining this understanding may also be useful in identifying fraud risks factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses (Ref: Para. 28)

- A33. Determining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism, for example, through:
- Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
 - Increased recognition of the need to corroborate management explanations or representations concerning material matters.

It also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters listed in paragraph 29, which are discussed below.

Assignment and Supervision of Personnel (Ref: Para. 29(a))

- A34. The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement.

¹⁸ HKSA 315 (Revised), paragraph A55.

There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior management, legal counsel, or those charged with governance.

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of staff in accounting, information technology, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:

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Communication with Those Charged with Governance

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- A2. In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, a council of governors, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee. When governance is a collective responsibility, a subgroup such as an audit committee or even an individual, may be charged with specific tasks to assist the governing body in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body.
- A3. Such diversity means that it is not possible for this HKSA to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. In such cases, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with HKSA 315 (Revised)⁴ is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.
- A4. HKSA 600 includes specific matters to be communicated by group auditors with those charged with governance.⁵ When the entity is a component of a group, the appropriate person(s) with whom the component auditor communicates depends on the engagement circumstances and the matter to be communicated. In some cases, a number of components may be conducting the same businesses within the same system of internal control and using the same accounting practices. Where those charged with governance of those components are the same (for example, common board of directors), duplication may be avoided by dealing with these components concurrently for the purpose of communication.

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

- A5. When considering communicating with a subgroup of those charged with governance, the auditor may take into account such matters as:
- The respective responsibilities of the subgroup and the governing body.
 - The nature of the matter to be communicated.
 - Relevant legal or regulatory requirements.
 - Whether the subgroup has the authority to take action in relation to the information communicated, and can provide further information and explanations the auditor may need.

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

⁵ HKSA 600, "Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)," paragraphs 46-49.

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

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

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

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

A12. Care is required when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly where some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable.

A13. Matters communicated may include:

- How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error.
- The auditor's approach to internal control relevant to the audit.
- The application of the concept of materiality in the context of an audit.⁶

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

- Where the entity has an internal audit function, how the external auditor and internal auditors can work in a constructive and complementary manner, including any planned use of the work of the internal audit function, and the nature and extent of any planned use of internal auditors to provide direct assistance.⁷
- The views of those charged with governance of:
 - The appropriate person(s) in the entity's governance structure with whom to communicate.
 - The allocation of responsibilities between those charged with governance and management.
 - The entity's objectives and strategies, and the related business risks that may result in material misstatements.

⁶ HKSA 320, "Materiality in Planning and Performing an Audit."

⁷ HKSA 610 (Revised 2013), paragraphs 20 and 31

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.⁸

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

A19. Significant matters discussed, or subject to correspondence with management may include such matters as:

- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- Concerns about management's consultations with other accountants on accounting or auditing matters.
- Discussions or correspondence in connection with the initial or recurring appointment of the auditor regarding accounting practices, the application of auditing standards, or fees for audit or other services.

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

A20. Other significant matters arising from the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material misstatements of fact or material inconsistencies in information accompanying the audited financial statements that have been corrected.

Auditor Independence (Ref: Para. 17)

A21. The auditor is required to comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.⁹

A22. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:

- (a) Threats to independence, which may be categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and
- (b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm's own systems and procedures.

The communication required by paragraph 17(a) may include an inadvertent violation of relevant ethical requirements as they relate to auditor independence, and any remedial action taken or proposed.

A23. The communication requirements relating to auditor independence that apply in the case of listed entities may also be relevant in the case of some other entities, particularly those that may be of significant public interest because, as a result of their business, their size or their corporate status, they have a wide range of stakeholders. Examples of entities that are not listed entities, but where communication of auditor independence may be appropriate, include public sector entities, credit institutions, insurance companies, and retirement benefit funds. On the other hand, there may be situations where communications regarding independence may not be relevant, for example, where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where

⁸ HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

⁹ HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph 14.

- The process for taking action and reporting back on matters communicated by the auditor.
- The process for taking action and reporting back on matters communicated by those charged with governance.

A30. The communication process will vary with the circumstances, including the size and governance structure of the entity, how those charged with governance operate, and the auditor's view of the significance of matters to be communicated. Difficulty in establishing effective two-way communication may indicate that the communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraph A44).

Considerations Specific to Smaller Entities

A31. In the case of audits of smaller entities, the auditor may communicate in a less structured manner with those charged with governance than in the case of listed or larger entities.

Communication with Management

A32. Many matters may be discussed with management in the ordinary course of an audit, including matters required by this HKSA to be communicated with those charged with governance. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the preparation of the financial statements.

A33. Before communicating matters with those charged with governance, the auditor may discuss them with management, unless that is inappropriate. For example, it may not be appropriate to discuss questions of management's competence or integrity with management. In addition to recognizing management's executive responsibility, these initial discussions may clarify facts and issues, and give management an opportunity to provide further information and explanations. Similarly, when the entity has an internal audit function, the auditor may discuss matters with appropriate individuals within the function before communicating with those charged with governance.

Communication with Third Parties

A34. Those charged with governance may wish to provide third parties, for example, bankers or certain regulatory authorities, with copies of a written communication from the auditor. In some cases, disclosure to third parties may be illegal or otherwise inappropriate. When a written communication prepared for those charged with governance is provided to third parties, it may be important in the circumstances that the third parties be informed that the communication was not prepared with them in mind, for example, by stating in written communications with those charged with governance:

- (a) That the communication has been prepared for the sole use of those charged with governance and, where applicable, the group management and the group auditor, and should not be relied upon by third parties;
- (b) That no responsibility is assumed by the auditor to third parties; and
- (c) Any restrictions on disclosure or distribution to third parties.

A35. In some jurisdictions the auditor may be required by law or regulation to, for example:

- Notify a regulatory or enforcement body of certain matters communicated with those charged with governance. For example, in some countries the auditor has a duty to

report misstatements to authorities where management and those charged with governance fail to take corrective action;

- Submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies, or other bodies such as a central authority in the case of some public sector entities; or
- Make reports prepared for those charged with governance publicly available.

A36. Unless required by law or regulation to provide a third party with a copy of the auditor's written communications with those charged with governance, the auditor may need the prior consent of those charged with governance before doing so.

Forms of Communication (Ref: Para. 19-20)

A37. Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The auditor may communicate matters other than those identified in paragraphs 19 and 20 either orally or in writing. Written communications may include an engagement letter that is provided to those charged with governance.

A38. In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:

- Whether the matter has been satisfactorily resolved.
- Whether management has previously communicated the matter.
- The size, operating structure, control environment, and legal structure of the entity.
- In the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.
- Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.
- The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- The amount of ongoing contact and dialogue the auditor has with those charged with governance.
- Whether there have been significant changes in the membership of a governing body.

A39. When a significant matter is discussed with an individual member of those charged with governance, for example, the chair of an audit committee, it may be appropriate for the auditor to summarize the matter in later communications so that all of those charged with governance have full and balanced information.

Timing of Communications (Ref: Para. 21)

A40. The appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by those charged with governance. For example:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, may be made as part of agreeing the terms of the engagement.
- It may be appropriate to communicate a significant difficulty encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulty, or if it is likely to lead to a modified opinion. Similarly, the auditor may communicate orally to those charged with governance as soon as practicable significant deficiencies in internal control that the auditor has identified, prior to communicating these in writing as required by HKSA 265.¹⁰
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards, for example, when accepting an engagement to provide non-audit services, and at a concluding discussion. A concluding discussion may also be an appropriate time to communicate findings from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices.
- When auditing both general purpose and special purpose financial statements, it may be appropriate to coordinate the timing of communications.

A41. Other factors that may be relevant to the timing of communications include:

- The size, operating structure, control environment, and legal structure of the entity being audited.
- Any legal obligation to communicate certain matters within a specified timeframe.
- The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- The time at which the auditor identifies certain matters, for example, the auditor may not identify a particular matter (for example, noncompliance with a law) in time for preventive action to be taken, but communication of the matter may enable remedial action to be taken.

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

A42. The auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and those charged with governance; rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include:

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

¹⁰ HKSA 265, paragraphs 9 and A14.

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

A43. As noted in paragraph 4, effective two-way communication assists both the auditor and those charged with governance. Further, HKSA 315 (Revised) identifies participation by those charged with governance, including their interaction with the internal audit function, if any, and external auditors, as an element of the entity's control environment.¹¹ Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements.

A44. If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take such actions as:

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

Documentation (Ref: Para. 23)

A45. Documentation of oral communication may include a copy of minutes prepared by the entity retained as part of the audit documentation where those minutes are an appropriate record of the communication.

¹¹ HKSA 315 (Revised), paragraph A77.

Appendix 1

(Ref: Para. 3)

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

This appendix identifies paragraphs in HKSQC 1¹ and other HKSA's in effect for audits of financial statements for periods beginning on or after 15 December 2009 that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSA's.

- HKSQC 1, "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" – paragraph 30(a)
- HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" – paragraphs 21, 38(c)(i) and 40-42
- HKSA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements" – paragraphs 14, 19 and 22-24
- HKSA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" – paragraph 9
- HKSA 450, "Evaluation of Misstatements Identified during the Audit" – paragraphs 12-13
- HKSA 505, "External Confirmations" – paragraph 9
- HKSA 510, "Initial Audit Engagements — Opening Balances" – paragraph 7
- HKSA 550, "Related Parties" – paragraph 27
- HKSA 560, "Subsequent Events" – paragraphs 7(b)-(c), 10(a), 13(b), 14(a) and 17
- HKSA 570, "Going Concern" – paragraph 23
- HKSA 600, "Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)" – paragraph 49
- HKSA 610 (Revised 2013), "Using the Work of Internal Auditors" – paragraphs 20 and 31
- HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report" – paragraphs 12, 14, 19(a) and 28
- HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" – paragraph 9
- HKSA 710, "Comparative Information — Corresponding Figures and Comparative Financial Statements" – paragraph 18
- HKSA 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements" – paragraphs 10, 13 and 16

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

HKSA 265
Issued June 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 265

Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

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



Hong Kong Institute of
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香港會計師公會

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control¹ that the auditor has identified in an audit of financial statements. This HKSA does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control and designing and performing tests of controls over and above the requirements of HKSA 315 (Revised) and HKSA 330.² HKSA 260³ establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance in relation to the audit.
2. The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement.⁴ In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit. This HKSA specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.
3. Nothing in this HKSA precludes the auditor from communicating to those charged with governance and management other internal control matters that the auditor has identified during the audit.

Effective Date

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

Objective

5. The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

Definitions

6. For purposes of the HKSAs, the following terms have the meanings attributed below:
 - (a) Deficiency in internal control – This exists when:
 - (i) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or

¹ HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraphs 4 and 12.

² HKSA 330, "The Auditor's Responses to Assessed Risks."

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

⁴ HKSA 315 (Revised), paragraph 12. Paragraphs A67-A72 provide guidance on controls relevant to the audit.

- Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
 - Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
 - Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
 - Evidence of an ineffective response to identified significant risks (for example, absence of controls over such a risk).
 - Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
 - Restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud.
 - Evidence of management's inability to oversee the preparation of the financial statements.
- A8. Controls may be designed to operate individually or in combination to effectively prevent, or detect and correct, misstatements.⁵ For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency. However, a combination of deficiencies affecting the same account balance or disclosure, relevant assertion, or component of internal control may increase the risks of misstatement to such an extent as to give rise to a significant deficiency.
- A9. Law or regulation in some jurisdictions may establish a requirement (particularly for audits of listed entities) for the auditor to communicate to those charged with governance or to other relevant parties (such as regulators) one or more specific types of deficiency in internal control that the auditor has identified during the audit. Where law or regulation has established specific terms and definitions for these types of deficiency and requires the auditor to use these terms and definitions for the purpose of the communication, the auditor uses such terms and definitions when communicating in accordance with the legal or regulatory requirement.
- A9-1. Guidance on the auditor's responsibility to report direct to regulators in regulated industries is provided in Practice Note 820 (Revised) "The Audit of Licensed Corporations and Associated Entities of Intermediaries", Practice Note 620.2 "Communication between the Auditor and the Insurance Authority", Practice Note 860.1 (Revised) "The Audit of Retirement Schemes" and Practice Note 830 (Revised) "Reports by the Auditor under the Banking Ordinance".
- A10. Where the jurisdiction has established specific terms for the types of deficiency in internal control to be communicated but has not defined such terms, it may be necessary for the auditor to use judgment to determine the matters to be communicated further to the legal or regulatory requirement. In doing so, the auditor may consider it appropriate to have regard to the requirements and guidance in this HKSA. For example, if the purpose of the legal or regulatory requirement is to bring to the attention of those charged with governance certain internal control matters of which they should be aware, it may be appropriate to regard such

⁵ HKSA 315 (Revised), paragraph A73.

requirements and provides guidance regarding communication to those charged with governance when the auditor has identified fraud or suspected fraud involving management.¹⁰

Communication of Other Deficiencies in Internal Control to Management (Ref: Para. 10(b))

- A22. During the audit, the auditor may identify other deficiencies in internal control that are not significant deficiencies but that may be of sufficient importance to merit management's attention. The determination as to which other deficiencies in internal control merit management's attention is a matter of professional judgment in the circumstances, taking into account the likelihood and potential magnitude of misstatements that may arise in the financial statements as a result of those deficiencies.
- A23. The communication of other deficiencies in internal control that merit management's attention need not be in writing but may be oral. Where the auditor has discussed the facts and circumstances of the auditor's findings with management, the auditor may consider an oral communication of the other deficiencies to have been made to management at the time of these discussions. Accordingly, a formal communication need not be made subsequently.
- A24. If the auditor has communicated deficiencies in internal control other than significant deficiencies to management in a prior period and management has chosen not to remedy them for cost or other reasons, the auditor need not repeat the communication in the current period. The auditor is also not required to repeat information about such deficiencies if it has been previously communicated to management by other parties, such as the internal audit function or regulators. It may, however, be appropriate for the auditor to re-communicate these other deficiencies if there has been a change of management, or if new information has come to the auditor's attention that alters the prior understanding of the auditor and management regarding the deficiencies. Nevertheless, the failure of management to remedy other deficiencies in internal control that were previously communicated may become a significant deficiency requiring communication with those charged with governance. Whether this is the case depends on the auditor's judgment in the circumstances.
- A25. In some circumstances, those charged with governance may wish to be made aware of the details of other deficiencies in internal control the auditor has communicated to management, or be briefly informed of the nature of the other deficiencies. Alternatively, the auditor may consider it appropriate to inform those charged with governance of the communication of the other deficiencies to management. In either case, the auditor may report orally or in writing to those charged with governance as appropriate.
- A26. HKSA 260 establishes relevant considerations regarding communication with those charged with governance when all of them are involved in managing the entity.¹¹

Considerations Specific to Public Sector Entities (Ref: Para. 9-10)

- A27. Public sector auditors may have additional responsibilities to communicate deficiencies in internal control that the auditor has identified during the audit, in ways, at a level of detail and to parties not envisaged in this HKSA. For example, significant deficiencies may have to be communicated to the legislature or other governing body. Law, regulation or other authority may also mandate that public sector auditors report deficiencies in internal control, irrespective of the significance of the potential effects of those deficiencies. Further, legislation may require public sector auditors to report on broader internal control-related matters than the deficiencies in internal control required to be communicated by this HKSA,

¹⁰ HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph 41.

¹¹ HKSA 260, paragraph 13.

HKSA 300
Issued June 2009; revised July 2010, December 2012, May 2013,
February 2015

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

Hong Kong Standard on Auditing 300

Planning an Audit of Financial Statements

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

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



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Preliminary Engagement Activities

6. The auditor shall undertake the following activities at the beginning of the current audit engagement:
 - (a) Performing procedures required by HKSA 220 regarding the continuance of the client relationship and the specific audit engagement;¹
 - (b) Evaluating compliance with relevant ethical requirements, including independence, in accordance with HKSA 220;² and
 - (c) Establishing an understanding of the terms of the engagement, as required by HKSA 210.³ (Ref: Para. A5-A7)

Planning Activities

7. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.
8. In establishing the overall audit strategy, the auditor shall:
 - (a) Identify the characteristics of the engagement that define its scope;
 - (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
 - (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
 - (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
 - (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement. (Ref: Para. A8-A11)
9. The auditor shall develop an audit plan that shall include a description of:
 - (a) The nature, timing and extent of planned risk assessment procedures, as determined under HKSA 315 (Revised).⁴
 - (b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under HKSA 330.⁵
 - (c) Other planned audit procedures that are required to be carried out so that the engagement complies with HKSAs. (Ref: Para. A12)
10. The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. (Ref: Para. A13)

¹ HKSA 220, "Quality Control for an Audit of Financial Statements," paragraphs 12-13.

² HKSA 220, paragraphs 9-11.

³ HKSA 210, "Agreeing the Terms of Audit Engagements," paragraphs 9-13.

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

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

- The determination of materiality.
 - The involvement of experts.
 - The performance of other risk assessment procedures.
- A3. The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

Involvement of Key Engagement Team Members (Ref: Para. 5)

- A4. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process.⁸

Preliminary Engagement Activities (Ref: Para. 6)

- A5. Performing the preliminary engagement activities specified in paragraph 6 at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement.
- A6. Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which, for example:
- The auditor maintains the necessary independence and ability to perform the engagement.
 - There are no issues with management integrity that may affect the auditor's willingness to continue the engagement.
 - There is no misunderstanding with the client as to the terms of the engagement.
- A7. The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur. Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often occur shortly after (or in connection with) the completion of the previous audit.

⁸ HKSA 315 (Revised), paragraph 10, establishes requirements and provides guidance on the engagement team's discussion of the susceptibility of the entity to material misstatements of the financial statements. HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph 15, provides guidance on the emphasis given during this discussion to the susceptibility of the entity's financial statements to material misstatement due to fraud.

Appendix

(Ref: Para. 7-8, A8-A11)

Considerations in Establishing the Overall Audit Strategy

This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters will also influence the auditor's detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. While some of the matters referred to below may be required by other HKSA's, not all matters are relevant to every audit engagement and the list is not necessarily complete.

Characteristics of the Engagement

- The financial reporting framework on which the financial information to be audited has been prepared, including any need for reconciliations to another financial reporting framework.
- Industry-specific reporting requirements such as reports mandated by industry regulators.
- The expected audit coverage, including the number and locations of components to be included.
- The nature of the control relationships between a parent and its components that determine how the group is to be consolidated.
- The extent to which components are audited by other auditors.
- The nature of the business segments to be audited, including the need for specialized knowledge.
- The reporting currency to be used, including any need for currency translation for the financial information audited.
- The need for a statutory audit of standalone financial statements in addition to an audit for consolidation purposes.
- Whether the entity has an internal audit function and if so, whether, in which areas and to what extent, the work of the function can be used, or internal auditors can be used to provide direct assistance, for purposes of the audit.
- The entity's use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them.
- The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls.
- The effect of information technology on the audit procedures, including the availability of data and the expected use of computer-assisted audit techniques.
- The coordination of the expected coverage and timing of the audit work with any reviews of interim financial information and the effect on the audit of the information obtained during such reviews.
- The availability of client personnel and data.

HKSA 402
Issued July 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 402

Audit Considerations Relating to an Entity Using a Service Organization

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



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

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations. Specifically, it expands on how the user auditor applies HKSA 315 (Revised)¹ and HKSA 330² in obtaining an understanding of the user entity, including internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement and in designing and performing further audit procedures responsive to those risks.
2. Many entities outsource aspects of their business to organizations that provide services ranging from performing a specific task under the direction of an entity to replacing an entity's entire business units or functions, such as the tax compliance function. Many of the services provided by such organizations are integral to the entity's business operations; however, not all those services are relevant to the audit.
3. Services provided by a service organization are relevant to the audit of a user entity's financial statements when those services, and the controls over them, are part of the user entity's information system, including related business processes, relevant to financial reporting. Although most controls at the service organization are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organization's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:
 - (a) The classes of transactions in the user entity's operations that are significant to the user entity's financial statements;
 - (b) The procedures, within both information technology (IT) and manual systems, by which the user entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
 - (c) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial statements that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;
 - (d) How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;
 - (e) The financial reporting process used to prepare the user entity's financial statements, including significant accounting estimates and disclosures; and
 - (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.
4. The nature and extent of work to be performed by the user auditor regarding the services provided by a service organization depend on the nature and significance of those services to the user entity and the relevance of those services to the audit.

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

² HKSA 330, "The Auditor's Responses to Assessed Risks."

- a. The service auditor's opinion on the description of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
 - b. A description of the service auditor's tests of the controls and the results thereof.
- (d) Service auditor – An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization.
- (e) Service organization – A third-party organization (or segment of a third-party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.
- (f) Service organization's system – The policies and procedures designed, implemented and maintained by the service organization to provide user entities with the services covered by the service auditor's report.
- (g) Subservice organization – A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information systems relevant to financial reporting.
- (h) User auditor – An auditor who audits and reports on the financial statements of a user entity.
- (i) User entity – An entity that uses a service organization and whose financial statements are being audited.

Requirements

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

9. When obtaining an understanding of the user entity in accordance with HKSA 315 (Revised),³ the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operations, including: (Ref: Para. A1-A2)
- (a) The nature of the services provided by the service organization and the significance of those services to the user entity, including the effect thereof on the user entity's internal control; (Ref: Para. A3-A5)
 - (b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization; (Ref: Para. A6)
 - (c) The degree of interaction between the activities of the service organization and those of the user entity; and (Ref: Para. A7)
 - (d) The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization. (Ref: Para. A8-A11)

³ HKSA 315 (Revised), paragraph 11.

10. When obtaining an understanding of internal control relevant to the audit in accordance with HKSA 315 (Revised),⁴ the user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organization, including those that are applied to the transactions processed by the service organization. (Ref: Para. A12-A14)
11. The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.
12. If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:
 - (a) Obtaining a type 1 or type 2 report, if available;
 - (b) Contacting the service organization, through the user entity, to obtain specific information;
 - (c) Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization; or
 - (d) Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization. (Ref: Para. A15-A20)

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization

13. In determining the sufficiency and appropriateness of the audit evidence provided by a type 1 or type 2 report, the user auditor shall be satisfied as to:
 - (a) The service auditor's professional competence and independence from the service organization; and
 - (b) The adequacy of the standards under which the type 1 or type 2 report was issued. (Ref: Para. A21)
14. If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organization, the user auditor shall:
 - (a) Evaluate whether the description and design of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes;
 - (b) Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal control relevant to the audit; and
 - (c) Determine whether complementary user entity controls identified by the service organization are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls. (Ref: Para. A22-A23)

⁴ HKSA 315 (Revised), paragraph 12.

- System overviews.
 - Technical manuals.
 - The contract or service level agreement between the user entity and the service organization.
 - Reports by service organizations, the internal audit function or regulatory authorities on controls at the service organization.
 - Reports by the service auditor, including management letters, if available.
- A2. Knowledge obtained through the user auditor's experience with the service organization, for example, through experience with other audit engagements, may also be helpful in obtaining an understanding of the nature of the services provided by the service organization. This may be particularly helpful if the services and controls at the service organization over those services are highly standardized.

Nature of the Services Provided by the Service Organization (Ref: Para. 9(a))

- A3. A user entity may use a service organization such as one that processes transactions and maintains related accountability, or records transactions and processes related data. Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others; mortgage bankers that service mortgages for others; and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions.
- A4. Examples of service organization services that are relevant to the audit include:
- Maintenance of the user entity's accounting records.
 - Management of assets.
 - Initiating, recording or processing transactions as agent of the user entity.

