DECEMBER 2016 AND JUNE 2017
SUPPLEMENT

Qualification Programme

Module C
Business Assurance

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

Published by BPP Learning Media Ltd.

Changes at a glance

Introduction

This Supplement is to be used in conjunction with the fifth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack and 31 May 2016, the cut-off date for examinable standards and legislation for the December 2016 and June 2017 examinations. You will find a list of the standards that are examinable in your examination session by logging onto the HKICPA online QP Learning Centre.

The Supplement comprises a technical update on developments that will be examinable in December 2016 and June 2017 examination sessions that are not currently covered in the Learning Pack. The topics covered are listed on the contents page and are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Good luck with your studies!

Identified Errata – Learning Pack

Answers to exam practice questions

Page 727: Replace HKAS 220 (Clarified) with HKSA 220.

Technical Updates – Learning Pack

Chapter 2 Corporate governance reports and practice

2.1.2 Principles of the HK Code and the UK Corporate Governance Code

Section C: Accountability and audit

Internal controls is replaced by the following.

Risk management and internal control

The board is responsible for evaluating and determining the nature and extent of the risks it is willing to take in achieving the issuer's strategic objectives, and ensuring that the issuer establishes and maintains appropriate and effective risk management and internal control systems. The board should oversee management in the design, implementation and monitoring of the risk management and internal control systems, and management should provide a confirmation to the board on the effectiveness of these systems.

2.1.2 Principles of the HK Code and the UK Corporate Governance Code

Section C: Accountability and audit

Audit committee

Replace 'to consider how it will apply financial reporting and internal control principles' *with* 'to consider how it will apply financial reporting, risk management and internal control principles'.

3.5 Structure of the Code in Hong Kong

Section C: Accountability and audit

The two bullet points about internal controls are replaced by the following.

Risk management and internal control (see section 1.2 and 1.3 of Chapter 3 for further information)

- The board should oversee the issuer's risk management and internal control systems on an ongoing basis, ensure that a review of the effectiveness of the issuer's and its subsidiaries' risk management and internal control systems has been conducted at least annually and report to shareholders that it has done so in its Corporate Governance Report. The review should cover all material controls, including financial, operational and compliance controls.
- The board's annual review should, in particular, ensure the adequacy of resources, staff qualifications and experience, training programmes and budget of the issuer's accounting, internal audit and financial reporting functions.
- The issuer should have an internal audit function. Issuers without an internal audit function should review the need for one on an annual basis and should disclose the reasons for the absence of such a function in the Corporate Governance Report.

3.6 Corporate Governance Report (CGR) in Hong Kong

Mandatory disclosure requirements

The following is added after (x) Investor relations.

(xi) Risk management and internal control

Where an issuer includes the board's statement that it has conducted a review of its risk management and internal control systems in the annual report, it must disclose the following:

(a) Whether the issuer has an internal audit function;

(b) How often the risk management and internal control systems are reviewed, the period covered, and where an issuer has not conducted a review during the year, an explanation why not; and

(c) A statement that a review of the effectiveness of the risk management and internal control systems has been conducted and whether the issuer considers them effective and adequate.

Section C of the Code also requires issuers to include, as part of their Corporate Governance Report, a narrative statement about how they have complied with the Code provisions on risk management and internal control during the reporting period. This statement should include:

(a) The processes used by the issuer for identifying, evaluating and managing the significant risks that it faced

(b) The main features of the issuer's risk management and internal control systems

(c) An acknowledgement by the board that it is responsible for the risk management and internal control systems and reviewing their effectiveness. It should also explain that such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss

(d) The process used to review the effectiveness of the risk management and internal control systems and to resolve material internal control defects

(e) The procedures and internal controls for the handling and dissemination of inside information

---

3.6 Corporate Governance Report (CGR) in Hong Kong

Recommended disclosures

Section (iii) is replaced by the following.

(iii) Risk management and internal control

- The board may disclose in the Corporate Governance Report that it has received a confirmation from management on the effectiveness of the issuer's risk management and internal control systems.
- The board may disclose in the Corporate Governance Report details of any significant areas of concern.

3.6 Corporate Governance Report (CGR) in Hong Kong

Recommended disclosures

(iv) Management functions

Remove the following paragraphs.

According to HKSA 720 (Clarified) *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*, the auditor should read the narrative statement of how a listed company has complied with the principles in the HK Code for any inconsistencies with the audited financial statements.

