

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

Hong Kong Standard on Auditing 720

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

* 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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HONG KONG STANDARD ON AUDITING 720

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

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

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Hong Kong Standard on Auditing (HKSA) 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

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

Effective Date

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

Objective

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

Definitions

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

¹ HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph 2.

Requirements

Reading Other Information

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

Material Inconsistencies ^{1a}

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

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

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

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

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

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

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

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

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

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

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

Material Misstatements of Fact

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

Conformity and Compliance with International Standards on Auditing

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

Application and Other Explanatory Material

Scope of this HKSA

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

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

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

Considerations Specific to Smaller Entities

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

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

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

Reading Other Information (Ref: Para. 7)

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

Material Inconsistencies

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

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

Considerations Specific to Public Sector Entities

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

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

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

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

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

Appendix

Additional Local Guidance on Material Inconsistencies and Misstatements of Fact

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

1. The auditor has regard to the nature of the inconsistency between the financial statements and the other information or the misstatement of fact in the other information that in his opinion exists. A distinction may be drawn between a matter of fact and one of judgment. It is generally more difficult for the auditor to take issue with a matter of judgment (such as management's view of the likely out-turn for the following year) than a factual error. Although the auditor does not substitute his judgment for that of management in such matters, there may be circumstances in which auditor is aware that the expressed view of management is significantly at variance with the entity's internal assessment or is so unreasonable as not to be credible to someone with the auditor's knowledge. The courses of action to be taken by auditor will depend on the auditor's perception of the seriousness of the inconsistency between the financial statements and the other information or the misstatement of fact.
2. The auditor who is considering the course of including a paragraph after the audit opinion in the auditor's report describing the material inconsistency between the financial statements and the other information or the material misstatement of fact in the other information is advised that the qualified privilege (i.e. the defence to an action for defamation) which an auditor's report normally enjoys may not extend to comments on items of the other information which appear to be misleading. Similarly, no qualified privilege may attach to statements made by the auditor on such matter at a general meeting pursuant to his right under section 141(7) of the Companies Ordinance. The auditor would also bear in mind the provisions of section 140A of the Companies Ordinance, and in particular the obligation imposed by subsection (2) thereof, before deciding whether resignation from the engagement would be likely to resolve the problem. The auditor would consider seeking legal advice both as to which course of action he would adopt and as to the precise form of any wording to be used.

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

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

Material Misstatements of Fact (Ref: Para. 16)

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

AMENDMENTS RESULTING FROM THE HONG KONG COMPANIES ORDINANCE (CAP. 622)

Note: The following sets out the amended text required for this Standard resulting from Hong Kong Companies Ordinance (Cap. 622) which became effective on 3 March 2014. The amended text 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).

Appendix:

...

2. Section 406(2) of the Hong Kong Companies Ordinance states that if a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor
 - a. must state that opinion in the auditor's report; and
 - b. may bring that opinion to the members' attention at a general meeting.

3. The auditor who is considering the course of including a paragraph after the audit opinion in the auditor's report describing the material inconsistency between the financial statements and the other information or the material misstatement of fact in the other information (with the exception of reporting inconsistencies with the director's report) is advised that the qualified privilege (i.e. the defence to an action for defamation) which an auditor's report normally enjoys may not extend to comments on items of the other information which appear to be misleading. Similarly, no qualified privilege may attach to statements made by the auditor on such matter at a general meeting pursuant to his right under section 411 of the Companies Ordinance. The auditor would also bear in mind the provisions of sections 417 and 424 of the Companies Ordinance before deciding whether resignation from the engagement would be likely to resolve the problem. The auditor would consider seeking legal advice both as to which course of action he would adopt and as to the precise form of any wording to be used.

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

4. When management refuses to revise the other information, the auditor's possible further course of action may involve using his right under section 411 of the Companies Ordinance to be heard at any general meeting of the members on any business of the meeting which concerns him as auditor.

Material Misstatements of Fact (Ref: Para. 16)

5. If an amendment is necessary in the other information and the entity refuses to make the amendment, the auditor's possible further courses of action may involve the following:
 - (a) including a paragraph after the audit opinion in the auditor's report describing the material misstatement of fact in the other information;
 - (b) using his right under section 411 of the Companies Ordinance to be heard at any general meeting of the members on any business of the meeting which concerns him as auditor;
 - (c) withdrawing from the engagement.