Considerations Specific to Smaller Entities

- A5. Smaller entities may use external bookkeeping services ranging from the processing of certain transactions (for example, payment of payroll taxes) and maintenance of their accounting records to the preparation of their financial statements. The use of such a service organization for the preparation of its financial statements does not relieve management of the smaller entity and, where appropriate, those charged with governance of their responsibilities for the financial statements.⁶

Nature and Materiality of Transactions Processed by the Service Organization (Ref: Para. 9(b))

- A6. A service organization may establish policies and procedures that affect the user entity's internal control. These policies and procedures are at least in part physically and operationally separate from the user entity. The significance of the controls of the service organization to those of the user entity depends on the nature of the services provided by the service organization, including the nature and materiality of the transactions it processes for the user entity. In certain situations, the transactions processed and the accounts affected by the

⁶ HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraphs 4 and A2-A3.

- (b) Substantive procedures on the user entity's financial statement transactions and balances maintained by a service organization.

Considerations Specific to Public Sector Entities

- A10. Public sector auditors generally have broad rights of access established by legislation. However, there may be situations where such rights of access are not available, for example, when the service organization is located in a different jurisdiction. In such cases, a public sector auditor may need to obtain an understanding of the legislation applicable in the different jurisdiction to determine whether appropriate access rights can be obtained. A public sector auditor may also obtain or ask the user entity to incorporate rights of access in any contractual arrangements between the user entity and the service organization.
- A11. Public sector auditors may also use another auditor to perform tests of controls or substantive procedures in relation to compliance with law, regulation or other authority.

Understanding the Controls Relating to Services Provided by the Service Organization (Ref: Para. 10)

- A12. The user entity may establish controls over the service organization's services that may be tested by the user auditor and that may enable the user auditor to conclude that the user entity's controls are operating effectively for some or all of the related assertions, regardless of the controls in place at the service organization. If a user entity, for example, uses a service organization to process its payroll transactions, the user entity may establish controls over the submission and receipt of payroll information that could prevent or detect material misstatements. These controls may include:
- Comparing the data submitted to the service organization with reports of information received from the service organization after the data has been processed.
 - Recomputing a sample of the payroll amounts for clerical accuracy and reviewing the total amount of the payroll for reasonableness.
- A13. In this situation, the user auditor may perform tests of the user entity's controls over payroll processing that would provide a basis for the user auditor to conclude that the user entity's controls are operating effectively for the assertions related to payroll transactions.
- A14. As noted in HKSA 315 (Revised),⁷ in respect of some risks, the user auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. Such automated processing characteristics may be particularly present when the user entity uses service organizations. In such cases, the user entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of, and to evaluate, such controls in accordance with paragraphs 9 and 10 of this HKSA.

Further Procedures When a Sufficient Understanding Cannot Be Obtained from the User Entity (Ref: Para. 12)

- A15. The user auditor's decision as to which procedure, individually or in combination, in paragraph 12 to undertake, in order to obtain the information necessary to provide a basis for the identification and assessment of the risks of material misstatement in relation to the user entity's use of the service organization, may be influenced by such matters as:

⁷ HKSA 315 (Revised), paragraph 30.

HKSA 500
Issued July 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 500

Audit Evidence

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



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

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.
2. This HKSA is applicable to all the audit evidence obtained during the course of the audit. Other HKSAs deal with specific aspects of the audit (for example, HKSA 315 (Revised)¹), the audit evidence to be obtained in relation to a particular topic (for example, HKSA 570²), specific procedures to obtain audit evidence (for example, HKSA 520³), and the evaluation of whether sufficient appropriate audit evidence has been obtained (HKSA 200⁴ and HKSA 330⁵).

Effective Date

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

Objective

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

Definitions

5. For purposes of the HKSAs, the following terms have the meanings attributed below:
 - (a) Accounting records – The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
 - (b) Appropriateness (of audit evidence) – The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.
 - (c) Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

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

² HKSA 570, "Going Concern."

³ HKSA 520, "Analytical Procedures."

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

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

Inconsistency in, or Doubts over Reliability of, Audit Evidence

11. If:
- (a) audit evidence obtained from one source is inconsistent with that obtained from another; or
 - (b) the auditor has doubts over the reliability of information to be used as audit evidence,
- the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit. (Ref: Para. A57)

Conformity and Compliance with International Standards on Auditing

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

Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

- A1. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit⁶) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.
- A2. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
- A3. As explained in HKSA 200,⁷ reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

⁶ HKSA 315 (Revised), paragraph 9.

⁷ HKSA 200, paragraph 5.

- A4. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.
- A5. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
- A6. HKSA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained.⁸ Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. HKSA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.

Sources of Audit Evidence

- A7. Some audit evidence is obtained by performing audit procedures to test the accounting records, for example, through analysis and review, reperforming procedures followed in the financial reporting process, and reconciling related types and applications of the same information. Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements.
- A8. More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.
- A9. Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors (benchmarking data).

Audit Procedures for Obtaining Audit Evidence

- A10. As required by, and explained further in, HKSA 315 (Revised) and HKSA 330, audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:
 - (a) Risk assessment procedures; and
 - (b) Further audit procedures, which comprise:
 - (i) Tests of controls, when required by the HKSAs or when the auditor has chosen to do so; and

⁸ HKSA 330, paragraph 26.

Evaluating the Appropriateness of the Management's Expert's Work (Ref: Para. 8(c))

A48. Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

- The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

Information Produced by the Entity and Used for the Auditor's Purposes (Ref: Para. 9(a)-(b))

A49. In order for the auditor to obtain reliable audit evidence, information produced by the entity that is used for performing audit procedures needs to be sufficiently complete and accurate. For example, the effectiveness of auditing revenue by applying standard prices to records of sales volume is affected by the accuracy of the price information and the completeness and accuracy of the sales volume data. Similarly, if the auditor intends to test a population (for example, payments) for a certain characteristic (for example, authorization), the results of the test will be less reliable if the population from which items are selected for testing is not complete.

A50. Obtaining audit evidence about the accuracy and completeness of such information may be performed concurrently with the actual audit procedure applied to the information when obtaining such audit evidence is an integral part of the audit procedure itself. In other situations, the auditor may have obtained audit evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the auditor may determine that additional audit procedures are needed.

A51. In some cases, the auditor may intend to use information produced by the entity for other audit purposes. For example, the auditor may intend to make use of the entity's performance measures for the purpose of analytical procedures, or to make use of the entity's information produced for monitoring activities, such as reports of the internal audit function. In such cases, the appropriateness of the audit evidence obtained is affected by whether the information is sufficiently precise or detailed for the auditor's purposes. For example, performance measures used by management may not be precise enough to detect material misstatements.

Selecting Items for Testing to Obtain Audit Evidence (Ref: Para. 10)

A52. An effective test provides appropriate audit evidence to an extent that, taken with other audit evidence obtained or to be obtained, will be sufficient for the auditor's purposes. In selecting items for testing, the auditor is required by paragraph 7 to determine the relevance and reliability of information to be used as audit evidence; the other aspect of effectiveness (sufficiency) is an important consideration in selecting items to test. The means available to the auditor for selecting items for testing are:

- (a) Selecting all items (100% examination);
- (b) Selecting specific items; and
- (c) Audit sampling.

Inconsistency in, or Doubts over Reliability of, Audit Evidence (Ref: Para. 11)

A57. Obtaining audit evidence from different sources or of a different nature may indicate that an individual item of audit evidence is not reliable, such as when audit evidence obtained from one source is inconsistent with that obtained from another. This may be the case when, for example, responses to inquiries of management, internal auditors, and others are inconsistent, or when responses to inquiries of those charged with governance made to corroborate the responses to inquiries of management are inconsistent with the response by management. HKSA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.¹⁷

¹⁷ HKSA 230, "Audit Documentation," paragraph 11.

HKSA 550
Issued July 2009; revised July 2010, May 2013, February 2015

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

Hong Kong Standard on Auditing 550

Related Parties

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



Hong Kong Institute of
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香港會計師公會

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements. Specifically, it expands on how HKSA 315 (Revised),¹ HKSA 330,² and HKSA 240³ are to be applied in relation to risks of material misstatement associated with related party relationships and transactions.

Nature of Related Party Relationships and Transactions

2. Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example:
 - Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
 - Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
 - Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Responsibilities of the Auditor

3. Because related parties are not independent of each other, many financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Where the applicable financial reporting framework establishes such requirements, the auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the framework.
4. Even if the applicable financial reporting framework establishes minimal or no related party requirements, the auditor nevertheless needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions: (Ref: Para. A1)
 - (a) Achieve fair presentation (for fair presentation frameworks); or (Ref: Para. A2)
 - (b) Are not misleading (for compliance frameworks). (Ref: Para. A3)

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

² HKSA 330, "The Auditor's Responses to Assessed Risks."

³ HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

- (b) In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.

Definitions

10. For purposes of the HKSA's, the following terms have the meanings attributed below:

- (a) Arm's length transaction – A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.
- (b) Related party – A party that is either: (Ref: Para. A4-A7)
- (i) A related party as defined in the applicable financial reporting framework; or
 - (ii) Where the applicable financial reporting framework establishes minimal or no related party requirements:
 - a. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
 - b. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
 - c. Another entity that is under common control with the reporting entity through having:
 - i. Common controlling ownership;
 - ii. Owners who are close family members; or
 - iii. Common key management.

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

Requirements

Risk Assessment Procedures and Related Activities

11. As part of the risk assessment procedures and related activities that HKSA 315 (Revised) and HKSA 240 require the auditor to perform during the audit,⁷ the auditor shall perform the audit procedures and related activities set out in paragraphs 12-17 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions. (Ref: Para. A8)

⁷ HKSA 315 (Revised), paragraph 5; HKSA 240, paragraph 16.

Understanding the Entity's Related Party Relationships and Transactions

12. The engagement team discussion that HKSA 315 (Revised) and HKSA 240 require⁸ shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. (Ref: Para. A9-A10)
13. The auditor shall inquire of management regarding:
 - (a) The identity of the entity's related parties, including changes from the prior period; (Ref: Para. A11-A14)
 - (b) The nature of the relationships between the entity and these related parties; and
 - (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.
14. The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to: (Ref: Para. A15-A20)
 - (a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
 - (b) Authorize and approve significant transactions and arrangements with related parties; and (Ref: Para. A21)
 - (c) Authorize and approve significant transactions and arrangements outside the normal course of business.

Maintaining Alertness for Related Party Information When Reviewing Records or Documents

15. During the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. (Ref: Para. A22-A23)

In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

 - (a) Bank and legal confirmations obtained as part of the auditor's procedures;
 - (b) Minutes of meetings of shareholders and of those charged with governance; and
 - (c) Such other records or documents as the auditor considers necessary in the circumstances of the entity.
16. If the auditor identifies significant transactions outside the entity's normal course of business when performing the audit procedures required by paragraph 15 or through other audit procedures, the auditor shall inquire of management about: (Ref: Para. A24-A25)
 - (a) The nature of these transactions; and (Ref: Para. A26)

⁸ HKSA 315 (Revised), paragraph 10; HKSA 240, paragraph 15.

- (b) Whether related parties could be involved. (Ref: Para. A27)

Sharing Related Party Information with the Engagement Team

17. The auditor shall share relevant information obtained about the entity's related parties with the other members of the engagement team. (Ref: Para. A28)

Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

18. In meeting the HKSA 315 (Revised) requirement to identify and assess the risks of material misstatement,⁹ the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.
19. If the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor shall consider such information when identifying and assessing the risks of material misstatement due to fraud in accordance with HKSA 240. (Ref: Para. A6, A29-A30)

Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

20. As part of the HKSA 330 requirement that the auditor respond to assessed risks,¹⁰ the auditor designs and performs further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions. These audit procedures shall include those required by paragraphs 21-24. (Ref: Para. A31-A34)

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

21. If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.
22. If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor shall:
- (a) Promptly communicate the relevant information to the other members of the engagement team; (Ref: Para. A35)
 - (b) Where the applicable financial reporting framework establishes related party requirements:
 - (i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and

⁹ HKSA 315 (Revised), paragraph 25.

¹⁰ HKSA 330, paragraphs 5-6.

Related Parties with Dominant Influence

- A6. Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behavior is relevant when identifying and assessing the risks of material misstatement due to fraud, as further explained in paragraphs A29-A30.

Special-Purpose Entities as Related Parties

- A7. In some circumstances, a special-purpose entity¹⁸ may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special-purpose entity's equity.

Risk Assessment Procedures and Related Activities

Risks of Material Misstatement Associated with Related Party Relationships and Transactions (Ref: Para. 11)

Considerations Specific to Public Sector Entities

- A8. The public sector auditor's responsibilities regarding related party relationships and transactions may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority. Consequently, the public sector auditor's responsibilities may not be limited to addressing the risks of material misstatement associated with related party relationships and transactions, but may also include a broader responsibility to address the risks of non-compliance with law, regulation and other authority governing public sector bodies that lay down specific requirements in the conduct of business with related parties. Further, the public sector auditor may need to have regard to public sector financial reporting requirements for related party relationships and transactions that may differ from those in the private sector.

Understanding the Entity's Related Party Relationships and Transactions

Discussion among the Engagement Team (Ref: Para. 12)

- A9. Matters that may be addressed in the discussion among the engagement team include:
- The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
 - An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
 - The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (for example, a complex organizational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system).
 - The records or documents that may indicate the existence of related party relationships or transactions.

¹⁸ HKSA 315 (Revised), paragraphs A33-A34, provides guidance regarding the nature of a special-purpose entity.

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- The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of relevant controls.

A10. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

- How special-purpose entities controlled by management might be used to facilitate earnings management.
- How transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

The Identity of the Entity's Related Parties (Ref: Para. 13(a))

A11. Where the applicable financial reporting framework establishes related party requirements, information regarding the identity of the entity's related parties is likely to be readily available to management because the entity's information systems will need to record, process and summarize related party relationships and transactions to enable the entity to meet the accounting and disclosure requirements of the framework. Management is therefore likely to have a comprehensive list of related parties and changes from the prior period. For recurring engagements, making the inquiries provides a basis for comparing the information supplied by management with the auditor's record of related parties noted in previous audits.

A12. However, where the framework does not establish related party requirements, the entity may not have such information systems in place. Under such circumstances, it is possible that management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the inquiries specified by paragraph 13 still applies because management may be aware of parties that meet the related party definition set out in this HKSA. In such a case, however, the auditor's inquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with HKSA 315 (Revised) to obtain information regarding:

- The entity's ownership and governance structures;
- The types of investments that the entity is making and plans to make; and
- The way the entity is structured and how it is financed.

In the particular case of common control relationships, as management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions, or shares resources to a significant degree, are related parties.

A13. In the context of a group audit, HKSA 600 requires the group engagement team to provide each component auditor with a list of related parties prepared by group management and any other related parties of which the group engagement team is aware.¹⁹ Where the entity is a component within a group, this information provides a useful basis for the auditor's inquiries of management regarding the identity of the entity's related parties.

¹⁹ HKSA 600, "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)," paragraph 40(e).

A14. The auditor may also obtain some information regarding the identity of the entity's related parties through inquiries of management during the engagement acceptance or continuance process.

The Entity's Controls over Related Party Relationships and Transactions (Ref: Para. 14)

A15. Others within the entity are those considered likely to have knowledge of the entity's related party relationships and transactions, and the entity's controls over such relationships and transactions. These may include, to the extent that they do not form part of management:

- Those charged with governance;
- Personnel in a position to initiate, process, or record transactions that are both significant and outside the entity's normal course of business, and those who supervise or monitor such personnel;
- The internal audit function;
- In-house legal counsel; and
- The chief ethics officer or equivalent person.

A16. The audit is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged and understand that they have responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, and for such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.²⁰ Accordingly, where the framework establishes related party requirements, the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed in accordance with the framework. In their oversight role, those charged with governance monitor how management is discharging its responsibility for such controls. Regardless of any related party requirements the framework may establish, those charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business rationale of the entity's related party relationships and transactions.

A17. In meeting the HKSA 315 (Revised) requirement to obtain an understanding of the control environment,²¹ the auditor may consider features of the control environment relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as:

- Internal ethical codes, appropriately communicated to the entity's personnel and enforced, governing the circumstances in which the entity may enter into specific types of related party transactions.
- Policies and procedures for open and timely disclosure of the interests that management and those charged with governance have in related party transactions.

²⁰ HKSA 200, paragraph A2.

²¹ HKSA 315 (Revised), paragraph 14.

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- The assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing related party transactions.
- Timely disclosure and discussion between management and those charged with governance of significant related party transactions outside the entity's normal course of business, including whether those charged with governance have appropriately challenged the business rationale of such transactions (for example, by seeking advice from external professional advisors).
- Clear guidelines for the approval of related party transactions involving actual or perceived conflicts of interest, such as approval by a subcommittee of those charged with governance comprising individuals independent of management.
- Periodic reviews by the internal audit function, where applicable.
- Proactive action taken by management to resolve related party disclosure issues, such as by seeking advice from the auditor or external legal counsel.
- The existence of whistle-blowing policies and procedures, where applicable.

A18. Controls over related party relationships and transactions within some entities may be deficient or non-existent for a number of reasons, such as:

- The low importance attached by management to identifying and disclosing related party relationships and transactions.
- The lack of appropriate oversight by those charged with governance.
- An intentional disregard for such controls because related party disclosures may reveal information that management considers sensitive, for example, the existence of transactions involving family members of management.
- An insufficient understanding by management of the related party requirements of the applicable financial reporting framework.
- The absence of disclosure requirements under the applicable financial reporting framework.

Where such controls are ineffective or non-existent, the auditor may be unable to obtain sufficient appropriate audit evidence about related party relationships and transactions. If this were the case, the auditor would, in accordance with HKSA 705,²² consider the implications for the audit, including the opinion in the auditor's report.

A19. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.²³ The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management's financial interests in certain related parties may provide incentives for management to override controls by (a) directing the entity, against its interests, to conclude transactions for the benefit of these parties, or (b) colluding with such parties or controlling their actions. Examples of possible fraud include:

²² HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

²³ HKSA 240, paragraphs 31 and A4.

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- Records of the entity's investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity's ordinary course of business.
- Specific invoices and correspondence from the entity's professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.
- Reports of the internal audit function.
- Documents associated with the entity's filings with a securities regulator (for example, prospectuses).

Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions (Ref: Para. 15)

A23. An arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as:

- The establishment of a business relationship through appropriate vehicles or structures.
- The conduct of certain types of transactions under specific terms and conditions.
- The provision of designated services or financial support.

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include:

- Participation in unincorporated partnerships with other parties.
- Agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business.
- Guarantees and guarantor relationships.

Identification of Significant Transactions outside the Normal Course of Business (Ref: Para. 16)

A24. Obtaining further information on significant transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable financial reporting framework establishes related party requirements, to identify the risks of material misstatement.

A25. Examples of transactions outside the entity's normal course of business may include:

- Complex equity transactions, such as corporate restructurings or acquisitions.
- Transactions with offshore entities in jurisdictions with weak corporate laws.
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
- Sales transactions with unusually large discounts or returns.

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

Hong Kong Standard on Auditing 600

Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

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

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



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13. If the group engagement partner concludes that:
- (a) it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and
 - (b) the possible effect of this inability will result in a disclaimer of opinion on the group financial statements,⁴
- the group engagement partner shall either:
- (a) in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement, where withdrawal is possible under applicable law or regulation; or
 - (b) where law or regulation prohibits an auditor from declining an engagement or where withdrawal from an engagement is not otherwise possible, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: Para. A13-A19)

Terms of Engagement

14. The group engagement partner shall agree on the terms of the group audit engagement in accordance with HKSA 210.⁵ (Ref: Para. A20-A21)

Overall Audit Strategy and Audit Plan

15. The group engagement team shall establish an overall group audit strategy and shall develop a group audit plan in accordance with HKSA 300.⁶
16. The group engagement partner shall review the overall group audit strategy and group audit plan. (Ref: Para. A22)

Understanding the Group, Its Components, and Their Environments

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment.⁷ The group engagement team shall:
- (a) Enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage; and
 - (b) Obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: Para. A23-A29)
18. The group engagement team shall obtain an understanding that is sufficient to:
- (a) Confirm or revise its initial identification of components that are likely to be significant; and

⁴ HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

⁵ HKSA 210, "Agreeing the Terms of Audit Engagements."

⁶ HKSA 300, "Planning an Audit of Financial Statements," paragraphs 7-12.

⁷ HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

- (b) Assess the risks of material misstatement of the group financial statements, whether due to fraud or error.⁸ (Ref: Para. A30-A31)

Understanding the Component Auditor

- 19. If the group engagement team plans to request a component auditor to perform work on the financial information of a component, the group engagement team shall obtain an understanding of the following: (Ref: Para. A32-A35)
 - (a) Whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent. (Ref: Para. A37)
 - (b) The component auditor's professional competence. (Ref: Para. A38)
 - (c) Whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence.
 - (d) Whether the component auditor operates in a regulatory environment that actively oversees auditors. (Ref: Para. A36)
- 20. If a component auditor does not meet the independence requirements that are relevant to the group audit, or the group engagement team has serious concerns about the other matters listed in paragraph 19(a)-(c), the group engagement team shall obtain sufficient appropriate audit evidence relating to the financial information of the component without requesting that component auditor to perform work on the financial information of that component. (Ref: Para. A39-A41)

Materiality

- 21. The group engagement team shall determine the following: (Ref: Para. A42)
 - (a) Materiality for the group financial statements as a whole when establishing the overall group audit strategy.
 - (b) If, in the specific circumstances of the group, there are particular classes of transactions, account balances or disclosures in the group financial statements for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.
 - (c) Component materiality for those components where component auditors will perform an audit or a review for purposes of the group audit. To reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole, component materiality shall be lower than materiality for the group financial statements as a whole. (Ref: Para. A43-A44)
 - (d) The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: Para. A45)

⁸ HKSA 315 (Revised).

- A4. Components aggregated at a certain level may constitute a component for purposes of the group audit; however, such a component may also prepare group financial statements that incorporate the financial information of the components it encompasses (that is, a subgroup). This HKSA may therefore be applied by different group engagement partners and teams for different subgroups within a larger group.

Significant Component (Ref: Para. 9(m))

- A5. As the individual financial significance of a component increases, the risks of material misstatement of the group financial statements ordinarily increase. The group engagement team may apply a percentage to a chosen benchmark as an aid to identify components that are of individual financial significance. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgment. Depending on the nature and circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, profit or turnover. For example, the group engagement team may consider that components exceeding 15% of the chosen benchmark are significant components. A higher or lower percentage may, however, be deemed appropriate in the circumstances.
- A6. The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances (that is, risks that require special audit consideration¹⁴). For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

Component Auditor (Ref: Para. 9(b))

- A7. A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. Where this is the case, such a member of the engagement team is also a component auditor.

Responsibility (Ref: Para. 11)

- A8. Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings, conclusions or opinions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.
- A9. When the group audit opinion is modified because the group engagement team was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Modification paragraph in the auditor's report on the group financial statements describes the reasons for that inability without referring to the component auditor, unless such a reference is necessary for an adequate explanation of the circumstances.¹⁵

Acceptance and Continuance

Obtaining an Understanding at the Acceptance or Continuance Stage (Ref: Para. 12)

- A10. In the case of a new engagement, the group engagement team's understanding of the group, its components, and their environments may be obtained from:
- Information provided by group management;

¹⁴ HKSA 315 (Revised), paragraphs 27-29.

¹⁵ HKSA 705, paragraph 20.

Understanding the Group, Its Components, and Their Environments

Matters about Which the Group Engagement Team Obtains an Understanding (Ref: Para. 17)

A23. HKSA 315 (Revised) contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance.¹⁷ Appendix 2 of this HKSA contains guidance on matters specific to a group, including the consolidation process.

Instructions Issued by Group Management to Components (Ref: Para. 17)

A24. To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components. Such instructions specify the requirements for financial information of the components to be included in the group financial statements and often include financial reporting procedures manuals and a reporting package. A reporting package ordinarily consists of standard formats for providing financial information for incorporation in the group financial statements. Reporting packages generally do not, however, take the form of complete financial statements prepared and presented in accordance with the applicable financial reporting framework.