In addition, the Hong Kong Stock Exchange has amended the Rule to remove the requirement for issuers to publish a Next Day Disclosure Form following the exercise of an option for shares in the issuer by a director of its subsidiaries so that options for shares in the issuer exercised by a director of a subsidiary only triggers an announcement if the change in its share capital, individually or when aggregated with other events, is 5% or more since its last Monthly Return.

Chapter 3 Internal assurance

Section 1.2 (except section 1.2.1) is replaced with the following.

1.2 Directors' responsibilities for risk management and internal control

The board is responsible for:

- Evaluating and determining the nature and extent of the risks it is willing to take in achieving the issuer's strategic objectives;
- Ensuring the issuer establishes and maintains appropriate and effective risk management and internal control systems; and
- Overseeing management in the design, implementation and monitoring of the risk management and internal control systems, and management should provide a confirmation to the board on the effectiveness of these systems.

1.2.2 Monitoring risk management and internal control

The board should:

- Oversee the issuer's risk management and internal control systems on an ongoing basis;
- Ensure a review of the effectiveness of the issuer's and its subsidiaries' risk management and internal control systems has been conducted at least annually. The review should cover all material controls, including financial, operational and compliance controls; and
- Report to shareholders that it has done so in its Corporate Governance Report.

The board monitors risk management and internal control systems through an internal audit function. Code provision C.2.5 states the issuer should have an internal audit function. Issuers without an internal audit function should:

- Review the need for one on an annual basis; and
- Disclose the reasons for the absence of such a function in the Corporate Governance Report.

The annual review of the effectiveness of the issuer's risk management and internal control systems is explained in more detail in section 1.3.

Section 1.3 is replaced by the following.

1.3 Annual assessment of the effectiveness of risk management and internal control systems

There are several provisions in section C of the Code about the annual review of the risk management and internal control systems.

The Code states that the annual review should consider in particular:

- The adequacy of resources in the accounting, internal audit and financial reporting functions
- The qualifications and experience of the staff of the accounting, internal audit and financial reporting functions
- Their training programmes and budget.

The annual review should consider in particular:

(a) Any **changes** since the last **annual review** in the nature and extent of the significant **risks** faced by the company, and the company's **ability to respond to changes** in its business and external environment.

(b) The **scope** and **quality** of the ongoing monitoring of the risks and internal control systems by management, and the scope and quality of the work of the internal audit function, if such a function exists in the company.

(c) The **extent** and **frequency** of reporting to the board (or board committee) on the results of this ongoing monitoring activity. This regular reporting enables the board or board committee to assess control and the effectiveness of risk management.

(d) The incidence of any **significant control failings or weaknesses** that have been identified during the period, and the extent to which they have a material impact on the company's financial performance or condition, or might have a material impact in the future.

(e) The **effectiveness** of the company's **processes for compliance** with financial reporting rules and Listing Rules.

Refer to section 3.6 of Chapter 2 for details of the disclosure requirements in the Corporate Governance Report.

Chapter 4 Code of Ethics

A number of amendments have been made to the *Code of Ethics for Professional Accountants* (the *Code*). These include:

Section 2.4.3 is replaced by the following.

2.4.3 Preparing accounting records and financial statements

290.164 Management is responsible for the **preparation and fair presentation** of the financial statements in accordance with the applicable financial reporting framework. These responsibilities include:

- Originating or changing journal entries
- Determining or approving the account classifications of transactions
- Preparing or changing source documents
- Determining accounting policies

290.165 A firm provides an audit client with accounting and bookkeeping services, such as preparing accounting records or financial statements, creates a self-review threat when the firm subsequently audits the financial statements.

Audit clients that are not public interest entities

290.168 The firm may provide services related to the preparation of accounting records and financial statements to an audit client that is not a public interest entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Services that are routine or mechanical in nature require little to no professional judgment from the professional accountant. Examples of such services include preparing payroll calculations or reports based on client originated data for approval and payment by the client, or posting client approved entries to the trial balance.

In all cases, the firm must analyse the risks arising and put safeguards in place to reduce the threat to an acceptable level or eliminate it entirely. Examples of safeguards include using staff members other than audit team members to carry out the work or having a senior staff member with appropriate expertise who is not part of the audit team review the work.

Audit clients that are public interest entities

290.169 A firm shall not provide to an audit client that is a public interest entity accounting and bookkeeping services, including payroll services, or prepare financial statements on which the firm will express an opinion or financial information which forms the basis of the financial statements.