A25. The instructions ordinarily cover:

- The accounting policies to be applied;
- Statutory and other disclosure requirements applicable to the group financial statements, including:
 - The identification and reporting of segments;
 - Related party relationships and transactions;
 - Intra-group transactions and unrealized profits;
 - Intra-group account balances; and
- A reporting timetable.

A26. The group engagement team's understanding of the instructions may include the following:

- The clarity and practicality of the instructions for completing the reporting package.
- Whether the instructions:
 - Adequately describe the characteristics of the applicable financial reporting framework;
 - Provide for disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example disclosure of related party relationships and transactions, and segment information;
 - Provide for the identification of consolidation adjustments, for example intra-group transactions and unrealized profits, and intra-group account balances; and

¹⁷ HKSA 315 (Revised), paragraphs A24-A48.

- Provide for the approval of the financial information by component management.

Fraud (Ref: Para. 17)

A27. The auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and implement appropriate responses to the assessed risks.¹⁸ Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risks that the group financial statements may be materially misstated as a result of fraud.
- Group management's process for identifying and responding to the risks of fraud in the group, including any specific fraud risks identified by group management, or account balances, classes of transactions, or disclosures for which a risk of fraud is likely.
- Whether there are particular components for which a risk of fraud is likely.
- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and if considered appropriate, component management, the component auditors, and others) to the group engagement team's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.

Discussion among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: Para. 17)

A28. The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasizing the risks due to fraud. In a group audit, these discussions may also include the component auditors.¹⁹ The group engagement partner's determination of who to include in the discussions, how and when they occur, and their extent, is affected by factors such as prior experience with the group.

A29. The discussions provide an opportunity to:

- Share knowledge of the components and their environments, including group-wide controls.
- Exchange information about the business risks of the components or the group.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error, how group management and component management could perpetrate and conceal fraudulent financial reporting, and how assets of the components could be misappropriated.

¹⁸ HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

¹⁹ HKSA 240, paragraph 15; HKSA 315 (Revised), paragraph 10.

Significant Components (Ref: Para. 27(b)-(c))

- A48. The group engagement team may identify a component as a significant component because that component is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances. In that case, the group engagement team may be able to identify the account balances, classes of transactions or disclosures affected by the likely significant risks. Where this is the case, the group engagement team may decide to perform, or request a component auditor to perform, an audit of only those account balances, classes of transactions or disclosures. For example, in the situation described in paragraph A6, the work on the financial information of the component may be limited to an audit of the account balances, classes of transactions and disclosures affected by the foreign exchange trading of that component. Where the group engagement team requests a component auditor to perform an audit of one or more specific account balances, classes of transactions or disclosures, the communication of the group engagement team (see paragraph 40) takes account of the fact that many financial statement items are interrelated.
- A49. The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial statements. For example, in the case of a likely significant risk of inventory obsolescence, the group engagement team may perform, or request a component auditor to perform, specified audit procedures on the valuation of inventory at a component that holds a large volume of potentially obsolete inventory, but that is not otherwise significant.

Components that Are Not Significant Components (Ref: Para. 28-29)

- A50. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that there are no significant risks of material misstatement of the aggregated financial information of components that are not significant components.
- A51. The group engagement team's decision as to how many components to select in accordance with paragraph 29, which components to select, and the type of work to be performed on the financial information of the individual components selected may be affected by factors such as the following:
- The extent of audit evidence expected to be obtained on the financial information of the significant components.
 - Whether the component has been newly formed or acquired.
 - Whether significant changes have taken place in the component.
 - Whether the internal audit function has performed work at the component and any effect of that work on the group audit.
 - Whether the components apply common systems and processes.
 - The operating effectiveness of group-wide controls.
 - Abnormal fluctuations identified by analytical procedures performed at group level.
 - The individual financial significance of, or the risk posed by, the component in comparison with other components within this category.
 - Whether the component is subject to audit required by statute, regulation or for another reason.

Appendix 2

(Ref: Para. A23)

Examples of Matters about Which the Group Engagement Team Obtains an Understanding

The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement and the list of examples is not necessarily complete.

Group-Wide Controls

1. Group-wide controls may include a combination of the following:
 - Regular meetings between group and component management to discuss business developments and to review performance.
 - Monitoring of components' operations and their financial results, including regular reporting routines, which enables group management to monitor components' performance against budgets, and to take appropriate action.
 - Group management's risk assessment process, that is, the process for identifying, analyzing and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements.
 - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at group level.
 - A process for monitoring the timeliness and assessing the accuracy and completeness of financial information received from components.
 - A central IT system controlled by the same general IT controls for all or part of the group.
 - Control activities within an IT system that is common for all or some components.
 - Monitoring of controls, including activities of the internal audit function and self-assessment programs.
 - Consistent policies and procedures, including a group financial reporting procedures manual.
 - Group-wide programs, such as codes of conduct and fraud prevention programs.
 - Arrangements for assigning authority and responsibility to component management.
2. The internal audit function may be regarded as part of group-wide controls, for example, when the function is centralized. HKSA 610 (Revised 2013) ¹ deals with the group engagement team's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately supports the objectivity of internal auditors, the level of competence of the internal audit function, and whether the function applies a systematic and disciplined approach where the group engagement team expects to use the function's work.

¹ HKSA 610 (Revised 2013), "Using the Work of Internal Auditors," paragraph 15.

Appendix 5

(Ref: Para. A58)

Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction

Matters required by this HKSA to be communicated to the component auditor are shown in italicized text.

Matters that are relevant to the planning of the work of the component auditor:

- *A request for the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, to confirm that the component auditor will cooperate with the group engagement team.*
- The timetable for completing the audit.
- Dates of planned visits by group management and the group engagement team, and dates of planned meetings with component management and the component auditor.
- A list of key contacts.
- *The work to be performed by the component auditor, the use to be made of that work, and arrangements for coordinating efforts at the initial stage of and during the audit, including the group engagement team's planned involvement in the work of the component auditor.*
- *The ethical requirements that are relevant to the group audit and, in particular, the independence requirements, for example, where the group auditor is prohibited by law or regulation from using internal auditors to provide direct assistance, it is relevant for the group auditor to consider whether the prohibition also extends to component auditors and, if so, to address this in the communication to the component auditors.*¹
- *In the case of an audit or review of the financial information of the component, component materiality (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures), and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.*
- *A list of related parties prepared by group management, and any other related parties that the group engagement team is aware of, and a request that the component auditor communicates on a timely basis to the group engagement team related parties not previously identified by group management or the group engagement team.*
- Work to be performed on intra-group transactions and unrealized profits and intra-group account balances.
- Guidance on other statutory reporting responsibilities, for example reporting on group management's assertion on the effectiveness of internal control.
- Where time lag between completion of the work on the financial information of the components and the group engagement team's conclusion on the group financial statements is likely, specific instructions for a subsequent events review.

¹ HKSA 610 (Revised 2013), "Using the Work of Internal Auditors," paragraph A31.

Matters that are relevant to the conduct of the work of the component auditor:

- The findings of the group engagement team's tests of control activities of a processing system that is common for all or some components, and tests of controls to be performed by the component auditor.
- *Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor, and a request that the component auditor communicates on a timely basis any other significant risks of material misstatement of the group financial statements, due to fraud or error, identified in the component and the component auditor's response to such risks.*
- The findings of the internal audit function, based on work performed on controls at or relevant to components.
- A request for timely communication of audit evidence obtained from performing work on the financial information of the components that contradicts the audit evidence on which the group engagement team originally based the risk assessment performed at group level.
- A request for a written representation on component management's compliance with the applicable financial reporting framework, or a statement that differences between the accounting policies applied to the financial information of the component and those applied to the group financial statements have been disclosed.
- Matters to be documented by the component auditor.

Other information

- A request that the following be reported to the group engagement team on a timely basis:
 - Significant accounting, financial reporting and auditing matters, including accounting estimates and related judgments.
 - Matters relating to the going concern status of the component.
 - Matters relating to litigation and claims.
 - Significant deficiencies in internal control that the component auditor has identified during the performance of the work on the financial information of the component, and information that indicates the existence of fraud.
- A request that the group engagement team be notified of any significant or unusual events as early as possible.
- *A request that the matters listed in paragraph 41 be communicated to the group engagement team when the work on the financial information of the component is completed.*

HKSAE 3000
Issued March 2014; revised February 2015

Hong Kong Standard on Assurance Engagements

HKSAE 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information

and

Related Conforming Amendments



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- (a) Assurance engagement—An engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria). Each assurance engagement is classified on two dimensions: (Ref: Para. A3)
- (i) Either a reasonable assurance engagement or a limited assurance engagement:
- a. Reasonable assurance engagement—An assurance engagement in which the practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's conclusion. The practitioner's conclusion is expressed in a form that conveys the practitioner's opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.
- b. Limited assurance engagement—An assurance engagement in which the practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the practitioner's professional judgment, meaningful. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential. (Ref: Para. A3–A7)
- (ii) Either an attestation engagement or a direct engagement: (Ref: Para. A8)
- a. Attestation engagement—An assurance engagement in which a party other than the practitioner measures or evaluates the underlying subject matter against the criteria. A party other than the practitioner also often presents the resulting subject matter information in a report or statement. In some cases, however, the subject matter information may be presented by the practitioner in the assurance report. In an attestation engagement, the practitioner's conclusion addresses whether the subject matter information is free from material misstatement. The practitioner's conclusion may be phrased in terms of: (Ref: Para. A178, A180)
- (i) The underlying subject matter and the applicable criteria;
- (ii) The subject matter information and the applicable criteria; or
- (iii) A statement made by the appropriate party.
- b. Direct engagement—An assurance engagement in which the practitioner measures or evaluates the underlying subject matter against the applicable criteria and the practitioner presents the resulting subject matter information as part of, or accompanying, the assurance report. In a direct engagement, the practitioner's conclusion addresses the reported outcome of the measurement or evaluation of the underlying subject matter against the criteria.
- (b) Assurance skills and techniques—Those planning, evidence gathering, evidence evaluation, communication and reporting skills and techniques demonstrated by an assurance practitioner that are distinct from expertise in the underlying subject matter of any particular assurance engagement or its measurement or evaluation. (Ref: Para. A9)

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- (o) Misstatement—A difference between the subject matter information and the appropriate measurement or evaluation of the underlying subject matter in accordance with the criteria. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions.
 - (p) Misstatement of fact (with respect to other information)—Other information that is unrelated to matters appearing in the subject matter information or the assurance report that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing the subject matter information.
 - (q) Other information—Information (other than the subject matter information and the assurance report thereon) which is included, either by law, regulation or custom, in a document containing the subject matter information and the assurance report thereon.
 - (r) Practitioner—The individual(s) conducting the engagement (usually the engagement partner or other members of the engagement team, or, as applicable, the firm). Where this HKSAE expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used. (Ref: Para. A37)
 - (s) Practitioner's expert—An individual or organization possessing expertise in a field other than assurance, whose work in that field is used by the practitioner to assist the practitioner in obtaining sufficient appropriate evidence. A practitioner's expert may be either a practitioner's internal expert (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm), or a practitioner's external expert.
 - (t) Professional judgment—The application of relevant training, knowledge and experience, within the context provided by assurance and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the engagement.
 - (u) Professional skepticism—An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement, and a critical assessment of evidence.
 - (v) Responsible party—The party(ies) responsible for the underlying subject matter. (Ref: Para. A37)
 - (w) Risk of material misstatement—The risk that the subject matter information is materially misstated prior to the engagement.
 - (x) Subject matter information—The outcome of the measurement or evaluation of the underlying subject matter against the criteria, that is, the information that results from applying the criteria to the underlying subject matter. (Ref: Para. A19)
 - (y) Underlying subject matter—The phenomenon that is measured or evaluated by applying criteria.
13. For the purposes of this HKSAE and other HKSAEs, references to "appropriate party(ies)" should be read hereafter as "the responsible party, the measurer or evaluator, or the engaging party, as appropriate." (Ref: Para. A20, A37)

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- (a) The practitioner has no reason to believe that relevant ethical requirements, including independence, will not be satisfied;
 - (b) The practitioner is satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities (see also paragraph 32); and
 - (c) The basis upon which the engagement is to be performed has been agreed, through:
 - (i) Establishing that the preconditions for an assurance engagement are present (see also paragraphs 24–26); and
 - (ii) Confirming that there is a common understanding between the practitioner and the engaging party of the terms of the engagement, including the practitioner's reporting responsibilities.
23. If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.

Preconditions for the Assurance Engagement

24. In order to establish whether the preconditions for an assurance engagement are present, the practitioner shall, on the basis of a preliminary knowledge of the engagement circumstances and discussion with the appropriate party(ies), determine whether: (Ref: Para. A35–A36)
- (a) The roles and responsibilities of the appropriate parties are suitable in the circumstances; and (Ref: Para. A37–A39)
 - (b) The engagement exhibits all of the following characteristics:
 - (i) The underlying subject matter is appropriate; (Ref: Para. A40–A44)
 - (ii) The criteria that the practitioner expects to be applied in the preparation of the subject matter information are suitable for the engagement circumstances, including that they exhibit the following characteristics: (Ref: Para. A45–A50)
 - a. Relevance.
 - b. Completeness.
 - c. Reliability.
 - d. Neutrality.
 - e. Understandability.
 - (iii) The criteria that the practitioner expects to be applied in the preparation of the subject matter information will be available to the intended users; (Ref: Para. A51–A52)
 - (iv) The practitioner expects to be able to obtain the evidence needed to support the practitioner's conclusion; (Ref: Para. A53–A55)
 - (v) The practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is to be contained in a written report; and

- (vi) A rational purpose including, in the case of a limited assurance engagement, that the practitioner expects to be able to obtain a meaningful level of assurance. (Ref: Para. A56)
25. If the preconditions for an assurance engagement are not present, the practitioner shall discuss the matter with the engaging party. If changes cannot be made to meet the preconditions, the practitioner shall not accept the engagement as an assurance engagement unless required by law or regulation to do so. However, an engagement conducted under such circumstances does not comply with HKSAEs. Accordingly, the practitioner shall not include any reference within the assurance report to the engagement having been conducted in accordance with this HKSAE or any other HKSAE(s).

Limitation on Scope Prior to Acceptance of the Engagement

26. If the engaging party imposes a limitation on the scope of the practitioner's work in the terms of a proposed assurance engagement such that the practitioner believes the limitation will result in the practitioner disclaiming a conclusion on the subject matter information, the practitioner shall not accept such an engagement as an assurance engagement, unless required by law or regulation to do so. (Ref: Para. A155(c))

Agreeing on the Terms of the Engagement

27. The practitioner shall agree the terms of the engagement with the engaging party. The agreed terms of the engagement shall be specified in sufficient detail in an engagement letter or other suitable form of written agreement, written confirmation, or in law or regulation. (Ref: Para. A57–A58)
28. On recurring engagements, the practitioner shall assess whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the engaging party of the existing terms of the engagement.

Acceptance of a Change in the Terms of the Engagement

29. The practitioner shall not agree to a change in the terms of the engagement where there is no reasonable justification for doing so. If such a change is made, the practitioner shall not disregard evidence that was obtained prior to the change. (Ref: Para. A59)

Assurance Report Prescribed by Law or Regulation

30. In some cases, law or regulation of the relevant jurisdiction prescribes the layout or wording of the assurance report. In these circumstances, the practitioner shall evaluate:
- (a) Whether intended users might misunderstand the assurance conclusion; and
 - (b) If so, whether additional explanation in the assurance report can mitigate possible misunderstanding.

If the practitioner concludes that additional explanation in the assurance report cannot mitigate possible misunderstanding, the practitioner shall not accept the engagement, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with HKSAEs. Accordingly, the practitioner shall not include any reference within the assurance report to the engagement having been conducted in accordance with this HKSAE or any other HKSAE(s) (see also paragraph 71).

42. If it is discovered after the engagement has been accepted that one or more preconditions for an assurance engagement is not present, the practitioner shall discuss the matter with the appropriate party(ies), and shall determine:
- (a) Whether the matter can be resolved to the practitioner's satisfaction;
 - (b) Whether it is appropriate to continue with the engagement; and
 - (c) Whether and, if so, how to communicate the matter in the assurance report.
43. If it is discovered after the engagement has been accepted that some or all of the applicable criteria are unsuitable or some or all of the underlying subject matter is not appropriate for an assurance engagement, the practitioner shall consider withdrawing from the engagement, if withdrawal is possible under applicable law or regulation. If the practitioner continues with the engagement, the practitioner shall express a qualified or adverse conclusion, or disclaimer of conclusion, as appropriate in the circumstances. (Ref: Para. A90–A91)

Materiality

44. The practitioner shall consider materiality when: (Ref: Para. A92–A100)
- (a) Planning and performing the assurance engagement, including when determining the nature, timing and extent of procedures; and
 - (b) Evaluating whether the subject matter information is free from material misstatement.

Understanding the Underlying Subject Matter and Other Engagement Circumstances

45. The practitioner shall make inquiries of the appropriate party(ies) regarding:
- (a) Whether they have knowledge of any actual, suspected or alleged intentional misstatement or non-compliance with laws and regulations affecting the subject matter information; (Ref: Para. A101)
 - (b) Whether the responsible party has an internal audit function and, if so, make further inquiries to obtain an understanding of the activities and main findings of the internal audit function with respect to the subject matter information; and
 - (c) Whether the responsible party has used any experts in the preparation of the subject matter information.

| Limited Assurance | Reasonable Assurance |
|--|---|
| <p>46L. The practitioner shall obtain an understanding of the underlying subject matter and other engagement circumstances sufficient to:</p> <ul style="list-style-type: none"> (a) Enable the practitioner to identify areas where a material misstatement of the subject matter information is likely to arise; and (b) Thereby, provide a basis for designing and performing procedures to address the areas identified in paragraph 46L(a) and to obtain limited assurance to support the practitioner's conclusion. (Ref: Para. A101–A104, A107) | <p>46R. The practitioner shall obtain an understanding of the underlying subject matter and other engagement circumstances sufficient to:</p> <ul style="list-style-type: none"> (a) Enable the practitioner to identify and assess the risks of material misstatement in the subject matter information; and (b) Thereby, provide a basis for designing and performing procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's conclusion. (Ref: Para. A101–A103, A107) |

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| <p>47L. In obtaining an understanding of the underlying subject matter and other engagement circumstances under paragraph 46L, the practitioner shall consider the process used to prepare the subject matter information. (Ref: Para. A106)</p> | <p>47R. In obtaining an understanding of the underlying subject matter and other engagement circumstances under paragraph 46R, the practitioner shall obtain an understanding of internal control over the preparation of the subject matter information relevant to the engagement. This includes evaluating the design of those controls relevant to the engagement and determining whether they have been implemented by performing procedures in addition to inquiry of the personnel responsible for the subject matter information. (Ref: Para. A105)</p> |
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Obtaining Evidence

Risk Consideration and Responses to Risks

| <p>Limited Assurance</p> | <p>Reasonable Assurance</p> |
|---|---|
| <p>48L. Based on the practitioner's understanding (see paragraph 46L), the practitioner shall: (Ref: Para. A108–A112)</p> <ul style="list-style-type: none"> (a) Identify areas where a material misstatement of the subject matter information is likely to arise; and (b) Design and perform procedures to address the areas identified in paragraph 48L(a) and to obtain limited assurance to support the practitioner's conclusion. | <p>48R. Based on the practitioner's understanding (see paragraph 46R) the practitioner shall: (Ref: Para. A108–A110)</p> <ul style="list-style-type: none"> (a) Identify and assess the risks of material misstatement in the subject matter information; and (b) Design and perform procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's conclusion. In addition to any other procedures on the subject matter information that are appropriate in the engagement circumstances, the practitioner's procedures shall include obtaining sufficient appropriate evidence as to the operating effectiveness of relevant controls over the subject matter information when: <ul style="list-style-type: none"> (i) The practitioner's assessment of the risks of material misstatement includes an expectation that controls are operating effectively, or (ii) Procedures other than testing of controls cannot alone provide sufficient appropriate evidence. |
| <p>Determining Whether Additional Procedures Are Necessary in a Limited Assurance Engagement</p> <p>49L. If the practitioner becomes aware of a matter(s) that causes the practitioner to believe that the subject matter information may be materially misstated, the practitioner shall design and perform additional procedures to obtain further evidence until</p> | <p>Revision of Risk Assessment in a Reasonable Assurance Engagement</p> <p>49R. The practitioner's assessment of the risks of material misstatement in the subject matter information may change during the course of the engagement as additional evidence is obtained. In circumstances where the practitioner obtains evidence that is</p> |

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| <p>the practitioner is able to: (Ref: Para. A112–A117)</p> <p>(a) Conclude that the matter is not likely to cause the subject matter information to be materially misstated; or</p> <p>(b) Determine that the matter(s) causes the subject matter information to be materially misstated.</p> | <p>inconsistent with the evidence on which the practitioner originally based the assessment of the risks of material misstatement, the practitioner shall revise the assessment and modify the planned procedures accordingly. (Ref: Para. A112)</p> |
|---|--|

50. When designing and performing procedures, the practitioner shall consider the relevance and reliability of the information to be used as evidence. If:
- (a) Evidence obtained from one source is inconsistent with that obtained from another; or
 - (b) The practitioner has doubts about the reliability of information to be used as evidence,
- the practitioner shall determine what changes or additions to procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the engagement.
51. The practitioner shall accumulate uncorrected misstatements identified during the engagement other than those that are clearly trivial. (Ref: Para. A118–A119)

Work Performed by a Practitioner's Expert

52. When the work of a practitioner's expert is to be used, the practitioner shall also: (Ref: Para. A120–A124)
- (a) Evaluate whether the practitioner's expert has the necessary competence, capabilities and objectivity for the practitioner's purposes. In the case of a practitioner's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity; (Ref: Para. A125–A128)
 - (b) Obtain a sufficient understanding of the field of expertise of the practitioner's expert; (Ref: Para. A129–A130)
 - (c) Agree with the practitioner's expert on the nature, scope and objectives of that expert's work; and (Ref: Para. A131–A132)
 - (d) Evaluate the adequacy of the practitioner's expert's work for the practitioner's purposes. (Ref: Para. A133–A134)

Work Performed by Another Practitioner, a Responsible Party's or Measurer's or Evaluator's Expert, or an Internal Auditor (Ref: Para. A135)

53. When the work of another practitioner is to be used, the practitioner shall evaluate whether that work is adequate for the practitioner's purposes.
54. If information to be used as evidence has been prepared using the work of a responsible party's or a measurer's or evaluator's expert, the practitioner shall, to the extent necessary having regard to the significance of that expert's work for the practitioner's purposes:
- (a) Evaluate the competence, capabilities and objectivity of that expert;
 - (b) Obtain an understanding of the work of that expert; and
 - (c) Evaluate the appropriateness of that expert's work as evidence.

Subsequent Events

61. When relevant to the engagement, the practitioner shall consider the effect on the subject matter information and on the assurance report of events up to the date of the assurance report, and shall respond appropriately to facts that become known to the practitioner after the date of the assurance report, that, had they been known to the practitioner at that date, may have caused the practitioner to amend the assurance report. The extent of consideration of subsequent events depends on the potential for such events to affect the subject matter information and to affect the appropriateness of the practitioner's conclusion. However, the practitioner has no responsibility to perform any procedures regarding the subject matter information after the date of the assurance report. (Ref: Para. A140–A141)

Other Information

62. When documents containing the subject matter information and the assurance report thereon include other information, the practitioner shall read that other information to identify material inconsistencies, if any, with the subject matter information or the assurance report and, if on reading that other information, the practitioner: (Ref: Para. A142)

- (a) Identifies a material inconsistency between that other information and the subject matter information or the assurance report; or
- (b) Becomes aware of a material misstatement of fact in that other information that is unrelated to matters appearing in the subject matter information or the assurance report,

the practitioner shall discuss the matter with the appropriate party(ies) and take further action as appropriate.

Description of Applicable Criteria

63. The practitioner shall evaluate whether the subject matter information adequately refers to or describes the applicable criteria. (Ref: Para. A143–A145)

Forming the Assurance Conclusion

64. The practitioner shall evaluate the sufficiency and appropriateness of the evidence obtained in the context of the engagement and, if necessary in the circumstances, attempt to obtain further evidence. The practitioner shall consider all relevant evidence, regardless of whether it appears to corroborate or to contradict the measurement or evaluation of the underlying subject matter against the applicable criteria. If the practitioner is unable to obtain necessary further evidence, the practitioner shall consider the implications for the practitioner's conclusion in paragraph 65. (Ref: Para. A146–A152)
65. The practitioner shall form a conclusion about whether the subject matter information is free from material misstatement. In forming that conclusion, the practitioner shall consider the practitioner's conclusion in paragraph 64 regarding the sufficiency and appropriateness of evidence obtained and an evaluation of whether uncorrected misstatements are material, individually or in the aggregate. (Ref: Para. A3 and A153–A154)
66. If the practitioner is unable to obtain sufficient appropriate evidence, a scope limitation exists and the practitioner shall express a qualified conclusion, disclaim a conclusion, or withdraw from the engagement, where withdrawal is possible under applicable law or regulation, as appropriate. (Ref: Para. A155–A157)

Preparing the Assurance Report

67. The assurance report shall be in writing and shall contain a clear expression of the practitioner's conclusion about the subject matter information. (Ref: Para. A2, A158–A160)

68. The practitioner's conclusion shall be clearly separated from information or explanations that are not intended to affect the practitioner's conclusion, including any Emphasis of Matter, Other Matter, findings related to particular aspects of the engagements, recommendations or additional information included in the assurance report. The wording used shall make it clear that an Emphasis of Matter, Other Matter, findings, recommendations or additional information is not intended to detract from the practitioner's conclusion. (Ref: Para. A158–A160)

Assurance Report Content

69. The assurance report shall include, at a minimum, the following basic elements:
- (a) A title that clearly indicates the report is an independent assurance report. (Ref: Para. A161)
 - (b) An addressee. (Ref: Para. A162)
 - (c) An identification or description of the level of assurance obtained by the practitioner, the subject matter information and, when appropriate, the underlying subject matter. When the practitioner's conclusion is phrased in terms of a statement made by the appropriate party, that statement shall accompany the assurance report, be reproduced in the assurance report or be referenced therein to a source that is available to the intended users. (Ref: Para A163)
 - (d) Identification of the applicable criteria. (Ref: Para. A164)
 - (e) Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria. (Ref: Para. A165)
 - (f) When the applicable criteria are designed for a specific purpose, a statement alerting readers to this fact and that, as a result, the subject matter information may not be suitable for another purpose. (Ref: Para. A166–A167)
 - (g) A statement to identify the responsible party and the measurer or evaluator if different, and to describe their responsibilities and the practitioner's responsibilities. (Ref: Para. A168)
 - (h) A statement that the engagement was performed in accordance with this HKSAE or, where there is a subject-matter specific HKSAE, that HKSAE. (Ref: Para. A169–A170)
 - (i) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1. (Ref: Para. A171)
 - (j) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Parts A, B and D of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Parts A, B and D of the Code related to assurance engagements. (Ref: Para. A172)
 - (k) An informative summary of the work performed as the basis for the practitioner's conclusion. In the case of a limited assurance engagement, an appreciation of the nature, timing and extent of procedures performed is essential to understanding the practitioner's conclusion. In a limited assurance engagement, the summary of the work performed shall state that:

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- (i) The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement; and
 - (ii) Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed. (Ref: Para. A6, A173–A177)
- (l) The practitioner's conclusion: (Ref: Para. A2, A178–A180)
- (i) When appropriate, the conclusion shall inform the intended users of the context in which the practitioner's conclusion is to be read. (Ref: Para. A179)
 - (ii) In a reasonable assurance engagement, the conclusion shall be expressed in a positive form. (Ref: Para. A178)
 - (iii) In a limited assurance engagement, the conclusion shall be expressed in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe that the subject matter information is materially misstated. (Ref: Para. A180)
 - (iv) The conclusion in (ii) or (iii) shall be phrased using appropriate words for the underlying subject matter and applicable criteria given the engagement circumstances and shall be phrased in terms of: (Ref: Para. A181)
 - a. The underlying subject matter and the applicable criteria;
 - b. The subject matter information and the applicable criteria; or
 - c. A statement made by the appropriate party.
 - (v) When the practitioner expresses a modified conclusion, the assurance report shall contain:
 - a. A section that provides a description of the matter(s) giving rise to the modification; and
 - b. A section that contains the practitioner's modified conclusion. (Ref: Para. A182)
- (m) The practitioner's signature. (Ref: Para. A183)
- (n) The date of the assurance report. The assurance report shall be dated no earlier than the date on which the practitioner has obtained the evidence on which the practitioner's conclusion is based, including evidence that those with the recognized authority have asserted that they have taken responsibility for the subject matter information. (Ref: Para. A184)
- (o) The location in the jurisdiction where the practitioner practices.

Reference to the Practitioner's Expert in the Assurance Report

70. If the practitioner refers to the work of a practitioner's expert in the assurance report, the wording of that report shall not imply that the practitioner's responsibility for the conclusion expressed in that report is reduced because of the involvement of that expert. (Ref: Para. A185–A187)

85. Additional local guidance is provided in footnotes 1a and 3a.

Application and Other Explanatory Material

Introduction (Ref: Para. 6)

A1. In a consulting engagement, the practitioner applies technical skills, education, observations, experiences, and knowledge. Consulting engagements involve an analytical process that typically involves some combination of activities relating to: objective-setting, fact-finding, definition of problems or opportunities, evaluation of alternatives, development of recommendations including actions, communication of results, and sometimes implementation and follow-up. Reports (if issued) are generally written in a narrative (or "long-form") style. Generally the work performed is only for the use and benefit of the client. The nature and scope of work is determined by agreement between the practitioner and the client. Any service that meets the definition of an assurance engagement is not a consulting engagement but an assurance engagement.

Objectives

Engagements with Subject Matter Information Comprising a Number of Aspects (Ref: Para. 10, 65, 69(I))

A2. Where the subject matter information is made up of a number of aspects, separate conclusions may be provided on each aspect. All such separate conclusions do not need to relate to the same level of assurance. Rather, each conclusion is expressed in the form that is appropriate to either a reasonable assurance engagement or a limited assurance engagement. References in this HKSAE to the conclusion in the assurance report include each conclusion when separate conclusions are provided.

Definitions

The Nature, Timing and Extent of Procedures in Limited and Reasonable Assurance Engagements (Ref: Para. 12(a)(i))

A3. Because the level of assurance obtained in a limited assurance engagement is lower than in a reasonable assurance engagement, the procedures the practitioner performs in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. The primary differences between the procedures for a reasonable assurance engagement and a limited assurance engagement include:

- (a) The emphasis placed on the nature of various procedures as a source of evidence will likely differ, depending on the engagement circumstances. For example, the practitioner may judge it to be appropriate in the circumstances of a particular limited assurance engagement to place relatively greater emphasis on inquiries of the entity's personnel and analytical procedures, and relatively less emphasis, if any, on testing of controls and obtaining evidence from external sources than may be the case for a reasonable assurance engagement.
- (b) In a limited assurance engagement the practitioner may:
 - Select less items for examination; or
 - Perform fewer procedures (for example, performing only analytical procedures in circumstances when, in a reasonable assurance engagement, both analytical procedures and other procedures would be performed).

- (c) In a reasonable assurance engagement, analytical procedures performed in response to the engagement risk involve developing expectations that are sufficiently precise to identify material misstatements. In a limited assurance engagement, analytical procedures may be designed to support expectations regarding the direction of trends, relationships and ratios rather than to identify misstatements with the level of precision expected in a reasonable assurance engagement.
- (d) Further, when significant fluctuations, relationships or differences are identified, appropriate evidence in a limited assurance engagement may be obtained by making inquiries and considering responses received in the light of known engagement circumstances.
- (e) In addition, when undertaking analytical procedures in a limited assurance engagement the practitioner may, for example use data that is more highly aggregated, such as quarterly data rather than monthly data, or use data that has not been subjected to separate procedures to test its reliability to the same extent as it would be for a reasonable assurance engagement.

A Level of Assurance that is Meaningful (Ref: Para. 12(a)(i)(b), 47L)

- A4. The level of assurance the practitioner plans to obtain is not ordinarily susceptible to quantification, and whether it is meaningful is a matter of professional judgment for the practitioner to determine in the circumstances of the engagement. In a limited assurance engagement, the practitioner performs procedures that are limited compared with those necessary in a reasonable assurance engagement but are, nonetheless, planned to obtain a level of assurance that is meaningful. To be meaningful the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential (see also paragraphs A16–A18).
- A5. Across the range of all limited assurance engagements, what is meaningful assurance can vary from just above assurance that is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential to just below reasonable assurance. What is meaningful in a particular engagement represents a judgment within that range that depends on the engagement circumstances, including the information needs of intended users as a group, the criteria, and the underlying subject matter of the engagement.
- A6. Because the level of assurance obtained by the practitioner in limited assurance engagements varies, the practitioner's report contains an informative summary of the procedures performed, recognizing that an appreciation of the nature, timing and extent of procedures performed is essential to understanding the practitioner's conclusion (see paragraphs 69(k) and A173–A177).
- A7. Some of the factors that may be relevant in determining what constitutes meaningful assurance in a specific engagement include, for example:
 - The characteristics of the underlying subject matter and the criteria, and whether there are any relevant subject matter-specific HKSAs.
 - Instructions or other indications from the engaging party about the nature of the assurance the engaging party is seeking the practitioner to obtain. For example, the terms of the engagement may stipulate particular procedures that the engaging party considers necessary or particular aspects of the subject matter information on which the engaging party would like the practitioner to focus procedures. However, the practitioner may consider that other procedures are required to obtain sufficient appropriate evidence to obtain meaningful assurance.
 - Generally accepted practice, if it exists, with respect to assurance engagements for the particular subject matter information, or similar or related subject matter information.

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- The information needs of intended users as a group. Generally, the greater the consequence to intended users of receiving an inappropriate conclusion when the subject matter information is materially misstated, the greater the assurance that would be needed in order to be meaningful to them. For example, in some cases, the consequence to intended users of receiving an inappropriate conclusion may be so great that a reasonable assurance engagement is needed for the practitioner to obtain assurance that is meaningful in the circumstances.
- The expectation by intended users that the practitioner will form the limited assurance conclusion on the subject matter information within a short timeframe and at a low cost.

Examples of Attestation Engagements (Ref: Para. 12(a)(ii)(a))

A8. Examples of engagements that may be conducted under this HKSAE include:

- (a) Sustainability – An engagement on sustainability involves obtaining assurance on a report prepared by management or management's expert (the measurer or evaluator) on the sustainability performance of the entity.
- (b) Compliance with law or regulation – An engagement on compliance with law or regulation involves obtaining assurance on a statement by another party (the measurer or evaluator) of compliance with the relevant law or regulation.
- (c) Value for money – An engagement on value for money involves obtaining assurance on a measurement or evaluation of value for money by another party (the measurer or evaluator).

Assurance Skills and Techniques (Ref: Para. 12(b))

A9. Assurance skills and techniques include:

- Application of professional skepticism and professional judgment;
- Planning and performing an assurance engagement, including obtaining and evaluating evidence;
- Understanding information systems and the role and limitations of internal control;
- Linking the consideration of materiality and engagement risks to the nature, timing and extent of procedures;
- Applying procedures as appropriate to the engagement (which may include inquiry, inspection, recalculation, reperformance, observation, confirmation, and analytical procedures); and
- Systematic documentation practices and assurance report-writing skills.

Criteria (Ref: Para. 12(c), Appendix)

A10. Suitable criteria are required for reasonably consistent measurement or evaluation of an underlying subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. The suitability of criteria is context-sensitive, that is, it is determined in the context of the engagement circumstances. Even for the same underlying subject matter there can be different criteria, which will yield a different measurement or evaluation. For example, a measurer or evaluator might select, as one of the criteria for the underlying subject matter of customer satisfaction, the number of customer complaints resolved to the acknowledged satisfaction of the customer; another measurer or evaluator might select the number of repeat purchases in the three months following the initial purchase. The suitability of criteria is not

- In some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria.

The Engaging Party (Ref: Para. 12(g), Appendix)

A15. The engaging party may be, under different circumstances, management or those charged with governance of the responsible party, a legislature, the intended users, the measurer or evaluator, or a different third party.

Intended Users (Ref: Para. 12(m), Appendix)

A16. In some cases, there may be intended users other than those to whom the assurance report is addressed. The practitioner may not be able to identify all those who will read the assurance report, particularly where a large number of people have access to it. In such cases, particularly where possible users are likely to have a broad range of interests in the underlying subject matter, intended users may be limited to major stakeholders with significant and common interests. Intended users may be identified in different ways, for example, by agreement between the practitioner and the responsible party or engaging party, or by law or regulation.

A17. Intended users or their representatives may be directly involved with the practitioner and the responsible party (and the engaging party if different) in determining the requirements of the engagement. Regardless of the involvement of others however, and unlike an agreed-upon procedures engagement (which involves reporting factual findings based upon procedures agreed with the engaging party and any appropriate third parties, rather than a conclusion):

- (a) The practitioner is responsible for determining the nature, timing and extent of procedures; and
- (b) The practitioner may need to perform additional procedures if information comes to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based (see paragraphs A115–A117).

A18. In some cases, intended users (for example, bankers and regulators) impose a requirement on, or request the appropriate party(ies) to arrange for an assurance engagement to be performed for a specific purpose. When engagements use criteria that are designed for a specific purpose, paragraph 69(f) requires a statement alerting readers to this fact. In addition, the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users. Depending on the engagement circumstances, this may be achieved by restricting the distribution or use of the assurance report (see paragraphs A166–A167).

Subject Matter Information (Ref: Para. 12(x), Appendix)

A19. In some cases, the subject matter information may be a statement that evaluates an aspect of a process, or of performance or compliance, in relation to the criteria. For example, "ABC's internal control operated effectively in terms of XYZ criteria during the period" or "ABC's governance structure conformed with XYZ criteria during the period ...".

The Appropriate Party(ies) (Ref: Para. 13, Appendix)

A20. The roles played by the responsible party, the measurer or evaluator, and the engaging party can vary (see paragraph A37). Also, management and governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Such diversity means that it is not possible for HKSAEs to specify for all engagements the person(s) with whom the practitioner is to inquire of, request representations from, or otherwise communicate with in all circumstances. In some cases, for example, when the appropriate party(ies) is only part of a complete legal entity, identifying the appropriate management personnel or those charged with governance with whom to communicate will require the exercise of professional judgment to determine which person(s) have the appropriate responsibilities for, and knowledge of, the matters concerned.

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- Developed collectively by a group that does not follow a transparent due process.
- Published in scholarly journals or books.
- Developed for sale on a proprietary basis.
- Specifically designed for the purpose of preparing the subject matter information in the particular circumstances of the engagement.

How criteria are developed may affect the work that the practitioner carries out to assess their suitability.

A49. In some cases, law or regulation prescribes the criteria to be used for the engagement. In the absence of indications to the contrary, such criteria are presumed to be suitable, as are criteria issued by authorized or recognized bodies of experts that follow a transparent due process if they are relevant to the intended users' information needs. Such criteria are known as established criteria. Even when established criteria exist for an underlying subject matter, specific users may agree to other criteria for their specific purposes. For example, various frameworks can be used as established criteria for evaluating the effectiveness of internal control. Specific users may, however, develop a more detailed set of criteria that meet their specific information needs in relation to, for example, prudential supervision. In such cases, the assurance report:

- (a) Alerts readers that the subject matter information is prepared in accordance with special purpose criteria and that, as a result, the subject matter information may not be suitable for another purpose (see paragraph 69(f)); and
- (b) May note, when it is relevant to the circumstances of the engagement, that the criteria are not embodied in law or regulation, or issued by authorized or recognized bodies of experts that follow a transparent due process.

A50. If criteria are specifically designed for the purpose of preparing the subject matter information in the particular circumstances of the engagement, they are not suitable if they result in subject matter information or an assurance report that is misleading to the intended users. It is desirable for the intended users or the engaging party to acknowledge that specifically developed criteria are suitable for the intended users' purposes. The absence of such an acknowledgement may affect what is to be done to assess the suitability of the criteria, and the information provided about the criteria in the assurance report.

Availability of the criteria (Ref: Para. 24(b)(iii))

A51. Criteria need to be available to the intended users to allow them to understand how the underlying subject matter has been measured or evaluated. Criteria are made available to the intended users in one or more of the following ways:

- (a) Publicly.
- (b) Through inclusion in a clear manner in the presentation of the subject matter information.
- (c) Through inclusion in a clear manner in the assurance report (see paragraph A164).
- (d) By general understanding, for example the criterion for measuring time in hours and minutes.

A52. Criteria may also be available only to intended users, for example the terms of a contract, or criteria issued by an industry association that are available only to those in the industry because they are relevant only to a specific purpose. When this is the case, paragraph 69(f) requires a statement alerting readers to this fact. In addition, the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users (see paragraph A166–A167).

Access to Evidence (Ref: Para. 24(b)(iv))

Quantity and quality of available evidence

A53. The quantity or quality of available evidence is affected by:

- (a) The characteristics of the underlying subject matter or the subject matter information. For example, less objective evidence might be expected when the subject matter information is future oriented rather than historical; and
- (b) Other circumstances, such as when evidence that could reasonably be expected to exist is not available because of, for example, the timing of the practitioner's appointment, an entity's document retention policy, inadequate information systems, or a restriction imposed by the responsible party.

Ordinarily, evidence will be persuasive rather than conclusive.

Access to records (Ref: Para. 56)

A54. Seeking the agreement of the appropriate party(ies) that it acknowledges and understands its responsibility to provide the practitioner with the following may assist the practitioner in determining whether the engagement exhibits the characteristic of access to evidence:

- (a) Access to all information of which the appropriate party(ies) is aware that is relevant to the preparation of the subject matter information such as records, documentation and other matters;
- (b) Additional information that the practitioner may request from the appropriate party(ies) for the purpose of the engagement; and
- (c) Unrestricted access to persons from the appropriate party(ies) from whom the practitioner determines it necessary to obtain evidence.

A55. The nature of relationships between the responsible party, the measurer or evaluator, and the engaging party may affect the practitioner's ability to access records, documentation and other information the practitioner may require as evidence to complete the engagement. The nature of such relationships may therefore be a relevant consideration when determining whether or not to accept the engagement. Examples of some circumstances in which the nature of these relationships may be problematic are included in paragraph A139.

A Rational Purpose (Ref: Para. 24(b)(vi))

A56. In determining whether the engagement has a rational purpose, relevant considerations may include the following:

- The intended users of the subject matter information and the assurance report (particularly, when the criteria are designed for a special purpose). A further consideration is the likelihood that the subject matter information and the assurance report will be used or distributed more broadly than to intended users.
- Whether aspects of the subject matter information are expected to be excluded from the assurance engagement, and the reason for their exclusion.
- The characteristics of the relationships between the responsible party, the measurer or evaluator, and the engaging party, for example, when the measurer or evaluator is not the responsible party, whether the responsible party consents to the use to be made of the subject matter information and will have the opportunity to review the subject matter information before it is made available to intended users or to distribute comments with the subject matter information.

- Who selected the criteria to be applied to measure or evaluate the underlying subject matter, and what the degree of judgment and scope for bias is in applying them. The engagement is more likely to have a rational purpose if the intended users selected or were involved in selecting the criteria.
- Any significant limitations on the scope of the practitioner's work.
- Whether the practitioner believes the engaging party intends to associate the practitioner's name with the underlying subject matter or the subject matter information in an inappropriate manner.

Agreeing on the Terms of the Engagement (Ref: Para. 27)

- A57. It is in the interests of both the engaging party and the practitioner that the practitioner communicates in writing the agreed terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the written agreement or contract will vary with the engagement circumstances. For example, if law or regulation prescribes in sufficient detail the terms of the engagement, the practitioner need not record them in a written agreement, except for the fact that such law or regulation applies and that the appropriate party acknowledges and understands its responsibilities under such law or regulation.
- A58. Law or regulation, particularly in the public sector, may mandate the appointment of a practitioner and set out specific powers, such as the power to access an appropriate party(ies)'s records and other information, and responsibilities, such as requiring the practitioner to report directly to a minister, the legislature or the public if an appropriate party(ies) attempts to limit the scope of the engagement.

Acceptance of a Change in the Terms of the Engagement (Ref: Para. 29)

- A59. A change in circumstances that affects the intended users' requirements, or a misunderstanding concerning the nature of the engagement, may justify a request for a change in the engagement, for example, from an assurance engagement to a non-assurance engagement, or from a reasonable assurance engagement to a limited assurance engagement. An inability to obtain sufficient appropriate evidence to form a reasonable assurance conclusion is not an acceptable reason to change from a reasonable assurance engagement to a limited assurance engagement.

Quality Control

Professional Accountants in Public Practice (Ref: Para. 20, 31(a)–(b))

- A60. This HKSAE has been written in the context of a range of measures taken to ensure the quality of assurance engagements undertaken by professional accountants in public practice, such as those taken by IFAC member bodies^{3a} in accordance with IFAC's Member Body Compliance Program and Statements of Membership Obligations. Such measures include:
- Competency requirements, such as education and experience benchmarks for entry to membership, and ongoing continuing professional development as well as life-long learning requirements.
 - Quality control policies and procedures implemented across the firm. HKSQC 1 applies to all firms of professional accountants in respect of assurance and related services engagements.
 - A comprehensive Code, including detailed independence requirements, founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

^{3a} The Hong Kong Institute of Certified Public Accountants is a member of IFAC.

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- Whether the other practitioner understands and complies with the ethical requirements that are relevant to the engagement and, in particular, is independent.
- The other practitioner's professional competence.
- The extent of the engagement team's involvement in the work of the other practitioner.
- Whether the other practitioner operates in a regulatory environment that actively oversees that practitioner.

Review Responsibilities (Ref: Para. 33(c))

A74. Under HKSQC 1, the firm's review responsibility policies and procedures are determined on the basis that the work of less experienced team members is reviewed by more experienced team members.⁶

Engagement Quality Control Review (Ref: Para. 36(b))

A75. Other matters that may be considered in an engagement quality control review include:

- (a) The engagement team's evaluation of the firm's independence in relation to the engagement;
- (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and
- (c) Whether engagement documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.

Professional Skepticism and Professional Judgment

Professional Skepticism (Ref: Para. 37)

A76. Professional skepticism is an attitude that includes being alert to, for example:

- Evidence that is inconsistent with other evidence obtained.
- Information that calls into question the reliability of documents and responses to inquiries to be used as evidence.
- Circumstances that suggest the need for procedures in addition to those required by relevant HKSAEs.
- Conditions that may indicate likely misstatement.

A77. Maintaining professional skepticism throughout the engagement is necessary if the practitioner is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
- Overgeneralizing when drawing conclusions from observations.
- Using inappropriate assumptions in determining the nature, timing and extent of the procedures, and evaluating the results thereof.

⁶ HKSQC 1, paragraph 33

- A78. Professional skepticism is necessary to the critical assessment of evidence. This includes questioning inconsistent evidence and the reliability of documents and responses to inquiries. It also includes consideration of the sufficiency and appropriateness of evidence obtained in the light of the circumstances.
- A79. Unless the engagement involves assurance about whether documents are genuine, the practitioner may accept records and documents as genuine unless the practitioner has reason to believe the contrary. Nevertheless, the practitioner is required by paragraph 50 to consider the reliability of information to be used as evidence.
- A80. The practitioner cannot be expected to disregard past experience of the honesty and integrity of those who provide evidence. Nevertheless, a belief that those who provide evidence are honest and have integrity does not relieve the practitioner of the need to maintain professional skepticism.