290.170 However, a firm may provide accounting and bookkeeping services, including payroll services and the preparation of financial statements or other financial information, of a routine or mechanical nature for divisions or related entities of an audit client that is a public interest entity if the personnel providing the services are not members of the audit team and:

(a) The divisions or related entities for which the service is provided are collectively immaterial to the financial statements on which the firm will express an opinion; or

(b) The services relate to matters that are collectively immaterial to the financial statements of the division or related entity.

2.4.3 Preparing accounting records and financial statements

In *Section 2.4.3, the paragraphs headed 'Emergency situations' are deleted.*

2.4.6 Taxation services

Under the section headed '(ii) **Audit clients that are public interest entities'**, *the words* 'Except in emergency situations' *are removed*.

Include a new section 2.4.10

2.4.10 Management responsibility

290.160-2 When providing non-assurance services to an audit client, a firm must be careful not to assume an audit client's management responsibility since no safeguards could reduce the resulting threats to an acceptable level. Examples of activities that would be viewed as a management responsibility include:

- Hiring or dismissing employees
- Setting policies or strategic direction
- Deciding which recommendations of the firm or other third parties to implement
- Authorising transactions

Assuming a management responsibility can create a familiarity threat where the views and interests of the firm become too closely aligned with those of management.

To avoid the risk of assuming a management responsibility, a firm shall be satisfied that the client management makes all judgments and decisions that are the responsibility of management. The firm must ensure there is a suitable individual at the client responsible for making decisions. Providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility.

Insert a new section 4.2

4.2 Conflicts between interests of different entities

There is nothing improper in a firm serving two or more entities whose interests may be in conflict.
431.14 Where the firm does act for two competing entities, it must manage its work so that the interests of
one entity do not adversely affect another entity. Where the acceptance or continuance of an
engagement would, even with safeguards, materially prejudice the interests of any entity, the
appointment should not be accepted or continued, or one of the appointments discontinued.

Material prejudice may mean information being leaked or for firms to be forced into a corner where they have to choose between the interests of one entity or the other.

431.10 A firm must take all reasonable steps to evaluate whether any conflict of interest exists between a
firm and its client, including implications arising from the possession of confidential information and
how this may be protected. The firm should continually review its relationships with both
431.13 prospective and existing entities before accepting or continuing engagements. If aware of possible
conflicts between clients or potential clients, the firm should introduce safeguards to try to manage
them. If the relationship ended over two years before, it would be unlikely to constitute a conflict.

431.21 Wherever there is identified a significant conflict between the interests of different clients or potential clients, sufficient disclosure in writing should be made to the clients or potential clients concerned together with details of the safeguards proposed below so that they may make an informed decision as to whether to engage the firm or continue their relationship with the firm.

Particular difficulties can arise when it comes to share issues, and takeovers. Professional
accountants are often involved in either situation. With regard to share issues, the firm should
431.43 never underwrite an issue of shares to the public of an entity it audits. In a takeover situation, if the
firm audits the accounts of both the offer and the target company, it must ensure that it does not:

- Act as the lead adviser to either party; or
- Issue reports assessing the financial statements of either party other than their audit report.

If they find that they possess material confidential information, they should contact the competent authority.

Chapter 5 Framework for assurance engagements

1 Overview of the Hong Kong Framework for Assurance Engagements

The table in this section is replaced as follows.

Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services	
Preface	
Preface (Amended)	*Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*
Glossary	
Glossary (Clarified)	*Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*
Hong Kong Standards on Quality Control (HKSQCs)	
HKSQC 1 (Clarified)	*Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*
Hong Kong Framework for Assurance Engagements	
Framework (Amended)	*Hong Kong Framework for Assurance Engagements*
Hong Kong Standards on Auditing (HKSAs)	
HKSA 200	*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*
HKSA 210	*Agreeing the Terms of Audit Engagements*
HKSA 220	*Quality Control for an Audit of Financial Statements*
HKSA 230	*Audit Documentation*
HKSA 240	*The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*
HKSA 250 (Clarified)	*Consideration of Laws and Regulations in an Audit of Financial Statements*
HKSA 260 (Revised)	*Communication with Those Charged with Governance*
HKSA 265 (Clarified)	*Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*
HKSA 300	*Planning an Audit of Financial Statements*
HKSA 315 (Revised 2016)	*Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*
HKSA 320	*Materiality in Planning and Performing an Audit*
HKSA 330	*The Auditor's Responses to Assessed Risks*
HKSA 402 (Clarified)	*Audit Considerations Relating to an Entity Using a Service Organization*
HKSA 450	*Evaluation of Misstatements Identified during the Audit*
HKSA 500	*Audit Evidence*
HKSA 501 (Clarified)	*Audit Evidence – Specific Considerations for Selected items*
HKSA 505 (Clarified)	*External Confirmations*
HKSA 510	*Initial Audit Engagements – Opening Balances*
HKSA 520 (Clarified)	*Analytical Procedures*
HKSA 530 (Clarified)	*Audit Sampling*
HKSA 540	*Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services	
HKSA 550 (Clarified)	*Related Parties*
HKSA 560	*Subsequent Events*
HKSA 570 (Revised)	*Going Concern*
HKSA 580	*Written Representations*
HKSA 600	*Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*
HKSA 610 (Revised 2013)	*Using the Work of Internal Auditors and Related Conforming Amendments*
HKSA 620 (Clarified)	*Using the Work of an Auditor's Expert*
HKSA 700 (Revised)	*Forming an Opinion and Reporting on Financial Statements*
HKSA 701	*Communicating Key Audit Matters in the Independent Auditor's Report*
HKAS 705 (Revised)	*Modifications to the Opinion in the Independent Auditor's Report*
HKSA 706 (Revised)	*Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
HKSA 710	*Comparative Information – Corresponding Figures and Comparative Financial Statements*
HKSA 720 (Revised)	*The Auditor's Responsibilities Relating to Other Information*
HKSA 800 (Clarified)	*Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*
HKSA 805 (Clarified)	*Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*
HKSA 810 (Clarified)	*Engagements to Report on Summary Financial Statements*
Hong Kong Standards on Review Engagements (HKSREs)	
HKSRE 2400 (Revised)	*Engagements to Review Historical Financial Statements*
HKSRE 2410	*Review of Interim Financial Information Performed by the Independent Auditor of the Entity*
Hong Kong Standards on Assurance Engagements (HKSAEs)	
HKSAE 3000 (Revised)	*Assurance Engagements Other Than Audits or Reviews of Historical Financial Information and Related Conforming Amendments*
HKSAE 3402	*Assurance Reports on Controls at a Service Organization*
HKSAE 3410	*Assurance Engagements on Greenhouse Gas Statements*
HKSAE 3420	*Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*
Hong Kong Standards on Related Services (HKSRSs)	
HKSRS 4400	*Engagements to Perform Agreed-upon Procedures Regarding Financial Information*
HKSRS 4410 (Revised)	*Compilation Engagements*
Hong Kong Standards on Investment Circular Reporting Engagements (HKSIRs)	
HKSIR 400	*Comfort Letters and Due Diligence Meetings*
HKSIR 500	*Reporting on Profit Forecasts, Statements of Sufficiency of Working Capital and Statements of Indebtedness*

Chapter 8 Planning, materiality and risk assessment

3 Materiality

Replace the following throughout this section:

- 'HKSA 260 (Clarified)' with 'HKSA 260 (Revised)'
- 'HKSA 320 (Clarified)' with 'HKSA 320'
- 'HKSA 450 (Clarified)' with 'HKSA 450'

3.1.1 Materiality in the context of an audit

HKSA 320 *Materiality in Planning and Performing an Audit* was amended in January 2016 as a result of the disclosures project. *Consequently, the following change is made to section 3.1.1 of Chapter 8.*

Replace this section with the following:

HKSA 320.A1a

The objective of the auditor is to apply the concept of materiality in planning and performing the audit and to evaluate the effect of identified and uncorrected misstatements on the financial statements. The auditor must consider the risk of material misstatement in disclosures in addition to account balances and classes of transactions. The auditor's determination of materiality is a matter of professional judgment.