Professional Judgment (Ref: Para. 38)

- A81. Professional judgment is essential to the proper conduct of an assurance engagement. This is because interpretation of relevant ethical requirements and relevant HKSAEs and the informed decisions required throughout the engagement cannot be made without the application of relevant training, knowledge, and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:
- Materiality and engagement risk.
 - The nature, timing and extent of procedures used to meet the requirements of relevant HKSAEs and obtain evidence.
 - Evaluating whether sufficient appropriate evidence has been obtained, and whether more needs to be done to achieve the objectives of this HKSAE and any relevant subject matter specific HKSAE. In particular, in the case of a limited assurance engagement, professional judgment is required in evaluating whether a meaningful level of assurance has been obtained.
 - The appropriate conclusions to draw based on the evidence obtained.
- A82. The distinguishing feature of the professional judgment expected of a practitioner is that it is exercised by a practitioner whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.
- A83. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the practitioner. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm assist the practitioner in making informed and reasonable judgments, including the extent to which particular items in the subject matter information are affected by judgment of the appropriate party.
- A84. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of assurance and measurement or evaluation principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the practitioner up to the date of the practitioner's assurance report.
- A85. Professional judgment needs to be exercised throughout the engagement. It also needs to be appropriately documented. In this regard, paragraph 79 requires the practitioner to prepare documentation sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the engagement. Professional judgment is not to

be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate evidence.

Planning and Performing the Engagement

Planning (Ref: Para. 40)

A86. Planning involves the engagement partner, other key members of the engagement team, and any key practitioner's external experts developing an overall strategy for the scope, emphasis, timing and conduct of the engagement, and an engagement plan, consisting of a detailed approach for the nature, timing and extent of procedures to be performed, and the reasons for selecting them. Adequate planning helps to devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis and properly organize and manage the engagement in order for it to be performed in an effective and efficient manner. Adequate planning also assists the practitioner to properly assign work to engagement team members, and facilitates the direction, supervision, and the review of their work. Further, it assists, where applicable, the coordination of work done by other practitioners and experts. The nature and extent of planning activities will vary with the engagement circumstances, for example the complexity of the underlying subject matter and criteria. Examples of the main matters that may be considered include:

- The characteristics of the engagement that define its scope, including the terms of the engagement and the characteristics of the underlying subject matter and the criteria.
- The expected timing and the nature of the communications required.
- The results of engagement acceptance activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the appropriate party(ies) is relevant.
- The engagement process.
- The practitioner's understanding of the appropriate party(ies) and its environment, including the risks that the subject matter information may be materially misstated.
- Identification of intended users and their information needs, and consideration of materiality and the components of engagement risk.
- The extent to which the risk of fraud is relevant to the engagement.
- The nature, timing and extent of resources necessary to perform the engagement, such as personnel and expertise requirements, including the nature and extent of experts' involvement.
- The impact of the internal audit function on the engagement.

A87. The practitioner may decide to discuss elements of planning with the appropriate party(ies) to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work of the appropriate party(ies)'s personnel). Although these discussions often occur, the overall engagement strategy and the engagement plan remain the practitioner's responsibility. When discussing matters included in the overall engagement strategy or engagement plan, care is required in order not to compromise the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the appropriate party(ies) may compromise the effectiveness of the engagement by making the procedures too predictable.

A88. Planning is not a discrete phase, but rather a continual and iterative process throughout the engagement. As a result of unexpected events, changes in conditions, or evidence obtained, the practitioner may need to revise the overall strategy and engagement plan, and thereby the resulting planned nature, timing and extent of procedures.

- Designing and performing procedures; and
- Evaluating evidence, including the reasonableness of the oral and written representations received by the practitioner.

A103. The practitioner ordinarily has a lesser depth of understanding of the underlying subject matter and other engagement circumstances than the responsible party. The practitioner also ordinarily has a lesser depth of understanding of the underlying subject matter and other engagement circumstances for a limited assurance engagement than for a reasonable assurance engagement, for example, while in some limited assurance engagements the practitioner may obtain an understanding of internal control over the preparation of the subject matter information, this is often not the case.

A104. In a limited assurance engagement, identifying the areas where a material misstatement of the subject matter information is likely to arise enables the practitioner to focus procedures on those areas. For example, in an engagement when the subject matter information is a sustainability report, the practitioner may focus on certain areas of the sustainability report. The practitioner may design and perform procedures over the entire subject matter information when the subject matter information consists of only a single area or when obtaining assurance over all areas of the subject matter information is necessary to obtain meaningful assurance.

A105. In a reasonable assurance engagement, understanding internal control over the subject matter information assists the practitioner in identifying the types of misstatements and factors that affect the risks of material misstatements in the subject matter information. The practitioner is required to evaluate the design of relevant controls and determines whether they have been implemented, by performing procedures in addition to inquiry of the responsible party. Professional judgment is needed to determine which controls are relevant in the engagement circumstances.

A106. In a limited assurance engagement, considering the process used to prepare the subject matter information assists the practitioner in designing and performing procedures that address the areas where a material misstatement of the subject matter information is likely to arise. In considering the process used, the practitioner uses professional judgment to determine which aspects of the process are relevant to the engagement, and may make inquiries of the appropriate party about those aspects.

A107. In both a reasonable assurance and a limited assurance engagement, the results of the entity's risk assessment process may also assist the practitioner in obtaining an understanding of the underlying subject matter and other engagement circumstances.

Obtaining Evidence

The Nature, Timing and Extent of Procedures (Ref: Para. 48(L)–49(R))

A108. The practitioner chooses a combination of procedures to obtain reasonable assurance or limited assurance, as appropriate. The procedures listed below may be used, for example, for planning or performing the engagement, depending on the context in which they are applied by the practitioner:

- Inspection;
- Observation;
- Confirmation;
- Recalculation;
- Reperformance;
- Analytical procedures; and
- Inquiry.

- If the results of analytical procedures are within expectations but are, nevertheless, close to exceeding the expected value, then additional procedures may be needed because the risk of a material misstatement may not be acceptable in the engagement circumstances.

A115. If, in the case of a limited assurance engagement, a matter(s) comes to the practitioner's attention that causes the practitioner to believe the subject matter information may be materially misstated, the practitioner is required by paragraph 49L to design and perform additional procedures. Additional procedures may include, for example, inquiring of the appropriate party(ies) or performing other procedures as appropriate in the circumstances.

A116. If, having performed the additional procedures required by paragraph 49L, the practitioner is not able to obtain sufficient appropriate evidence to either conclude that the matter(s) is not likely to cause the subject matter information to be materially misstated or determine that it does cause the subject matter information to be materially misstated, a scope limitation exists and paragraph 66 applies.

A117. The practitioner's judgment about the nature, timing and extent of additional procedures that are needed to obtain evidence to either conclude that a material misstatement is not likely, or determine that a material misstatement exists, is, for example, guided by:

- Information obtained from the practitioner's evaluation of the results of the procedures already performed;
- The practitioner's updated understanding of the underlying subject matter and other engagement circumstances obtained throughout the course of the engagement; and
- The practitioner's view on the persuasiveness of evidence needed to address the matter that causes the practitioner to believe that the subject matter information may be materially misstated.

Accumulating Uncorrected Misstatements (Ref: Para. 51, 65)

A118. Uncorrected misstatements are accumulated during the engagement (see paragraph 51) for the purpose of evaluating whether, individually or in aggregate, they are material when forming the practitioner's conclusion.

A119. The practitioner may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the practitioner expects that the accumulation of such amounts clearly would not have a material effect on the subject matter information. "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality determined in accordance with paragraph 44, and will be matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

Considerations When a Practitioner's Expert Is Involved on the Engagement

Nature, Timing and Extent of Procedures (Ref: Para. 52)

A120. The following matters are often relevant when determining the nature, timing and extent of procedures with respect to the work of a practitioner's expert when some of the assurance work is performed by one or more practitioner's expert (see paragraph A70):

- (a) The significance of that expert's work in the context of the engagement (see also paragraphs A121–A122);
- (b) The nature of the matter to which that expert's work relates;

- (a) Agreeing with that expert on the nature and extent of further work to be performed by that expert; or
- (b) Performing additional procedures appropriate to the circumstances.

Work Performed by Another Practitioner, a Responsible Party's or Measurer's or Evaluator's Expert or an Internal Auditor (Ref: Para. 53–55)

A135. While paragraphs A120–A134 have been written in the context of using work performed by a practitioner's expert, they may also provide helpful guidance with respect to using work performed by another practitioner, a responsible party's or measurer's or evaluator's expert, or an internal auditor.

Written Representations (Ref: Para. 56)

A136. Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the appropriate party(ies). The person(s) from whom the practitioner requests written representations will ordinarily be a member of senior management or those charged with governance depending on, for example, the management and governance structure of the appropriate party(ies), which may vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.

A137. Other written representations requested may include the following:

- Whether the appropriate party(ies) believes the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the subject matter information. A summary of such items is ordinarily included in or attached to the written representation;
- That significant assumptions used in making any material estimates are reasonable;
- That the appropriate party(ies) has communicated to the practitioner all deficiencies in internal control relevant to the engagement that are not clearly trivial and inconsequential of which the appropriate party(ies) is aware; and
- When the responsible party is different from the measurer or evaluator, that the responsible party acknowledges responsibility for the underlying subject matter.

A138. Representations by the appropriate party(ies) cannot replace other evidence the practitioner could reasonably expect to be available. Although written representations provide necessary evidence, they do not provide sufficient appropriate evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other evidence that the practitioner obtains.

Requested Written Representations Not Provided or Not Reliable (Ref: Para. 60)

A139. Circumstances in which the practitioner may not be able to obtain requested written representations include, for example, when:

- The responsible party contracts a third party to perform the relevant measurement or evaluation and later engages the practitioner to undertake an assurance engagement on the resultant subject matter information. In some such cases, for example where the responsible party has an ongoing relationship with the measurer or evaluator, the responsible party may be able to arrange for the measurer or evaluator to provide requested written representations, or the responsible party may be in a position to provide such representations if the responsible party has a reasonable basis for doing so, but, in other cases, this may not be so.

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- An intended user engages the practitioner to undertake an assurance engagement on publicly available information but does not have a relationship with the responsible party of the kind necessary to ensure that party responds to the practitioner's request for a written representation.
- The assurance engagement is undertaken against the wishes of the measurer or evaluator. This may be the case when, for example, the engagement is undertaken pursuant to a court order, or a public sector practitioner is required by the legislature or other competent authority to undertake a particular engagement.

In these or similar circumstances, the practitioner may not have access to the evidence needed to support the practitioner's conclusion. If this is the case, paragraph 66 of this HKSAE applies.

Subsequent Events (Ref: Para. 61)

A140. Consideration of subsequent events in some assurance engagements may not be relevant because of the nature of the underlying subject matter. For example, when the engagement requires a conclusion about the accuracy of a statistical return at a point in time, events occurring between that point in time and the date of the assurance report may not affect the conclusion or require disclosure in the return or the assurance report.

A141. As noted in paragraph 61, the practitioner has no responsibility to perform any procedures regarding the subject matter information after the date of the practitioner's report. However, if, after the date of the practitioner's report, a fact becomes known to the practitioner that, had it been known to the practitioner at the date of the practitioner's report, may have caused the practitioner to amend the report, the practitioner may need to discuss the matter with the appropriate party(ies) or take other action as appropriate in the circumstances.

Other Information (Ref: Para. 62)

A142. Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example:

- Requesting the appropriate party(ies) to consult with a qualified third party, such as the appropriate party(ies)'s legal counsel.
- Obtaining legal advice about the consequences of different courses of action.
- Communicating with third parties (for example, a regulator).
- Withholding the assurance report.
- Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.
- Describing the material inconsistency in the assurance report.

Description of Applicable Criteria (Ref: Para. 63)

A143. The description of the applicable criteria advises intended users of the framework on which the subject matter information is based, and is particularly important when there are significant differences between various criteria regarding how particular matters may be treated in the subject matter information.

A144. A description that the subject matter information is prepared in accordance with particular applicable criteria is appropriate only if the subject matter information complies with all relevant requirements of those applicable criteria that are effective.

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- Results of procedures performed, including whether such procedures identified specific misstatements.
- Source and reliability of the available information.
- Persuasiveness of the evidence.
- Understanding of the appropriate party(ies) and its environment.

Scope Limitations (Ref: Para. 26, 66)

A155. A scope limitation may arise from:

- (a) Circumstances beyond the control of the appropriate party(ies). For example, documentation the practitioner considers it necessary to inspect may have been accidentally destroyed;
- (b) Circumstances relating to the nature or timing of the practitioner's work. For example, a physical process the practitioner considers it necessary to observe may have occurred before the practitioner's engagement; or
- (c) Limitations imposed by the responsible party, the measurer or evaluator, or the engaging party on the practitioner that, for example, may prevent the practitioner from performing a procedure the practitioner considers to be necessary in the circumstances. Limitations of this kind may have other implications for the engagement, such as for the practitioner's consideration of engagement risk and engagement acceptance and continuance.

A156. An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate evidence by performing alternative procedures.

A157. The procedures performed in a limited assurance engagement are, by definition, limited compared with that necessary in a reasonable assurance engagement. Limitations known to exist prior to accepting a limited assurance engagement are a relevant consideration when establishing whether the preconditions for an assurance engagement are present, in particular, whether the engagement exhibits the characteristics of access to evidence (see paragraph 24b)(iv)) and a rational purpose (see paragraph 24(b)(vi)). If a further limitation is imposed by the appropriate party(ies) after a limited assurance engagement has been accepted, it may be appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation.

Preparing the Assurance Report

Form of Assurance Report (Ref: Para. 67–68)

A158. Oral and other forms of expressing conclusions can be misunderstood without the support of a written report. For this reason, the practitioner does not report orally or by use of symbols without also providing a written assurance report that is readily available whenever the oral report is provided or the symbol is used. For example, a symbol could be hyperlinked to a written assurance report on the Internet.

A159. This HKSAE does not require a standardized format for reporting on all assurance engagements. Instead it identifies the basic elements the assurance report is to include. Assurance reports are tailored to the specific engagement circumstances. The practitioner may use headings, paragraph numbers, typographical devices, for example the bolding of text, and other mechanisms to enhance the clarity and readability of the assurance report.

A160. The practitioner may choose a "short-form" or "long-form" style of reporting to facilitate effective communication to the intended users. "Short-form" reports ordinarily include only the basic elements. "Long-form" reports include other information and explanations that are not intended to

affect the practitioner's conclusion. In addition to the basic elements, long-form reports may describe in detail the terms of the engagement, the applicable criteria being used, findings relating to particular aspects of the engagement, details of the qualifications and experience of the practitioner and others involved with the engagement, disclosure of materiality levels, and, in some cases, recommendations. The practitioner may find it helpful to consider the significance of providing such information to the information needs of the intended users. As required by paragraph 68, additional information is clearly separated from the practitioner's conclusion and phrased in such a manner so as to make it clear that it is not intended to detract from that conclusion.

Assurance Report Content

Title (Ref: Para. 69(a))

A161. An appropriate title helps to identify the nature of the assurance report, and to distinguish it from reports issued by others, such as those who do not have to comply with the same ethical requirements as the practitioner.

Addressee (Ref: Para. 69(b))

A162. An addressee identifies the party or parties to whom the assurance report is directed. The assurance report is ordinarily addressed to the engaging party, but, in some cases, there may be other intended users.

Subject Matter Information and Underlying Subject Matter (Ref: Para. 69(c))

A163. Identification and description of the subject matter information and, when appropriate, the underlying subject matter may include, for example:

- The point in time or period of time to which the measurement or evaluation of the underlying subject matter relates.
- Where applicable, the name of the responsible party or component of the responsible party to which the underlying subject matter relates.
- An explanation of those characteristics of the underlying subject matter or the subject matter information of which the intended users should be aware, and how such characteristics may influence the precision of the measurement or evaluation of the underlying subject matter against the applicable criteria, or the persuasiveness of available evidence. For example:
 - The degree to which the subject matter information is qualitative versus quantitative, objective versus subjective, or historical versus prospective.
 - Changes in the underlying subject matter or other engagement circumstances that affect the comparability of the subject matter information from one period to the next.

Applicable Criteria (Ref: Para. 69(d))

A164. The assurance report identifies the applicable criteria against which the underlying subject matter was measured or evaluated so the intended users can understand the basis for the practitioner's conclusion. The assurance report may include the applicable criteria, or refer to them if they are included in the subject matter information or if they are otherwise available from a readily accessible source. It may be relevant in the circumstances, to disclose:

- The source of the applicable criteria, and whether or not the applicable criteria are embodied in law or regulation, or issued by authorized or recognized bodies of experts that follow a transparent due process, that is, whether they are established criteria in the

context of the underlying subject matter (and if they are not, a description of why they are considered suitable).

- Measurement or evaluation methods used when the applicable criteria allow for choice between a number of methods.
- Any significant interpretations made in applying the applicable criteria in the engagement circumstances.
- Whether there have been any changes in the measurement or evaluation methods used.

Inherent Limitations (Ref: Para. 69(e))

A165. While in some cases, inherent limitations can be expected to be well-understood by the intended users of an assurance report, in other cases it may be appropriate to make explicit reference to them in the assurance report. For example, in an assurance report related to the effectiveness of internal control, it may be appropriate to note that the historic evaluation of effectiveness is not relevant to future periods due to the risk that internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Specific Purpose (Ref: Para. 69(f))

A166. In some cases, the applicable criteria used to measure or evaluate the underlying subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular applicable criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts readers of the assurance report to this fact and that, therefore, the subject matter information may not be suitable for another purpose.

A167. In addition to the alert required by paragraph 69(f), the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users. Depending on the engagement circumstances, for example, the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the assurance report. While an assurance report may be restricted in this way, the absence of a restriction regarding a particular user or purpose does not itself indicate that a legal responsibility is owed by the practitioner in relation to that user or for that purpose. Whether a legal responsibility is owed will depend on the legal circumstances of each case and the relevant jurisdiction.

Relative Responsibilities (Ref: Para. 69(g))

A168. Identifying relative responsibilities informs the intended users that the responsible party is responsible for the underlying subject matter, that the measurer or evaluator is responsible for the measurement or evaluation of the underlying subject matter against the applicable criteria, and that the practitioner's role is to independently express a conclusion about the subject matter information.

Performance of the Engagement in Accordance with HKSAE 3000 (Revised) and a Subject Matter Specific HKSAE (Ref: Para. 69(h))

A169. Where a subject matter specific HKSAE applies to only part of the subject matter information, it may be appropriate to cite both that subject matter specific HKSAE and this HKSAE.

A170. A statement that contains imprecise qualifying or limiting language (for example "the engagement was performed by reference to HKSAE 3000") may mislead users of assurance reports.

Applicable Quality Control Requirements (Ref: Para. 69(i))

A171. The following is an illustration of a statement in the assurance report regarding applicable quality control requirements:

The firm applies Hong Kong Standard on Quality Control 1 and, accordingly, maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Compliance with Independence and Other Ethical Requirements (Ref: Para. 69(j))

A172. The following is an illustration of a statement in the assurance report regarding compliance with ethical requirements:

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Summary of the Work Performed (Ref: Para. A6, 69(k))

A173. The summary of the work performed helps the intended users understand the practitioner's conclusion. For many assurance engagements, infinite variations in procedures are possible in theory. In practice, however, these are difficult to communicate clearly and unambiguously. Other authoritative pronouncements issued by the Hong Kong Institute of Certified Public Accountants may be useful to practitioners in preparing the summary.

A174. Where no specific HKSAE provides guidance on procedures for a particular underlying subject matter, the summary might include a more detailed description of the work performed. It may be appropriate to include in the summary a statement that the work performed included evaluating the suitability of the applicable criteria.

A175. In a limited assurance engagement the summary of the work performed is ordinarily more detailed than for a reasonable assurance engagement and identifies the limitations on the nature, timing and extent of procedures. This is because an appreciation of the nature, timing and extent of procedures performed is essential to understanding a conclusion expressed in a form that conveys whether, based on the procedures performed, a material matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. It also may be appropriate to indicate in the summary of the work performed certain procedures that were not performed that would ordinarily be expected to be performed in a reasonable assurance engagement. However, a complete identification of all such procedures may not be possible because the practitioner's required understanding and consideration of engagement risk is less than in a reasonable assurance engagement.

A176. Factors to consider in determining the level of detail to be provided in the summary of the work performed may include:

- Circumstances specific to the entity (for example, the differing nature of the entity's activities compared to those typical in the sector).
- Specific engagement circumstances affecting the nature and extent of the procedures performed.
- The intended users' expectations of the level of detail to be provided in the report, based on market practice, or applicable law or regulation.

A177. It is important that the summary be written in an objective way that allows intended users to understand the work done as the basis for the practitioner's conclusion. In most cases, this will not involve detailing the entire work plan, but on the other hand it is important for it not to be so summarized as to be ambiguous, nor written in a way that is overstated or embellished.

The Practitioner's Conclusion (Ref: Para. 12(a)(i)(a), 69(l))

A178. Examples of conclusions expressed in a form appropriate for a reasonable assurance engagement include:

- When expressed in terms of the underlying subject matter and the applicable criteria, "In our opinion, the entity has complied, in all material respects, with XYZ law;"
- When expressed in terms of the subject matter information and the applicable criteria, "In our opinion, the forecast of the entity's financial performance is properly prepared, in all material respects, based on XYZ criteria;" or
- When expressed in terms of a statement made by the appropriate party, "In our opinion, the [appropriate party's] statement that the entity has complied with XYZ law is, in all material respects, fairly stated," or "In our opinion, the [appropriate party's] statement that the key performance indicators are presented in accordance with XYZ criteria is, in all material respects, fairly stated."

A179. It may be appropriate to inform the intended users of the context in which the practitioner's conclusion is to be read when the assurance report includes an explanation of particular characteristics of the underlying subject matter of which the intended users should be aware. The practitioner's conclusion may, for example, include wording such as: "This conclusion has been formed on the basis of the matters outlined elsewhere in this independent assurance report."

A180. Examples of conclusions expressed in a form appropriate for a limited assurance engagement include:

- When expressed in terms of the underlying subject matter and the applicable criteria, "Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that [the entity] has not complied, in all material respects, with XYZ law."
- When expressed in terms of the subject matter information and the applicable criteria, "Based on the procedures performed and evidence obtained, we are not aware of any material amendments that need to be made to the assessment of key performance indicators for them to be in accordance with XYZ criteria."
- When expressed in terms of a statement made by the appropriate party, "Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that the [appropriate party's] statement that [the entity] has complied with XYZ law, is not, in all material respects, fairly stated."

A181. Forms of expression that may be useful for underlying subject matters include, for example, one, or a combination of, the following:

- For compliance engagements—"in compliance with" or "in accordance with."
- For engagements when the applicable criteria describe a process or methodology for the preparation or presentation of the subject matter information—"properly prepared."
- For engagements when the principles of fair presentation are embodied in the applicable criteria—"fairly stated."

A182. Inclusion of a heading above paragraphs containing modified conclusions, and the matter(s) giving rise to the modification, aids the understandability of the practitioner's report. Examples of appropriate heading include "Qualified Conclusion," "Adverse Conclusion," or "Disclaimer of Conclusion" and "Basis for Qualified Conclusion," "Basis for Adverse Conclusion," as appropriate.

The Practitioner's Signature (Ref: Para. 69(m))

A183. The practitioner's signature is either in the name of the practitioner's firm, the personal name of the individual practitioner or both, as appropriate for the particular jurisdiction. In addition to the practitioner's signature, in certain jurisdictions, the practitioner may be required to make a declaration in the practitioner's report about professional designations or recognition by the appropriate licensing authority in that jurisdiction.

Date (Ref: Para. 69(n))

A184. Including the assurance report date informs the intended users that the practitioner has considered the effect on the subject matter information and on the assurance report of events that occurred up to that date.

Reference to the Practitioner's Expert in the Assurance Report (Ref: Para. 70)

A185. In some cases, law or regulation may require a reference to the work of a practitioner's expert in the assurance report, for example, for the purposes of transparency in the public sector. It may also be appropriate in other circumstances, for example, to explain the nature of a modification of the practitioner's conclusion, or when the work of an expert is integral to findings included in a long-form report.

A186. Nonetheless, the practitioner has sole responsibility for the conclusion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's expert. It is important therefore that if the assurance report refers to a practitioner's expert, that the wording of that report does not imply that the practitioner's responsibility for the conclusion expressed is reduced because of the involvement of that expert.

A187. A generic reference in a long-form report to the engagement having been conducted by suitably qualified personnel including subject matter experts and assurance specialists is unlikely to be misunderstood as reduced responsibility. The potential for misunderstanding is higher, however, in the case of short-form reports, where minimum contextual information is able to be presented, or when the practitioner's expert is referred to by name. Therefore, additional wording may be needed in such cases to prevent the assurance report implying that the practitioner's responsibility for the conclusion expressed is reduced because of the involvement of the expert.

Unmodified and Modified Conclusions (Ref: Para. 74–77, Appendix)

A188. The term 'pervasive' describes the effects on the subject matter information of misstatements or the possible effects on the subject matter information of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate evidence. Pervasive effects on the subject matter information are those that, in the practitioner's professional judgment:

- (a) Are not confined to specific aspects of the subject matter information;
- (b) If so confined, represent or could represent a substantial proportion of the subject matter information; or
- (c) In relation to disclosures, are fundamental to the intended users' understanding of the subject matter information.

A189. The nature of the matter, and the practitioner's judgment about the pervasiveness of the effects or possible effects on the subject matter information, affects the type of conclusion to be expressed.

A190. Examples of qualified and adverse conclusions and a disclaimer of conclusion are:

- Qualified conclusion (an example for limited assurance engagements with a material misstatement) – "Based on the procedures performed and the evidence obtained, except for the effect of the matter described in the Basis for Qualified Conclusion section of our

report, nothing has come to our attention that causes us to believe that the [appropriate party's] statement does not present fairly, in all material respects, the entity's compliance with XYZ law."

- Adverse conclusion (an example for a material and pervasive misstatement for both reasonable assurance and limited assurance engagements) – "Because of the significance of the matter described in the Basis for Adverse Conclusion section of our report, the [appropriate party's] statement does not present fairly the entity's compliance with XYZ law."
- Disclaimer of conclusion (an example for a material and pervasive limitation of scope for both reasonable assurance and limited assurance engagements) – "Because of the significance of the matter described in the Basis for Disclaimer of Conclusion section of our report, we have not been able to obtain sufficient appropriate evidence to form a conclusion on the [appropriate party's] statement. Accordingly, we do not express a conclusion on that statement."

A191. In some cases, the measurer or evaluator may identify and properly describe that the subject matter information is materially misstated. For example, in a compliance engagement the measurer or evaluator may correctly describe the instances of non-compliance. In such circumstances, paragraph 76 requires the practitioner to draw the intended users' attention to the description of the material misstatement, by either expressing a qualified or adverse conclusion or by expressing an unqualified conclusion but emphasizing the matter by specifically referring to it in the assurance report.

Other Communication Responsibilities (Ref: Para. 78)

A192. Matters that may be appropriate to communicate with the responsible party, the measurer or evaluator, the engaging party or others include fraud or suspected fraud, and bias in the preparation of the subject matter information.

Documentation (Ref: Para. 79–83)

A193. Documentation includes a record of the practitioner's reasoning on all significant matters that require the exercise of professional judgment, and related conclusions. When difficult questions of principle or professional judgment exist, documentation that includes the relevant facts that were known by the practitioner at the time the conclusion was reached may assist in demonstrating the practitioner's knowledge.

A194. It is neither necessary nor practical to document every matter considered, or professional judgment made, during an engagement. Further, it is unnecessary for the practitioner to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the engagement file. Similarly, the practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

A195. In applying professional judgment to assessing the extent of documentation to be prepared and retained, the practitioner may consider what is necessary to provide an understanding of the work performed and the basis of the principal decisions taken (but not the detailed aspects of the engagement) to another practitioner who has no previous experience with the engagement. That other practitioner may only be able to obtain an understanding of detailed aspects of the engagement by discussing them with the practitioner who prepared the documentation.

A196. Documentation may include a record of, for example:

- The identifying characteristics of the specific items or matters tested;
- Who performed the engagement work and the date such work was completed;

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

- Who reviewed the engagement work performed and the date and extent of such review; and
- Discussions of significant matters with the appropriate party(ies) and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

A197. Documentation may include a record of, for example:

- Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- Conclusions on compliance with independence requirements that apply to the engagement, and any relevant discussions with the firm that support these conclusions.
- Conclusions reached regarding the acceptance and continuance of client relationships and assurance engagements.
- The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the engagement.

Assembly of the Final Engagement File

A198. HKSQC 1 (or other professional requirements, or requirements in law or regulation that are at least as demanding as HKSQC 1) requires firms to establish policies and procedures for the timely completion of the assembly of engagement files.⁷ An appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the assurance report.⁸

A199. The completion of the assembly of the final engagement file after the date of the assurance report is an administrative process that does not involve the performance of new procedures or the drawing of new conclusions. Changes may, however, be made to the documentation during the final assembly process if they are administrative in nature. Examples of such changes include:

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

⁷ HKSQC 1, paragraph 45

⁸ HKSQC 1, paragraph A54

The changes with respect to the Companies Ordinance (Cap.622) are effective for financial statements which cover a period beginning on or after 3 March 2014. All other changes are effective upon issue*

Practice Note 810.2 (Revised)

The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance

* There are specific transition arrangements for reporting under Parts 8 and 9 of the Third Schedule to the Insurance Companies Ordinance (Examples 4(a) and (b) of Appendix 2 in this Practice Note), please refer to Appendix 5 of this Practice Note.



**PRACTICE NOTE
810.2 (REVISED)
THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED UNDER
THE INSURANCE COMPANIES ORDINANCE**

(Issued February 2015)

The changes with respect to the Companies Ordinance (Cap.622) are effective for financial statements which cover a period beginning on or after 3 March 2014. All other changes are effective upon issue.)

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Appendix 5 - Transition arrangements

Practice Note (PN) 810.2 (Revised) "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" should be read in the context of the "Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements" which sets out the application and authority of PNs.

**PRACTICE NOTE
810.2 (REVISED)
THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED UNDER
THE INSURANCE COMPANIES ORDINANCE**

The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.

Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.

PART I - GENERAL

Introduction

1. In this Practice Note ("PN") all the sections mentioned below are in respect of the Hong Kong Insurance Companies Ordinance (Cap.41) ("the Ordinance") unless otherwise stated.
2. This PN is intended to give guidance to members on the duties of the auditor of an insurer appointed under section 15 (see paragraphs 21 and 22) or paragraph 4(1A) of Part 1 of the Third Schedule to the Ordinance ("the Third Schedule"). In addition, guidance on the duties of the auditor of an insurance broker appointed under section 72 is also included (see paragraphs 55 to 57). This guidance is set out in Part II of this PN below.

This PN also provides guidance to members when reporting on levies paid to the insolvency schemes for Motor and Employee Compensation, and to the Terrorism scheme for Employee Compensation. This guidance is set out in Part III of this PN below.

It is not intended to provide detailed guidance on the general audit procedures to be adopted in respect of insurance companies and brokers.

3. The PN has been prepared following discussions with the Insurance Authority ("IA").
4. This is a guide to the provisions in the Ordinance which were effective as at 2 May 1997 (i.e. including the amendments introduced by the Insurance Companies (Amendment) Ordinance 1997), prepared for reference only. Every care has been taken in its preparation. However, the legislation itself is the sole authority of the law and the PN should be used in conjunction with the legislation.

**PART II – THE DUTIES OF THE AUDITOR UNDER THE INSURANCE COMPANIES
ORDINANCE**

Scope of the Ordinance

5. The Ordinance is applicable to all persons (companies or individuals) carrying on insurance business in Hong Kong (including insurance brokers) other than those persons noted in paragraph 7 and those specifically exempted by section 51 (see paragraph 8). Insurers which are deemed to carry on insurance business in or from Hong Kong will also fall within the scope of the Ordinance. Section 2(3) provides that a person shall be deemed to carry on insurance business in or from Hong Kong if he opens or maintains an office or agency in Hong Kong for the purpose of carrying on insurance business, or he holds himself out as carrying on insurance business, in or from Hong Kong. Insurers will fall within this scope if they are incorporated in Hong Kong, have a place of business here, are represented here by an agent or are holding themselves out as

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carrying on insurance business in or from Hong Kong. The following would therefore be included within the scope of and required to be authorized under the Ordinance:

- a. a Hong Kong incorporated company carrying on insurance business in Hong Kong;
 - b. a Hong Kong incorporated company carrying on insurance business through an overseas branch or agency, whether or not it is operating as an insurer in Hong Kong;
 - c. an overseas incorporated company carrying on insurance business through a Hong Kong branch;
 - d. an overseas company carrying on insurance business in Hong Kong by means of an agency;
 - e. a captive insurer, as defined in section 2(7);
 - f. reinsurance companies carrying on reinsurance business in or from Hong Kong (but see paragraph 8(b)); and
 - g. any other person holding himself out as carrying on insurance business in or from Hong Kong.
6. The location of the risks is not relevant in determining whether a particular entity falls within the scope of the Ordinance. Thus, for example, an insurer or a reinsurer who is incorporated overseas and who has not established a place of business in Hong Kong, is not represented by an agent in Hong Kong, and does not hold himself out as carrying on insurance business in or from Hong Kong, can accept insurance or reinsurance premiums relating to Hong Kong risks, without having to be authorized under the Ordinance.
7. Under section 6(1), Lloyd's and an association of underwriters approved by the IA are allowed to carry on insurance business in or from Hong Kong without having to be authorized under the Ordinance. Also, the following persons, although involved in insurance business, do not have to be authorized under the Ordinance:
- a. a Hong Kong incorporated company with an overseas incorporated subsidiary that carries on insurance business outside Hong Kong, provided that the Hong Kong holding company is not itself an insurer;
 - b. an insurance agent (being a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or subagent of one or more insurers). However, an insurer is required to register its appointed insurance agents in accordance with section 66 and the IA has the power, also under section 66, to direct the insurer to de-register its appointed insurance agents under certain conditions.
8. Section 51 specifically exempts the following persons from the provisions of the Ordinance:
- a. any body of persons carrying on insurance business in Hong Kong whose gross premiums do not exceed HK\$500,000 in any financial year and who are bound together for certain specified purposes but not for the purpose of gain;
 - b. persons carrying on only reinsurance business in Hong Kong (unless incorporated in Hong Kong or, if incorporated elsewhere, who have a place of business in Hong Kong or are represented in Hong Kong by an agent or any other person or partnership having a place of business in Hong Kong);
 - c. registered trade unions (subject to certain limitations);
 - d. registered co-operative societies;

- e. the Hong Kong Export Credit Insurance Corporation;
 - f. banks, restricted licence banks and deposit-taking companies carrying on insurance business, limited to certain long term or general insurance business carried on solely for the purposes of their banking or deposit-taking business;
 - g. the Credit Union League of Hong Kong;
 - h. a recognized clearing house (as defined in section 51(h));
 - i. a person who is authorized under Part III of the Securities and Futures Ordinance (as defined in section 51(i)).
9. Under section 53 the Chief Executive in Council has power to exempt any insurer from any of the provisions of the Ordinance or to modify or vary any of its provisions in respect of any insurer.

Financial information to be submitted by insurers

10. Section 20 requires two copies of the audited financial information required by the Third Schedule (as detailed in paragraph 11 and summarised in Appendix 1) to be submitted to the IA within six months of the end of the financial period to which they relate. At the same time, where an insurer is a company, section 21 requires that a copy of each document, except those required by Parts 8 and 9 of the Third Schedule (i.e. the returns on Hong Kong long term and/ or general businesses and statement of assets and liabilities), should be deposited with the Registrar of Companies.

11. Requirements for submitting financial information to the IA include:

- a. Statutory requirements

The Third Schedule requires, amongst other things, the following to be submitted annually to the IA:

- i. a report by the directors with respect to the profit or loss of the insurer for the financial year and the state of the insurer's affairs as at the end thereof (the detailed disclosure requirements of which are set out in Part 2 of the Third Schedule);
- ii. a balance sheet;
- iii. a revenue account;
- iv. a profit and loss account.

Where an insurer carrying on long term business only, or a captive insurer, is a holding company, whether or not it is itself a subsidiary of another body corporate, the statements in (ii) to (iv) above must in addition contain the equivalent consolidated information relating to the insurer and its subsidiaries.

Where an insurer is authorized to carry on general business:

- v. a return on Hong Kong business;
- vi. a statement of assets and liabilities (not applicable to reinsurers or captive insurers).

Where an insurer is authorized to carry on long term business:

- vii. a return on Hong Kong long term business.

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The detailed disclosure requirements for the statements in (ii) to (iv) above are outlined in Parts 3 to 5 of the Third Schedule while those relating to the returns referred to in (v) and (vii) above and the statement referred to in (vi) above are covered in Parts 8 and 9 of the Third Schedule respectively.

An auditor's report is required in respect of each of the statements referred to in (ii) to (iv) above (see paragraph 27), the returns referred to in (v) and (vii) above (see paragraphs 28 and 29) and the statement referred to in (vi) above (see paragraph 30).

b. Other requirements

Although it is not a statutory requirement, the IA requires an insurer to submit annually an audited cash flow statement in addition to the statutory requirements in (i) and (iv) above based on its previous circular.

12. The requirements for the submission of these statements to the IA do not override the requirements of the Companies Ordinance. Insurance companies which are incorporated in Hong Kong are also required to produce financial statements to lay before the shareholders in general meeting and these financial statements have to comply with the disclosure provisions of the Companies Ordinance.

Holding company

13. It should be noted that the additional provisions relating to an insurer which is a holding company (Part 3 (paragraphs 10 to 13) of the Third Schedule) may result in consolidated financial statements being prepared where none are required under the Companies Ordinance. Paragraph 10 of the Third Schedule provides that Part 3 of the Third Schedule shall apply to an insurer carrying on long term business only, or a captive insurer that is a holding company, whether or not it is itself a subsidiary of another body corporate. This means that such an insurer authorized in Hong Kong must prepare its own consolidated financial statements even if it is the wholly-owned subsidiary of a parent company, whether or not that parent company is an insurer. Where a group is structured vertically with each subsidiary or sub-subsidiary being an insurer in its own right, each holding company in the group will have to submit group financial statements in respect of its own subgroup. Depending on the merits of individual insurer, it may be possible for the insurer to obtain a modification of the Third Schedule requirements by making an application under section 17(2).
14. Apart from the requirements under Parts 8 and 9, which are in respect of Hong Kong Insurance Business and Hong Kong Long Term Insurance Business (as defined in paragraph 1(1) of the Third Schedule) only, the information to be submitted under the Third Schedule shall be in respect of the total business of the insurer.

Hong Kong branch

15. Where an overseas company carries on insurance business in Hong Kong through a branch, the information required by the IA apart from the requirements under Parts 8 and 9 must relate to the company's worldwide position. In this respect it should be noted that section 17(2) permits the IA to modify or vary any of the requirements of the Third Schedule in relation to an insurer, provided that the insurer requests such a modification in writing. The IA has indicated that it may be prepared to modify or vary the requirements of the Third Schedule in respect of an overseas company incorporated in a country where the insurer is subject to an acceptable standard of prudential supervision depending on the merits of individual insurer. The auditor who audits a Hong Kong branch of such company is therefore recommended to suggest to the client that the insurer discusses with the IA.
16. According to the IA, submission of audited branch financial statements is one of the standard requirements for the giving or renewal of an accounting concession under section 17(2).
- a. Unless specifically required by the IA, the audited branch financial statements need not comply with the requirements of the Insurance Companies (General Business) (Valuation)

Regulation. They shall, however, comply so far as applicable with the requirements of the Third Schedule.

- b. The audited branch financial statements would normally include a revenue account, and/or a profit and loss account, a balance sheet, a cash flow statement and notes thereto.

The auditor of the branch is required to ascertain whether the financial statements have been prepared in accordance with the IA's conditions on accounting concession granted to the branch. The IA would normally require the branch to submit financial statements prepared in accordance with the Hong Kong Financial Reporting Standards (HKFRSs) and audited by certified public accountants who are qualified under the Professional Accountants Ordinance (Cap.50) (and not disqualified under section 393(2) of the Companies Ordinance) for appointment as auditors of a company. Financial statements prepared in accordance with the HKFRSs will be needed in order for the auditor to issue a report for Part 8 for the financial year ending on or after 31 December 2015. The relevant transition arrangement is set out in Appendix 5.

Requirement for assets in Hong Kong

17. General and composite insurers, other than captive insurers or persons authorized to carry on reinsurance business only, are required by section 25A to maintain assets in Hong Kong at all times in respect of their liabilities as of the end of the last preceding year, arising from Hong Kong Insurance Business, and to file a statement of assets and liabilities with the IA annually to ensure compliance. The Eighth Schedule to the Ordinance sets out a list of assets which qualify as assets in Hong Kong. The auditor's requirements to report on this statement are set out in paragraph 30. Where the insurer has entered into contracts of reinsurance for which the premiums payable exceeded 50% of the gross premiums received, such assets shall be at least equal to the greater of:
 - a. the aggregate of:
 - i. 80%¹ of its liabilities after deducting the amount in respect of which contracts of reinsurance have been entered into; and
 - ii. the relevant amount (see paragraph 18); and
 - b. the aggregate of:
 - i. 40% of its liabilities before deducting the amount in respect of which contracts of reinsurance have been entered into; and
 - ii. the relevant amount (see paragraph 18).

Where the insurer has not entered into contracts of reinsurance for which the premiums payable exceeded 50% of the gross premiums received, then such assets shall be at least equal to the amount determined in (a) above.

18. "Relevant amount" means the relevant amount determined in accordance with section 10 (see paragraph 38) except that:
 - a. the reference to gross premium income in that section shall, for the purposes of section 25A, be deemed to be the gross premium income arising from the insurer's Hong Kong Insurance Business only; and
 - b. the references to claims outstanding, additional amount for unexpired risks and fund in section 10 shall, for the purposes of section 25A, be deemed to be the claims outstanding, additional amount for unexpired risks and fund respectively arising from the insurer's Hong Kong Insurance Business only.

¹ The IA may increase the percentage on individual case basis.

19. The value of assets and the amounts of liabilities shall be determined in accordance with any applicable valuation regulations made under section 59(1)(a). Existing valuation regulations at the time of issue of this PN are covered in paragraphs 41 to 51.
20. Pursuant to section 25A(8), if an insurer is required by law to, and does, maintain assets in a place outside Hong Kong for the sole purpose of making preferential payments to policyholders in respect of claims payable relating to Hong Kong insurance business where the insurer is in liquidation, then the assets to be maintained in Hong Kong by section 25A shall be reduced by the amount of these assets.

Appointment of the auditor

21. Under section 15, the insurer must appoint an auditor ("the Appointed auditor") who is:
 - a. qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance); or
 - b. qualified as an auditor in the country of incorporation, if the insurer is incorporated outside Hong Kong and who holds such qualification as the IA accepts as being of a comparable standard to that of a person referred to in (a) above.

Financial information and statements to be submitted by an insurer under Parts 3, 4 and 5 of the Third Schedule, as appropriate, must be audited by the Appointed auditor.

22. The forms and statements to be submitted by an insurer under Parts 8 and 9 of the Third Schedule must be audited by an auditor who is qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance). This auditor may or may not be the Appointed auditor of the insurer referred to in paragraph 21.
23. The insurer must notify the IA in writing of any appointment of, or change in, its Appointed auditor within one month. The first auditor must be appointed within one month of the insurer beginning to carry on insurance business. It is recommended that before beginning the audit the auditor ensures that he/ she has been formally appointed under the Ordinance and that the IA has been notified of the appointment. The IA keeps a record of all the Appointed auditors of insurers for its own use.
24. Section 15A(1) requires that the insurer immediately notifies the IA in writing if for any reason a person appointed under section 15 ceases to be the Appointed auditor or a Hong Kong incorporated insurer proposes to give notice to its shareholders of a resolution removing/replacing the Appointed auditor.
25. Section 15A(2) requires the Appointed auditor to notify the IA in writing immediately if the auditor resigns, decides not to seek reappointment, or decides to qualify any of the auditor's reports required in respect of the information to be submitted under the Third Schedule. Further guidance on this obligation may be found in PN 620.2 "Communications between the auditor and the Insurance Authority" issued by the HKICPA.

The auditor's reports

26. Separate requirements apply in respect of auditor's reports on the financial information, forms and statements required by the Third Schedule for different categories of insurers. These are set out below and in Appendix 1. Suggested forms of wording for each report are included in Appendix 2.
27. Paragraph 4 of Part 1 of the Third Schedule requires the auditor to audit the financial information prepared in accordance with Parts 3, 4 and 5 of that Schedule (being a balance sheet, revenue account, profit and loss account and, where applicable, consolidated financial statements) and to state in the auditor's report the items set out below. Definitions of "relevant premium income" and

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"relevant claims outstanding" are contained in paragraphs 32 to 37. Solvency requirements are set out in paragraph 38.

The auditor is required to state:

In the case of a general insurer other than a captive insurer,

- a. the relevant premium income and relevant claims outstanding of, and the relevant amount as defined in section 10 (see paragraph 38) in the case of, the insurer;
- b. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by that relevant amount;
- c. whether in the auditor's opinion proper records have been maintained in accordance with section 16; and
- d. whether in the auditor's opinion the balance sheet, revenue account and profit and loss account have been properly prepared in accordance with the provisions of the Ordinance.

In the case of an insurer carrying on long term business only,

- a. the greater of:
 - i. the relevant amount as defined in section 10 (see paragraph 38) in the case of the insurer, and
 - ii. the required margin of solvency, as determined by the insurer's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation;
- b. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by the amount under (a) above;
- c. whether in the auditor's opinion proper records have been maintained in accordance with section 16;
- d. whether in the auditor's opinion the balance sheet, revenue account, profit and loss account and (if it is a holding company submitting group financial statements) the group financial statements have been properly prepared in accordance with the provisions of the Ordinance; and
- e. whether in the auditor's opinion the financial statements give a true and fair view of:
 - i. the state of the insurer's affairs;
 - ii. the insurer's profit or loss for the financial year (if the financial statements are unconsolidated); and
 - iii. the state of the group's affairs and of its profit or loss for the financial year (in the case of group financial statements).

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In the case of a captive insurer,

- a. the net premium income and net claims outstanding of, and the relevant amount as defined in section 10 (see paragraph 38) in the case of, the insurer;
- b. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by that relevant amount;
- c. whether in the auditor's opinion proper records have been maintained in accordance with section 16;
- d. whether in the auditor's opinion the balance sheet, revenue account, profit and loss account and (if it is a holding company submitting group financial statements) the group financial statements have been properly prepared in accordance with the provisions of the Ordinance; and
- e. whether in the auditor's opinion the financial statements give a true and fair view of:
 - i. the state of the insurer's affairs;
 - ii. the insurer's profit or loss for the financial year (if the financial statements are unconsolidated); and
 - iii. the state of the group's affairs and of its profit or loss for the financial year (in the case of group financial statements).