Chapter 9	Audit evidence, procedures, audit methodologies and audit sampling

In January 2016, HKICPA published HKSA 315 (Revised 2016) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*. This was part of a wider project involving changes to various Hong Kong Standards on Auditing (HKSAs) as a result of the Disclosures project (Addressing Disclosures in the Audit of Financial Statements) developed by the International Auditing and Assurance Standards Board (IAASB). These changes are effective for audits of financial statements for periods ending on or after 15 December 2016. *As a result, the table in section 2 is replaced as follows.*

HKSA 315.A124

Assertions used by the auditor	
Assertions about **classes of transactions and events and related disclosures** for the period under audit	**Occurrence**: transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity **Completeness**: all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included **Accuracy**: amounts and other data relating to recorded transactions and events have been recorded appropriately and related disclosures have been appropriately measured and described **Cut-off**: transactions and events have been recorded in the correct accounting period **Classification**: transactions and events have been recorded in the proper accounts **Presentation**: transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework
Assertions about **account balances and related disclosures** at the period-end	**Existence**: assets, liabilities, and equity interests exist **Rights and obligations**: the entity holds or controls the rights to assets, and liabilities are the obligations of the entity **Completeness**: all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included **Accuracy, valuation and allocation**: assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described **Classification**: assets, liabilities and equity interests have been recorded in the proper accounts **Presentation**: assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework

Chapter 12 Substantive procedures, including analytical procedures

1.6.2 Substantive procedures related to the financial statement closing process

HKSA 330 *The Auditor's Responses to Assessed Risks* was amended in January 2016 as a result of the disclosures project. *Consequently, the following change is made to section 1.6.2 of Chapter 12.*

Replace this section with the following:

HKSA 330.20

HKSA 330 requires that the auditor shall perform the following procedures related to the financial statement closing process:

(a) Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers; and

(b) Examining material journal entries and other adjustments made during the course of preparing the financial statements.

Chapter 16 Overall audit review and finalisation

1 Subsequent events

1.1 Objectives of the auditor

Replace this section with the following:

HKSA 560.4

HKSA 560 *Subsequent Events* provides guidance to auditors in this area. The objectives of the auditor are described below:

(a) To obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that need **adjustment or disclosure** in the financial statements are appropriately reflected in the financial statements in accordance with the applicable financial reporting framework; and

(b) To respond appropriately to facts that become known to the auditor after the date of the auditor's report which may have caused the auditor to amend the auditor's report if they were known to the auditor at the date of the report

HKSA 560.1

The standard does not deal with matters relating to the auditor's responsibilities for other information obtained after the date of the auditor's report, which are addressed in HKSA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*. However, such other information may bring to light a subsequent event that is within the scope of this HKSA.

1.2.1 Situation 1: Events occurring between the date of the financial statements and the date of the auditor's report

Table titled 'Audit procedures to test subsequent events', section titled 'Inquiries of management or those charged with governance'.

Remove the following bullet point:

- '**Sales** or destruction of non-current **assets**'

Insert the following bullet points:

- '**Sales, acquisitions or destruction of assets**'
- 'Events that are relevant to the **measurement of estimates or provisions** made in the financial statements'
- 'Events that are relevant to the **recoverability of assets**'

Table titled 'Audit procedures to test subsequent events', section titled 'Other procedures'.

Remove the following bullet points:

- '**Review** management procedures for identifying subsequent events to ensure that management are aware of the risks.'
- '**Review** internal documents such as board and committee meeting minutes, inquire about unusual items.'

Insert the following bullet points:

- '**Obtain an understanding** of the management procedures that have been established to ensure the subsequent events are identified.'
- '**Read** minutes, if any, of the meetings of the entity's owners, management and those charged with governance that have been held after the date of the financial statements and enquire about matters discussed at any such meetings for which minutes are not yet available.'
- '**Consider** whether **written representations** covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.'

2 Going concern

Replace the following sections with the below.

In August 2015, HKICPA issued HKSA 570 (Revised) *Going Concern* as part of the project to update auditor reporting. The changes resulting from this project are covered further in Chapter 17. As a result of these changes, the following changes are made to section 2 of Chapter 16.

Topic highlights

Auditors should consider whether the going concern basis of accounting is appropriate, and whether disclosure of any going concern problems is sufficient.

Key term

HKSA 570.2

Under the **going concern basis of accounting**, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

2.1 Auditor's objectives

HKSA 570.9

The objectives of the auditor are:

(a) To obtain sufficient appropriate audit evidence regarding, and to conclude on, the **appropriateness** of management's use of the going concern basis of accounting in the preparation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a **material uncertainty** exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To **report** in accordance with this HKSA.

Sections 2.2 to 2.5

Replace the following throughout these sections.

- 'HKSA 570 (Clarified)' with 'HKSA 570 (Revised)'
- 'Going concern assumption' with 'going concern basis of accounting'

2.6 Events or conditions identified

Replace 'HKSA 570 (Clarified)' *with* 'HKSA 570 (Revised)'.