In the case of a composite insurer,

- a. the relevant premium income and relevant claims outstanding of, and the relevant amount as defined in section 10 (see paragraph 38) in the case of, the insurer's general business;
 - b. the greater of:
 - i. the relevant amount as defined in section 10 (see paragraph 38), and
 - ii. the required margin of solvency, as determined by the insurer's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation in the case of the insurer's long term business;
 - c. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by the aggregate of the relevant amount under (a) and the amount under (b) above;
 - d. whether in the auditor's opinion proper records have been maintained in accordance with section 16;
 - e. whether in the auditor's opinion the balance sheet, revenue account and profit and loss account have been properly prepared in accordance with the provisions of the Ordinance; and
 - f. whether in the auditor's opinion the financial statements give a true and fair view of the financial position of the insurer's long term business.
28. For insurers carrying on general insurance business, paragraph 4(1A)(a) of Part 1 of the Third Schedule requires the auditor to audit the forms (except Form HKL1) prepared in accordance with Part 8 of the Third Schedule (often referred to as the general business returns). The auditor is required to state:

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- a. whether in the auditor's opinion proper records have been maintained in accordance with section 16 for the purposes of preparing the forms;
 - b. whether the forms have been properly prepared in accordance with those records; and
 - c. whether the information supplied in the forms is prepared, in all material respects, in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance and, on that basis, the forms, when read in conjunction with the insurer's audited financial information for the year then ended prepared in accordance with Hong Kong Financial Reporting Standards and the provisions of the Ordinance, gives a true and fair view of the insurer's underwriting results pertaining to the Hong Kong Insurance Business for the year then ended.
29. For insurers carrying on long-term insurance business, paragraph 4(1A)(aa) of Part 1 of the Third Schedule requires the auditor to report on Form HKL1 prepared in accordance with Part 8 of the Third Schedule (revenue account), and to state:
- a. whether in the auditor's opinion proper records have been maintained in accordance with section 16 for the purposes of preparing the form; and
 - b. whether the form has been properly prepared in accordance with those records.
30. For insurers carrying on general insurance business, paragraph 4(1A)(b) of Part 1 of the Third Schedule requires the auditor to audit the statement of assets and liabilities ("the statement") prepared in accordance with Part 9 of the Third Schedule, and to state:
- a. whether in the auditor's opinion proper records have been maintained in accordance with section 16 for the purposes of preparing the statement;
 - b. whether the statement has been properly prepared in accordance with those records;
 - c. whether the values of the assets and liabilities have been determined in accordance with any applicable valuation regulations;
 - d. whether the relevant amount as defined in section 10 has been determined in accordance with section 25A(1) (see paragraph 18); and
 - e. where the statement is submitted pursuant to:
 - i. section 25A(9), the assets held by the insurer, as shown in the statement, enable it to comply with the requirement stipulated in section 25A as at the last day of the financial year and two such other dates in the financial year as the auditor may elect, provided that the intervening period between those two dates shall not be shorter than three months; or
 - ii. section 25B(3)(b), the assets held by the insurer, as shown in the statement, enable it to comply with the requirement stipulated in section 25B as at the date specified in the notice issued under that section.

Notwithstanding section 25A(3) which states that an insurer shall, at all times, maintain assets in Hong Kong in respect of its liabilities, as of the end of the last *preceding* financial year, it has been agreed with the IA that for the purposes of checking compliance with section 25A, the auditor compares the assets with liabilities on the last day of the *current* financial year as well as the assets at two dates during the year, as elected by the auditor, with the liabilities at the *preceding* financial year end date.

The auditor may add qualifications, amplifications or explanations to the auditor's reports as necessary.

31. The auditor's report required in respect of the financial information prepared in accordance with Parts 3, 4 and 5 of the Third Schedule relates to the financial information, which has to be submitted to the IA and the Registrar of Companies. Where the insurer is incorporated in Hong Kong, financial statements will also have to be prepared for the members in accordance with the applicable requirements of the Companies Ordinance. The auditor will be required to issue two separate audit reports, one for the members on the Companies Ordinance financial statements, and one addressed to the directors who will have the responsibility for submitting the financial information required by the Third Schedule to the IA. The report addressed to the directors will refer to the financial information prepared in accordance with the provisions of the Ordinance (see Appendix 2 for report format). The audit report addressed to members and relating only to the Companies Ordinance financial statements will also have to be submitted to the IA under section 20(5) (see Appendix – Illustration 1 of HKSA 700 "Forming an Opinion and Reporting on Financial Statements" for report format).

Definitions of "relevant premium income" and "relevant claims outstanding"

32. "Relevant premium income" is defined as the greater of:
- a. 50% of the annual gross premium income of the company; and
 - b. gross premium income less premiums payable by the company in respect of reinsurance.

Gross premium income is defined in section 10(4)(c) as the premiums receivable in that financial year in respect of all insurance business other than long term business. Premiums receivable are defined as the premiums paid or payable to an insurer in respect of contracts written or renewed in that financial year before deducting commissions of agents or brokers but after deducting any discounts specified in policies or refunds of premiums made in respect of any termination or reduction of risks. Discounts specified in policies are generally discounts that relate to the reduction of risks which are being underwritten and should not contain an element of rebate as regards the premiums paid by the insured. Gross premium income as defined above will normally be the amount disclosed in the revenue account under the requirements of paragraph 24(1)(a) of the Third Schedule, provided that the amounts recorded are consistent with the amounts written in the year. It should be noted however that this will not be the same as the earned premiums accounted for on an accruals basis since the former is based on all contracts written in the financial year.

33. "Relevant claims outstanding" is defined as:
- a. where no class of the general business of the insurer is accounted for on a fund accounting basis, the aggregate of the following:
 - i. an amount equal to 50% of the claims outstanding (see paragraph 35) before deducting any amount recoverable from reinsurers thereon, or the amount of claims outstanding after deducting any amount recoverable from reinsurers thereon, whichever is the greater; and
 - ii. the additional amount for unexpired risks (see paragraph 36);
 - b. where all classes of the general business are accounted for on a fund accounting basis, the fund (see paragraph 37);
 - c. where part of the general business is accounted for on a fund accounting basis, the aggregate of the following:
 - i. in respect of *that* part, the fund (see paragraph 37); and
 - ii. in respect of *the other* part of that business:

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- an amount equal to 50% of the claims outstanding (see paragraph 35) before deducting any amount recoverable from reinsurers thereon, or the amount of claims outstanding after deducting any amount recoverable from reinsurers thereon, whichever is the greater; and
 - the additional amount for unexpired risks (see paragraph 36).
34. "Claims outstanding", "additional amount for unexpired risks" and "fund" are defined in paragraph 1(1) of Part 1 of the Third Schedule.
35. "Claims outstanding" is defined as, the amount set aside by an insurer as at the beginning or end of its financial year as being an amount likely to be sufficient to meet:
- a. claims in respect of incidents occurring:
 - i. in the case of an amount set aside as at the beginning of the financial year, before the beginning of that year; and
 - ii. in the case of an amount set aside at the end of the financial year, before the end of that year,being claims which have not been treated as claims paid and including claims relating to business accounted for over a longer period than a financial year, claims the amount of which have not been determined and claims arising out of incidents that have not been notified to the insurer; and
 - b. expenses (such as legal, medical, surveying and engineering costs) which have been incurred but not yet recorded as paid or which are likely to be incurred by the insurer, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual claims which relate to incidents occurring before the beginning or the end of the financial year (as the case may be), whether or not the individual claims in question are those mentioned above.
36. "Additional amount for unexpired risks" (otherwise known as premium deficiency) means the amount set aside by an insurer at the end of its financial year, in addition to any unearned premiums, which is considered necessary to meet the cost of claims and expenses of settlement arising from risks to be borne by the insurer after the end of the financial year under contracts of insurance entered into before the end of that year.
37. "Fund", in relation to general business recorded as commencing in any financial year of an insurer but accounted for over a period longer than that financial year, means, during such period, an amount not less than the aggregate amount of the premiums receivable during that period (net of reinsurance premiums payable) reduced by the aggregate amount of the claims paid (net of reinsurance recoveries), expenses for settling claims, commission (net of reinsurance commission receivable) and premium taxes in respect of that business and any management expenses attributable to the management of the fund, and after the end of such period, means such amount as is considered necessary to discharge the remaining obligations (net of reinsurance) in respect of that business.

Solvency requirements

38. a. Each company authorized to conduct general business in or from Hong Kong (except a captive insurer) must maintain an excess of assets over liabilities by a relevant amount (often referred to as solvency margin) equivalent to 20% of relevant premium income or relevant claims outstanding, whichever is higher, up to HK\$200 million plus 10% of relevant premium income or relevant claims outstanding in excess of HK\$200 million. The minimum relevant amount required is HK\$10 million (HK\$20 million if authorized for statutory business).

- b. Each company authorized to conduct long term business in or from Hong Kong must maintain an excess of assets over liabilities by an amount equivalent to the greater of the relevant amount of HK\$2 million and the margin of solvency calculated in accordance with the Insurance Companies (Margin of Solvency) Regulation. At least the greater of HK\$2 million and one-sixth of the margin of solvency must be held in funds maintained in respect of its long term business (other than class G or H business specified in Part 2 of the First Schedule to the Ordinance).
- c. Each company authorized to conduct composite business in or from Hong Kong must maintain an excess of assets over liabilities by an amount equivalent to the aggregate of the amounts determined in accordance with (a) and (b) above.
- d. Each company authorized to conduct business as a captive insurer in or from Hong Kong must maintain an excess of assets over liabilities by a relevant amount equivalent to 5% of net premium income or net claims outstanding, whichever is higher. The minimum relevant amount is HK\$2 million.

A summary of solvency requirements is set out in Appendix 3 for easy reference.

Value of assets and liabilities

39. The calculation of relevant premium income, relevant claims outstanding and the relevant amount applicable (see paragraph 38), and the required margin of solvency as determined by the insurer's appointed actuary are required in order to enable the auditor to state in the auditor's report, whether in the auditor's opinion the value of the assets of the insurer exceed its liabilities by the required amount applicable according to the Ordinance. The required amount is determined as being the relevant amount applicable in relation to an insurer's general and captive insurance business and the greater of the relevant amount and the required margin of solvency in relation to an insurer's long term business. An insurer is under an obligation to ensure that the value of the assets exceed its liabilities by the required amount at all times but it is recommended that the auditor only verifies the position at the balance sheet date and two such other dates in the financial year as the auditor may elect, provided that the intervening period between those two dates shall not be shorter than three months. If the value of the assets does not exceed its liabilities by the relevant amount applicable, the insurer is deemed to be unable to pay its debts under section 42 and can be wound up.
40. Subject to any relevant valuation regulations issued under section 59(1)(a) (see paragraphs 41 to 51), it is necessary to base the calculation on the provisions laid down in section 8. This section requires assets to be valued having regard to their market value and the cost of realising such assets. In computing the amount of liabilities, all contingent and prospective liabilities shall be taken into account but not liabilities in respect of the insurer's share capital. In determining the amount of these liabilities, regard shall be made to cost of settlement of such liabilities and, where the amount of any such liabilities is assessed or estimated, to the experience of the insurer in carrying on any relevant insurance business or of other persons carrying on the same or similar insurance business.

Valuation Regulation for companies carrying on general business

41. In accordance with section 8(4)(b), the valuation of assets and liabilities of an insurer whose business includes or will include general business, other than a captive insurer, should be determined in accordance with the Insurance Companies (General Business) (Valuation) Regulation ("Valuation Regulation") issued in December 1995.
42. Different requirements are made in the Valuation Regulation in respect of different categories of assets. The major categories of assets in respect of which more detailed provisions are made, and the relevant sections in the Valuation Regulation, include:
 - a. land and buildings (section 3);
 - b. listed shares or securities, unit trusts or mutual funds (section 4);

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- c. shares in investment subsidiaries (section 5);
- d. shares in other insurers (section 6);
- e. other unlisted shares (section 7);
- f. unlisted securities (section 8); and
- g. premiums receivable (section 9).

Some provisions are also made in respect of:

- a. intangible assets and deferred acquisition costs (section 10);
 - b. discounting of claims (section 11); and
 - c. additional amount for unexpired risks (section 12).
43. Section 14 of the Valuation Regulation stipulates admissibility limits for the different categories of assets to ensure a prudent spread of investments. The admissibility limits are applicable to the financial information prepared in accordance with Parts 4 and 5 of the Third Schedule only. This section of the Valuation Regulation does not apply to the assets of an insurer required to be maintained in Hong Kong under section 25A or 25B and therefore does not apply to the statement of assets and liabilities prepared under Part 9 of the Third Schedule.
44. Notwithstanding that the value given to an asset of an insurer is permissible under the Valuation Regulation, if, in all circumstances of the case, it appears that the asset is of a lesser value than that given, such lesser value is to be the value of the asset (section 15 of the Valuation Regulation).
45. The Valuation Regulation reaffirms that where no provision for valuation is made under the Valuation Regulation in respect of any asset or liability, section 8(4)(c) continues to apply (section 13 of the Valuation Regulation).
46. In the case of a company carrying on or intending to carry on business as a captive insurer, the values of assets and liabilities may be determined in accordance with section 8.
47. Liabilities are defined in section 8(4) as including all contingent and prospective liabilities but excluding liabilities in respect of the insurer's share capital. Where specific valuation rules are not applicable, regard should be had to the cost of settlement of the liabilities and, where estimates are necessary, to the experience of the insurer in carrying on any relevant insurance business or of other persons carrying on the same or similar insurance business.
48. For the purpose of valuing the amount of liabilities, contingent liabilities will be assessed on the probability of their crystallisation. Generally it will be the auditor's responsibility to have regard to the nature of the contingency, the uncertainties which are expected to affect the ultimate outcome and a prudent estimate of the financial effect.

Liabilities Regulation for companies carrying on long term business

49. Where the liabilities of an insurer are in respect of long term business, they must be determined in accordance with the Insurance Companies (Determination of Long Term Liabilities) Regulation ("Liabilities Regulation").
50. The general principles and certain specific factors underlying the determination of long term liabilities are laid down in section 4 of the Liabilities Regulation. Generally, they shall be determined on actuarial principles, having due regard to the reasonable expectations of policyholders. Proper provisions shall be made for liabilities on a prudent basis including an allowance for adverse variations of relevant assumptions, and provisions shall be made for all

prospective liabilities as determined by the policy conditions for each contract, taking account of future premiums.

51. Specific requirements of the Liabilities Regulation, and the sections of that Regulation in which they are covered, are made in respect of options and guarantees (section 10), expenses (section 12), valuation of future premiums (section 14) and acquisition expenses (section 15). Section 5 of the Liabilities Regulation requires prospective calculations to be used in preference to retrospective calculations where possible.

Proper records

52. The Ordinance requires the auditor to state specifically in the auditor's report whether proper records have been maintained in accordance with section 16.
53. Without prejudice to the Companies Ordinance, section 16 requires the insurer to keep proper books of account which sufficiently exhibit and explain all transactions entered into by the insurer in the course of any business carried on by him. These books can be kept either in a legible form or in a non-legible form capable of being reproduced in a legible form. The Ordinance also requires adequate precautions to be taken to guard against falsification of these records and to facilitate the discovery of any such falsification. In the case of an overseas insurer carrying on insurance business through a branch or an agency, the IA would normally require books to be kept in respect of all its branch or agency business carried on in or from Hong Kong.
54. These books of account must be kept for seven years from the end of the financial year to which the last entry made or matter recorded therein relates.

Insurance brokers

55. Section 65 states that an insurer may not accept any business from an insurance broker in Hong Kong unless that broker is authorized. An authorized insurance broker may be an insurance broker directly authorized by the IA or a member of a body of insurance brokers approved by the IA. Sections 69 and 70 set out the requirements to be complied with by insurance brokers and bodies of insurance brokers in order to obtain the relevant authorization and approval.
56. Under section 72, the insurance broker must appoint an auditor who is:
 - a. qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance); or
 - b. qualified as an auditor in the country of incorporation, if the insurance broker is incorporated outside Hong Kong and who holds such qualification as the IA accepts as being of comparable to that of a person referred to in (a) above.
57. The auditor of an insurance broker is required to report on the broker's financial statements to its proprietor (in the case of an unincorporated broker) or its shareholders (in the case of an incorporated broker). The auditor is also required to report on an insurance broker's compliance with the minimum requirements. For further guidance on this area, members may refer to PN 810.1 "Insurance brokers - compliance with the minimum requirements specified by the Insurance Authority under sections 69(2) and 70(2) of the Insurance Companies Ordinance" issued by the HKICPA.

Communications between the auditor and the IA

58. Section 53D introduces statutory protection for an auditor from liability to the client for breach of confidentiality when he/ she communicates directly with the IA in good faith on matters relevant to any functions of the IA under the Ordinance. Sections 15A(2) (see paragraph 25) and 53E impose a statutory obligation on the auditor to report certain matters directly to the IA. Members may refer to PN 620.2 for further guidance in this area.

PART III – OTHER REPORTING

Annual return on employees' compensation gross premium

59. The Hong Kong Government (the "Government") has entered into an agreement with some authorized insurers for the provision of a facility covering terrorism risk in respect of employees' compensation insurance business. Under the agreement, the insurer is required to pay a monthly charge to the Government based on the gross premium in respect of the employees' compensation business written. An annual return together with a report by the auditor are required to be submitted to the IA within four months after the end of each financial year on the amounts of gross premium for the financial year and the charge payable thereon to the Government. For the IA's easy identification of the annual return which is reported on by the auditor, the auditor should bind the annual return together with the report thereon and stamp the identification chop on each page of the annual return. An auditor should conduct such an engagement in accordance with HKSAE 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information". An example auditor's report is set out in Example 1 in Appendix 4.

Report on levies paid to the insolvency scheme for motor compensation insurance

60. All insurance companies in Hong Kong that are authorized by the Government to write motor vehicle insurance are required to be members of the Motor Insurers' Bureau of Hong Kong ("MIB"). Each member has entered into an agreement with the MIB to contribute such funds as may be required by the MIB to meet its objectives, and furnish particulars of motor premium income and submit such report as the MIB may from time to time deem necessary. A practitioner should conduct such an engagement in accordance with HKSRS 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information". An example report is set out in Example 2 in Appendix 4.

Report on levies paid to the insolvency scheme for employees' compensation insurance

61. All insurance companies in Hong Kong who are authorized by the Government to write direct employees compensation insurance business are required to be members of the Employees Compensation Insurer Insolvency Bureau ("ECIIB"). Each member has entered into an agreement with the ECIIB to contribute such funds as may be required by the ECIIB to meet its objectives, and furnish particulars of employees' compensation premium income and submit such report as the ECIIB may from time to time deem necessary. A practitioner should conduct such an engagement in accordance with HKSRS 4400. An example report is set out in Example 3 in Appendix 4.

Appendix 1

What does the insurer need to submit to the IA?

The following summary lists out the references to different Parts of the Third Schedule to the Insurance Companies Ordinance and also includes the paragraph references in Part 1 of that Schedule that set out the reporting requirements.

| | Parts 3 ² , 4 and 5: Financial Information | | Part 8 ³ : Return on Hong Kong business | | Part 9 ³ : Statement on Hong Kong assets and liabilities under Hong Kong business | Notes |
|--|---|--------------------|--|----------------------|--|-------|
| | Part 3 | Parts 4, 5 | Forms 1-9 | Form HKL1 | | |
| General insurer | - | √ Para.4.(1AB) | √ Para.4.(1A)(a) | - | √ Para.4.(1A)(b) | a) |
| Long term insurer (including pure reinsurer) | √ Para.4.(1)* | √ Para.4.(1)* | - | √ Para.4.(1A)(aa) | - | b) |
| Composite insurer | - | √ Para.4.(1AC)^ | √ Para.4.(1A)(a) | √ Para.4.(1A)(aa) | √ Para.4.(1A)(b) | c) |
| Captive insurer | √ Para.4.(1AD)* | √ Para.4.(1AD)* | √ Para.4.(1A)(a) | | | |
| Pure reinsurer (General) | | √ Para.4.(1AB) | √ Para.4.(1A)(a) | | | |
| Pure reinsurer (Composite) | | √ Para.4.(1AC)^ | √ Para.4.(1A)(a) | √ Para.4.(1A)(aa) | | |
| Lloyd's | | | √ Para.4.(1A)(a) | | √ Para.4.(1A)(b) | |

* True and fair opinion required

^ True and fair opinion required in respect of the life insurance business only

² Part 3 of the Third Schedule deals with additional provisions relating to an insurer which is a holding company. It applies to an insurer carrying on long term business only or a captive insurer, which is a holding company preparing consolidated financial statements.

³ Part 8 return and Part 9 statement should be prepared in respect of the insurer's Hong Kong Insurance Business only.

Notes

a) General Insurer

i) *Financial information prepared under Parts 4 and 5 of the Third Schedule*

This financial information is submitted to the Insurance Authority by a general insurer. Part 4 deals with general provisions relating to the balance sheet. Part 5 deals with general provisions relating to the revenue account and profit and loss account.

The requirement to audit this financial information including the opinions to be given is set out in paragraph 4(1AB) of Part 1 of the Third Schedule. An example auditor's report is set out as Example 1 in Appendix 2.

ii) *Forms prepared under Part 8 of the Third Schedule*

These forms are submitted to the Insurance Authority by a general insurer. These forms are in respect of the Hong Kong insurance business only as defined in Part 1 of the Third Schedule.

The requirement to report on these forms including the opinions to be given is set out in paragraph 4(1A)(a) of Part 1 of the Third Schedule. The general insurer prepares the standard forms to which the auditor will annex the auditor's report. An example auditor's report is set out as Example 4(a) in Appendix 2.

iii) *Statement prepared under Part 9 of the Third Schedule*

This statement is submitted to the Insurance Authority by a general insurer. This statement is in respect of the Hong Kong assets and liabilities as defined in Section 25A of the Ordinance.

The requirement to report on this statement including the opinions to be given is set out in paragraph 4(1A)(b) of Part 1 of the Third Schedule. The general insurer prepares the statement under Part 9 and auditor will annex the auditor's report. An example auditor's report is set out as Example 4(b) in Appendix 2.

b) Long term insurer

i) *Financial information prepared under Parts 3, 4 and 5 of the Third Schedule*

This financial information is submitted to the Insurance Authority by a long term insurer. Part 3 deals with additional provisions relating to a long term insurer which is a holding company. Part 4 deals with general provisions relating to the balance sheet. Part 5 deals with general provisions relating to the revenue account and profit and loss account.

The requirement to audit this financial information including the opinions to be given is set out in paragraphs 4(1) and (1AA) of Part 1 of the Third Schedule. An example auditor's report is set out as Example 2 in Appendix 2.

ii) *Form HKL1 prepared under Part 8 of the Third Schedule*

This form is submitted to the Insurance Authority by a long term insurer. This form is in respect of the Hong Kong long term insurance business only as defined in Part 1 of the Third Schedule.

The requirement to report on this form including the opinions to be given is set out in paragraph 4(1A)(aa) of Part 1 of the Third Schedule. The long term insurer prepares the standard form to which the auditor will annex the auditor's report. An example auditor's report is set out as Example 5 in Appendix 2.

c) Composite insurer

i) *Financial information prepared under Parts 4 and 5 of the Third Schedule*

This financial information is submitted to the Insurance Authority by a composite insurer. Part 4 deals with general provisions relating to the balance sheet. Part 5 deals with general provisions relating to the revenue account and profit and loss account.

The requirement to audit this financial information including the opinions to be given is set out in paragraph 4(1AC) of Part 1 of the Third Schedule. An example auditor's report is set out as Example 3 in Appendix 2.

ii) *Forms prepared under Part 8 of the Third Schedule*

These forms are submitted to the Insurance Authority by a composite insurer. They relate only to the general business written in Hong Kong by a composite insurer.

The requirement to report on these forms including the opinions to be given is set out in paragraph 4(1A)(a) of Part 1 of the Third Schedule. The composite insurer prepares the standard forms to which auditor will annex the auditor's report. An example auditor's report is set out as Example 4(a) in Appendix 2.

iii) *Statement prepared under Part 9 of the Third Schedule*

This statement is submitted to the Insurance Authority by a composite insurer. The statement reports the Hong Kong assets and liabilities relating to the general business only.

The requirement to report on this statement including the opinions to be given is set out in paragraph 4(1A)(b) of Part 1 of the Third Schedule. The composite insurer prepares the statement under Part 9 and auditor will annex the auditor's report. An example auditor's report is set out as Example 4(b) in Appendix 2.

iv) *Form HKL1 prepared under Part 8 of the Third Schedule*

This form is submitted to the Insurance Authority by a composite insurer. The form is in respect of the Hong Kong long term insurance business only as defined in Part 1 of the Third Schedule.

The requirement to report on this form including the opinions to be given is set out in paragraph 4(1A)(aa) of Part 1 of the Third Schedule. The composite insurer prepares the standard form to which the auditor will annex the auditor's report. An example auditor's report is set out as Example 5 in Appendix 2.

Appendix 2

Example unmodified auditor's reports under the Third Schedule to the Insurance Companies Ordinance

- Example 1 – **General insurer:** an auditor's report on financial information to be submitted to the Insurance Authority in accordance with Parts 4 and 5 of the Third Schedule
- Example 2 – **Long term insurer:** an auditor's report on financial information to be submitted to the Insurance Authority in accordance with Parts 4 and 5 of the Third Schedule
- Example 3 – **Composite insurer:** an auditor's report on financial information to be submitted to the Insurance Authority in accordance with Parts 4 and 5 of the Third Schedule
- Example 4 – **General insurer/ Composite insurer:**
- (a) an auditor's report on forms (except Form HKL1) to be submitted to the Insurance Authority under Part 8 of the Third Schedule
 - (b) an auditor's report on statement to be submitted to the Insurance Authority under Part 9 of the Third Schedule
- Example 5 – **Long term insurer/ Composite insurer:** an auditor's report on Form HKL1 to be submitted to the Insurance Authority under Part 8 of the Third Schedule

**Example 1 - General insurer: an auditor's report on financial information
to be submitted to the Insurance Authority
in accordance with Parts 4 and 5 of the Third Schedule**

INDEPENDENT AUDITOR'S REPORT

TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Report on the Financial Information

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

Directors' Responsibility for the Financial Information

The directors are responsible for the preparation of financial information in accordance with the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance"), and for such internal control as the directors determine is necessary to enable the preparation of financial information that is free from material misstatement, whether due to fraud or error.

In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain the relevant amount applicable as defined in section 10 of the Ordinance.

Auditor's Responsibility

Our responsibility is to express an opinion on this financial information based on our audit. We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the relevant amount applicable as at year end. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial information 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 information.

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 information of the Company for the year ended 31 December 20X1 is prepared, in all material respects, in accordance with the provisions of the Ordinance.

Report on matters under paragraph 4(1AB) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance

The relevant premium income, the relevant claims outstanding and the relevant amount applicable, as defined in section 10 of the Ordinance and reported in note x to the financial information, amounted to HK\$ _____, HK\$ _____ and HK\$ _____ respectively as at 31 December 20X1.

In our opinion:

- (i) proper records have been maintained in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1; and
- (ii) the value of the assets of the Company as determined under the Ordinance and reported in note x to the financial information exceeds its liabilities by not less than the relevant amount applicable as at 31 December 20X1.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to comply with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report⁴.

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

⁴ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 2 - Long term insurer: an auditor's report on financial information
to be submitted to the Insurance Authority
in accordance with Parts 4 and 5 of the Third Schedule**

INDEPENDENT AUDITOR'S REPORT

TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Report on the Financial Information

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

Directors' Responsibilities for the Financial Information

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

In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable as defined in the Ordinance (the "minimum solvency requirements").

Auditor's Responsibility

Our responsibility is to express an opinion on this financial information based on our audit. We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the minimum solvency requirements applicable as at year end. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial information that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. 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 information.

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 information gives a true and fair view of the state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and is prepared, in all material respects, in accordance with the provisions of the Ordinance.#

Report on matters under paragraphs 4(1) and (1AA) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance

The [relevant amount applicable, as defined in section 10 of the Ordinance]/[required margin of solvency, as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]*, being greater than the [required margin of solvency, as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]/[relevant amount applicable, as defined in section 10 of the Ordinance]*, amounted to HK\$ _____** as at 31 December 20X1.

In our opinion:

- (i) proper records have been maintained in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1; and
- (ii) the value of the assets of the Company as stated in the financial information exceeds its liabilities by not less than HK\$ _____** as at 31 December 20X1.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to comply with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report⁵.

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

* Delete where appropriate.

** The amount stated should be the same.

May be qualified where the valuation of any asset or liability is in accordance with any statutory provision which does not give a true and fair view, indicating the items affected by such valuation and the statutory provisions in question.

⁵ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 3 - Composite insurer: an auditor's report on financial information
to be submitted to the Insurance Authority
in accordance with Parts 4 and 5 of the Third Schedule**

INDEPENDENT AUDITOR'S REPORT

TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Report on the Financial Information

We have audited the financial information of XYZ Insurance Company Limited ("the Company") set out on pages to, which comprises the [balance sheet][statement of financial position] as at 31 December 20X1, and the [income statement][statement of profit or loss and other comprehensive income], [statement of changes in equity], [cash flow statement][statement of cash flows] and the revenue account for the year then ended, and a summary of significant accounting policies and other explanatory information, and the supplementary schedules set out on pages to

Directors' Responsibilities for the Financial Information

The directors are responsible for the preparation of financial information that is in accordance with the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance"). This responsibility includes the preparation of a long term business [balance sheet][statement of financial position] which, when read in conjunction with the notes and supplementary schedules to the financial information, gives a true and fair view of the financial position of the Company's long term business, in accordance with the provisions of the Ordinance and Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, and for such internal control as the directors determine is necessary to enable the preparation of financial information that is free from material misstatement, whether due to fraud or error.

In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain an excess of assets over liabilities by the aggregate of the relevant amount applicable and attributable to its general business as defined in section 10 of the Ordinance and the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable and attributable to its long term business as defined in the Ordinance.

Auditor's Responsibility

Our responsibility is to express an opinion on this financial information based on our audit. We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the relevant amount applicable and attributable to general business and the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable and attributable to its long term business as defined in the Ordinance as at year end. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial information 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

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED
UNDER THE INSURANCE COMPANIES ORDINANCE

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 information.

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 information set out on pages to is prepared, in all material respects, in accordance with the provisions of the Ordinance and, on that basis, the long term business [balance sheet][statement of financial position] on page, when read in conjunction with the notes on pages to and the supplementary schedules on pages to, gives a true and fair view of the financial position of the Company's long term business as at 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards and the provisions of the Ordinance.#

Report on matters under paragraph 4 (1AC) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance

In respect of the Company's general business, the relevant premium income, the relevant claims outstanding and the relevant amount applicable, as defined in section 10 of the Ordinance and reported in note x to the financial information, amounted to HK\$_____, HK\$_____ and HK\$_____ respectively as at 31 December 20X1.

In respect of the Company's long term business, the [relevant amount applicable, as defined in Section 10 of the Ordinance]/[required margin of solvency, as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]**, being greater than the [required margin of solvency, as determined by the company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]/[relevant amount applicable, as defined in Section 10 of the Ordinance]**, amounted to HK\$_____ as at 31 December 20X1.

In our opinion:

- (i) proper records have been maintained in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1; and
- (ii) the value of the assets of the Company as stated in the financial information exceeds its liabilities by not less than HK\$_____ , being the aggregate of the [relevant amount applicable attributable to its general business and the required margin of solvency attributable to its long term business]/[relevant amounts applicable]** as at 31 December 20X1.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to comply with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report⁶.

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

** Delete where appropriate.

May be qualified where the valuation of any asset or liability is in accordance with any statutory provision which does not give a true and fair view, indicating the items affected by such valuation and the statutory provisions in question.

⁶ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 4(a) - General insurer/ Composite insurer: an auditor's report
on forms (except Form HKL1)
to be submitted to the Insurance Authority
under Part 8 of the Third Schedule**

INDEPENDENT AUDITOR'S REPORT

TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Pursuant to paragraph 4(1A)(a) of Part 1 of the Third Schedule to the Insurance Companies Ordinance ("the Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited ("the Company") to the Insurance Authority ("the IA").

Directors' Responsibilities

The directors are responsible for the preparation of forms in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance ("the Forms") set out on pages to This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Forms and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

Auditor's Responsibility

It is our responsibility to express a conclusion, based on our work performed and to report our conclusion.

Basis of Conclusion

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants.

Our engagement includes examining, on a test basis, evidence supporting that proper records have been maintained by the Company in accordance with section 16 of the Ordinance for the purpose of preparing the Forms, and that the Forms have been properly compiled from those records. We believe that our engagement provides a reasonable basis for our conclusion.

Conclusion

Based on the foregoing, in our opinion:

- (i) the Company has maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1 for the purpose of preparing the Forms;
- (ii) the Forms have been properly prepared in accordance with those records; and
- (iii) the information supplied in the Forms is prepared, in all material respects, in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance and, on that basis, the Forms, when read in conjunction with the Company's audited financial information for the year ended 31 December 20X1 prepared in accordance with Hong Kong Financial Reporting Standards and the provisions of the Ordinance dated [], gives a true and fair view of the Company's underwriting results pertaining to the Hong Kong Insurance Business for the year then ended.*

Use of this Report

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report⁷.

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

- * To facilitate compliance with various reporting requirements, the Insurance Authority expects an insurer to prepare a combined set of financial statements in accordance with the Hong Kong Companies Ordinance (Cap.622) and financial information in accordance with the Insurance Companies Ordinance (Cap.41) in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule to the Insurance Companies Ordinance. The effective date for this combined set of financial statements and information is for the financial year ending on or after 31 December 2015 with early adoption permitted.

As a transition arrangement for reporting under Part 8 of the Third Schedule to the Insurance Companies Ordinance, the auditor should continue to use the report template in the superseded Auditing Bulletin 2 "Insurance Companies Ordinance – Auditors' Reports issued pursuant to the Third Schedule" if there is no early adoption.

- ** This example report is also to be applied, tailored as necessary, to a reporting entity which is a Hong Kong branch of an overseas insurance company. Branch financial statements prepared in accordance with the HKFRSs will normally be required in order for the auditor to issue a report for Part 8 for the financial year ending on or after 31 December 2015. For details of the transition arrangements for branch reporting, please refer to Appendix 5.

⁷ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

Example 4(b) - General insurer/ Composite insurer: an auditor's report on statement to be submitted to the Insurance Authority under Part 9 of the Third Schedule

INDEPENDENT AUDITOR'S REPORT

TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Pursuant to paragraph 4(1A)(b) of Part 1 of the Third Schedule to the Insurance Companies Ordinance ("the Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited ("the Company") to the Insurance Authority ("the IA").

Directors' Responsibilities

The directors are responsible for the preparation of a statement in accordance with the provisions of Part 9 of the Third Schedule to the Ordinance ("the Statement") set out on pages toand to maintain at all times assets in Hong Kong which enable the Company to comply with the requirement of section 25A of the Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Statement and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

Auditor's Responsibility

It is our responsibility to express a conclusion on the matters referred to in paragraph 4(1A)(b) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our conclusion.

Basis of Conclusion

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants.

We have performed such procedures as we consider are necessary for the purpose of our report, which include:

- (i) on the basis of the work we performed in connection with the audit of the Company's financial information prepared under Parts 4 and 5 of the Third Schedule for the year ended 31 December 20X1, assessing whether records have been properly maintained in accordance with section 16 of the Ordinance for the purpose of preparing the Statement;
- (ii) comparing the Statement with the Company's records, and assessing whether the Statement has been properly prepared in accordance with those records and the requirements of Part 9 of the Third Schedule and whether the assets held by the Company, as shown in the Statement, enable it to comply with the requirement of Section 25A of the Ordinance as at 31 December 20X1; and
- (iii) comparing the assets held by the Company at two other dates during the year ended 31 December 20X1, as reflected in the Company's records, with the liabilities at the preceding financial year end date for the purpose of determining whether such assets enable it to comply with the requirement of section 25A of the Ordinance.

We believe that our engagement provides a reasonable basis for our conclusion.

Conclusion

Based on the foregoing, in our opinion:

- (i) the Company maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1 for the purpose of preparing the Statement;
- (ii) the Statement has been properly prepared in accordance with those records;
- (iii) the value of assets and amount of liabilities, as shown in the Statement, have been determined in accordance with the Insurance Companies (General Business) (Valuation) Regulation;
- (iv) the relevant amount, as shown in the Statement, has been determined in accordance with Section 25A(1) of the Ordinance; and
- (v) the assets held by the Company, as shown in the Statement, enable it to comply with the requirement of section 25A of the Ordinance as at 31 December 20X1 and, based on the records of the Company, the assets held by the Company as at [date 2*] and [date 3 *] enable it to comply with the requirement of section 25A of the Ordinance as at those dates#.

Use of this Report

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report⁸.

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

* The two dates selected must be not less than three months apart.

* * This example report is also to be applied, tailored as necessary, to a reporting entity which is a Hong Kong branch of an overseas insurance company. Branch financial statements prepared in accordance with the HKFRSs will normally be required for the financial year ending on or after 31 December 2015. For details of transition arrangements for branch reporting, please refer to Appendix 5.

Where the Company has received a notice under section 25B of the Ordinance then the opinion "(v)" will need to be amended accordingly as follows:

- (v) the assets held by the Company, as shown in the Statement, enable it to comply with the requirement stipulated in section 25B of the Ordinance as at [date##].

The date specified in the notice issued under section 25B of the Ordinance.

⁸ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 5 - Long term insurer/ Composite insurer: an auditor's report
on Form HKL1 to be submitted to the Insurance Authority
under Part 8 of the Third Schedule**

INDEPENDENT AUDITOR'S REPORT

TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Pursuant to paragraph 4(1A)(aa) of Part 1 of the Third Schedule to the Insurance Companies Ordinance (the "Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited (the "Company") to the Insurance Authority ("the IA").

Directors' Responsibilities

Pursuant to the provisions of Part 8 of the Third Schedule to the Ordinance, the directors have a responsibility for ensuring that Form HKL1 set out on pages tohas been properly compiled from the records of the Company in accordance with the Guide to Forms HKL1, HKL2 and HKL3 issued by the IA on 26 February 2004, as further updated on 7 April 2004. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of Form HKL1 and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

Auditor's Responsibility

It is our responsibility to express a conclusion on the matters referred to in paragraph 4(1A)(aa) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our conclusion.

Basis of Conclusion

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants.

Our engagement includes examining, on a test basis, evidence supporting that proper records have been maintained by the Company in accordance with section 16 of the Ordinance for the purpose of preparing the attached Form HKL1, and that the attached Form HKL1 has been properly compiled from the records of the Company in accordance with the Guide to Forms HKL1, HKL2 and HKL3 issued by the IA on 26 February 2004, as further updated on 7 April 2004. We believe that our engagement provides a reasonable basis for our conclusion.

Conclusion

Based on the foregoing, in our opinion:

- a. the Company has maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended [year end date] for the purposes of preparing the attached Form HKL1; and
- b. the attached Form HKL1 has been properly prepared in accordance with those records.

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED
UNDER THE INSURANCE COMPANIES ORDINANCE

Use of this Report

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report⁹.

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

⁹ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

Appendix 3
Solvency requirements

| Business | Solvency requirements | Relevant amount | Maximum relevant amount | Minimum relevant amount |
|-----------|---|--|--|--|
| General | An excess of assets over liabilities by the relevant amount | 20% of relevant premium income or relevant claims outstanding, whichever is higher | HK\$40 million plus 10% of relevant premium income or relevant claims outstanding in excess of HK\$200 million | HK\$10 million (HK\$20 million if authorized for statutory business) |
| Long term | An excess of assets over liabilities by the greater of the relevant amount and the required margin of solvency calculated in accordance with the Insurance Companies (Margin of Solvency) Regulation* | Other than classes G & H: HK\$2 million Classes G & H: HK\$ nil | - | - |
| Composite | An excess of assets over liabilities by the aggregate of the amounts for general and long term business | - | - | - |
| Captive | An excess of assets over liabilities by the relevant amount | 5% of net premium income or net claims outstanding, whichever is higher | - | HK\$2 million |

* At least the greater of HK\$2 million and one-sixth of the margin of solvency must be held in funds maintained in respect of its long term business (other than classes G & H business specified in Part 2 of the First Schedule to the Ordinance).

Appendix 4

Example reports for other reporting

- Example 1 – Report by the auditor on annual return on employees' compensation gross premium
- Example 2 – Report on levies paid to the insolvency scheme for motor compensation insurance
- Example 3 – Report on levies paid to the insolvency scheme for employees' compensation insurance

Example 1 – Report by the auditor on annual return on employees' compensation gross premium

INDEPENDENT AUDITOR'S REPORT ON ANNUAL RETURN ON EMPLOYEES' COMPENSATION GROSS PREMIUM TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

Pursuant to the Agreement for Provision of Facility covering Terrorism Risks in respect of Employees' Compensation Insurance Business entered into between XYZ Insurance Company Limited ("the Company") and the Government of the Hong Kong Special Administrative Region ("HKSAR") dated [date] ("Agreement"), we have been requested to report on the attached Annual Return on Employees' Compensation Gross Premium for the [*year ended [date]/period from [date] to [date]] ("Annual Return").

Directors' Responsibilities

Pursuant to the Agreement, the directors are responsible for preparing the Annual Return. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation of the Annual Return. In addition, the directors are responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Insurance Companies Ordinance (Cap.41).

Auditor's Responsibility

It is our responsibility to express a conclusion on the Annual Return, based on our work performed and to report our conclusion.

Basis of Conclusion

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 810.2 "The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants.

Our engagement includes examining evidence supporting that proper records have been maintained in accordance with section 16 of the Insurance Companies Ordinance (Cap.41) and the amounts in the Annual Return, and performing such other procedures as we considered necessary in the circumstances. We believe that our engagement provides a reasonable basis for our conclusion.

Conclusion

Based on the foregoing, in our opinion:

- (a) the Company has maintained proper records in accordance with section 16 of the Insurance Companies Ordinance (Cap.41) for the purpose of preparing the Annual Return; and
- (b) the Annual Return has been properly prepared, in all material respects, from the books and records of the Company.

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED
UNDER THE INSURANCE COMPANIES ORDINANCE

Use of this Report

This report is intended for filing with the Government of the HKSAR pursuant to the Agreement and is not intended to be, and should not be, distributed to or used by, anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report¹⁰.

ABC & Co.

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

[Address]

Date

¹⁰ The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

Example 2 – Report on levies paid to the insolvency scheme for motor compensation insurance

REPORT OF FACTUAL FINDINGS TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

We have performed the procedures agreed with you and enumerated below with respect to the premium surcharges ("the Surcharges") for motor insurance business of XYZ Insurance Company Limited ("the Company") for the year ended 31 December 20X1 as set forth in the accompanying schedules. The procedures were performed solely to assist you in connection with the requirements of the Motor Insurers' Bureau of Hong Kong as to annual reporting of the Surcharges payable according to the books and records of the Company.

Our engagement was undertaken in accordance with Hong Kong Standard on Related Services 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). The procedures performed are summarised as follows:

1. We obtained and checked the summation of the 20X1 quarterly returns prepared by the Company regarding the determination of Surcharges due in respect of the First Fund and the Insolvency Fund Scheme ("the Quarterly Returns").
2. We compared the Surcharges as stated in the Quarterly Returns to the books and records of the Company.

We report our findings below:

- (a) With respect to item 1, we found the summation of the Surcharges payable for motor insurance business of the Company for the year ended 31 December 20X1 to be correct.
- (b) With respect to item 2, we found the amounts to be in agreement.

Because the above procedures do not constitute an assurance engagement made in accordance with Hong Kong Standards on Auditing ("HKSA"), Hong Kong Standards on Review Engagements ("HKSREs") or Hong Kong Standards on Assurance Engagements ("HKSAEs"), we do not express any assurance on the figures as set forth in the accompanying schedules.

Had we performed additional procedures or had we performed an assurance engagement on the information provided in accordance with HKSA, HKSREs or HKSAEs issued by the HKICPA, other matters might have come to our attention that would have been reported to you.

Our report is prepared solely for the purpose set forth in the first paragraph of this report and for your information and use of the Company for submission to the Motor Insurers' Bureau of Hong Kong and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to items specified above and does not extend to any financial statements of the Company, taken as a whole.

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

Example 3 – Report on levies paid to the insolvency scheme for employees' compensation insurance

REPORT OF FACTUAL FINDINGS TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED

We have performed the procedures agreed with you and enumerated below with respect to the Gross Premium Income as defined under Clause 1.01 of the Insolvency Fund Agreement and the amount of contributions payable ("the Contributions") for employees' compensation business of XYZ Insurance Company Limited ("the Company") for the year ended 31 December 20X1 as set forth in the accompanying schedules. The procedures were performed solely to assist you in connection with the requirements of the Employees Compensation Insurer Insolvency Bureau as to annual reporting of the Gross Premium Income and the Contributions according to the books and records of the Company.

Our engagement was undertaken in accordance with Hong Kong Standard on Related Services 4400 "Engagements to perform agreed-upon procedures regarding financial information" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). The procedures performed are summarised as follows:

1. We obtained and checked the summation of the 20X1 quarterly returns prepared by the Company regarding the Gross Premium Income and the determination of Contributions due in respect of the Insolvency Fund Scheme ("the Quarterly Returns").
2. We compared the Gross Premium Income and the Contributions as stated in the Quarterly Returns to the books and records of the Company.

We report our findings below:

- (c) With respect to item 1, we found the summation of the Gross Premium Income and the amount of the Contributions payable for employees' compensation business of the Company for the year ended 31 December 20X1 to be correct.
- (d) With respect to item 2, we found the amounts to be in agreement.

Because the above procedures do not constitute an assurance engagement made in accordance with Hong Kong Standards on Auditing ("HKSA"), Hong Kong Standards on Review Engagements ("HKSREs") or Hong Kong Standards on Assurance Engagements ("HKSAEs"), we do not express any assurance on the figures as set forth in the accompanying schedules.

Had we performed additional procedures or had we performed an assurance engagement on the information provided in accordance with HKSA, HKSREs or HKSAEs issued by the HKICPA, other matters might have come to our attention that would have been reported to you.

Our report is prepared solely for the purpose set forth in the first paragraph of this report and for your information and use of the Company for the submission to the Employees Compensation Insurer Insolvency Bureau and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to items specified above and does not extend to any financial statements of the Company, taken as a whole.

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

Appendix 5

Transition arrangements

For General Insurer/ Composite Insurer:

1. Reporting under Part 8 of the Third Schedule (*Example 4(a) in Appendix 2*)
 - a. To facilitate compliance with various reporting requirements, the Insurance Authority expects an insurer to prepare a combined set of financial statements in accordance with the Hong Kong Companies Ordinance (Cap.622) and financial information in accordance with the Insurance Companies Ordinance (Cap.41) ("the Ordinance") in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule to the Ordinance. The effective date for this combined set of financial statements and information is for the financial year ending on or after 31 December 2015 with early adoption permitted.

As a transition arrangement, the auditor should continue to use the report template in the superseded Auditing Bulletin 2 "Insurance Companies Ordinance – Auditors' Reports issued pursuant to the Third Schedule" if there is no early adoption.

- b. When the reporting entity is a Hong Kong branch of an overseas insurance company which has been granted accounting concession under section 17(2) of the Ordinance, the branch is normally required to prepare financial statements in accordance with the HKFRSs and audited by certified public accountants who are qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance) for appointment as auditors of a company in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule to the Ordinance. The effective date is for the financial year ending on or after 31 December 2015 with early adoption permitted.

As a transition arrangement, the auditor should continue to use the report template in the superseded Auditing Bulletin 2 "Insurance Companies Ordinance – Auditors' Reports issued pursuant to the Third Schedule" if there is no early adoption.

2. Reporting under Part 9 of the Third Schedule (*Example 4(b) in Appendix 2*)

The same transition arrangement as set out in 1.b. above applies.