Remove the following bullet points:

- 'Requesting management to make its **assessment** where this has not been done'
- 'Evaluating management's **plans for future actions**'
- 'Evaluating the **reliability of underlying data** used to prepare cash flow forecast and considering the **assumptions** used to make the forecast'
- 'Reviewing subsequent events affecting going concern'
- 'Confirming financial support and their ability to provide the support from shareholders, creditors or related parties'

Insert the following bullet points:

- 'Requesting management to make its **assessment** of the entity's ability to continue as a going concern where this has not been done'
- 'Evaluating management's **plans for future actions** in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances. For example, enquiry of management as to its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital'
- 'Evaluating the **reliability of the underlying data** generated to prepare the forecast and determining whether there is **adequate support for the assumptions** underlying the forecast'
- 'Performing **audit procedures regarding subsequent events** to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern'
- 'Confirming the **existence, legality and enforceability** of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds'
- 'Considering whether any **additional facts or information** have become available since the date on which management made its assessment'

2.7 Audit reporting

Insert the following table which summarises the implications on the auditor's report relating to the appropriateness of the going concern basis of accounting. These are then explained in sections 2.7.1 to 2.7.4.

Is going concern basis of accounting appropriate?	Are treatment and disclosures adequate?	Implication on auditor's report
Appropriate	Adequate	• Standard unmodified report, which describes both management's and the auditor's responsibilities in relation to going concern
Appropriate, but material uncertainty exists	Adequate	• Unmodified opinion • Include a separate section headed 'Material Uncertainty Related to Going Concern' • Refer to the disclosures in the financial statements • State that opinion is not modified
Appropriate, but material uncertainty exists	Inadequate	• Qualified or adverse opinion • Statement in the 'Basis for Qualified/Adverse Opinion' paragraph that material uncertainty exists and disclosures in the financial statements are inadequate

Is going concern basis of accounting appropriate?	Are treatment and disclosures adequate?	Implication on auditor's report
Inappropriate	Financial statements inappropriately prepared using the going concern basis of accounting, regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting	• Adverse opinion • Description of circumstances in the 'Basis for Adverse Opinion' paragraph
Inappropriate	Adequately disclosed that the financial statements are prepared on an alternative basis, e.g. liquidation basis	• Unmodified opinion • Consider including an Emphasis of Matter paragraph to draw attention to alternative basis of accounting

Replace sections 2.7.1 to 2.7.4 with the following.

2.7.1 Use of going concern basis of accounting is appropriate but a material uncertainty exists

HKSA 570.19

The auditor determines whether disclosures in the financial statements are adequate. Specifically, whether the financial statements adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and management's plans to deal with these events or conditions.

The financial statements should clearly disclose that there is a material uncertainty and, therefore, that the entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

If the disclosures are adequate, then the auditor issues an unmodified opinion and includes a separate paragraph in the auditor's report, headed 'Material Uncertainty Related to Going Concern'. An example of this paragraph is given in HKSA 570 (Revised) and is also extracted below.

Material Uncertainty Related to Going Concern

We draw attention to Note 6 in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended 31 December 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note 6, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

This is a change from the previous version of HKSA 570, which required the auditor to include an Emphasis of Matter paragraph to refer to the disclosures already made in the financial statements. Emphasis of Matter paragraphs are now not used in respect of going concern.

If disclosures are not adequate, then the opinion will be either a qualified or an adverse opinion:

HKSA 570.23

If adequate disclosure is not made in the financial statements, the auditor shall:

(a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with HKSA 705 (Revised); and

(b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

The following is an illustration of the relevant paragraph when a material uncertainty exists and the financial statements are materially misstated due to inadequate disclosure.

Qualified Opinion

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

Basis for Qualified Opinion

As discussed in Note yy, the Company's financing arrangements expire and amounts outstanding are payable on 19 March 20X2. The Company has been unable to conclude re-negotiations or obtain replacement financing. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.

2.7.2 Inappropriate use of going concern basis of accounting

HKSA 570.21

If the financial statements have been prepared on a going concern basis of accounting, but in the auditor's judgment, this is inappropriate, the auditor must express an **adverse** opinion. This applies regardless of whether the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting.

The following is an illustration of the relevant paragraphs when an adverse opinion is to be expressed, which is extracted from HKSA 570 (Revised).

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the financial statements do not give a true and fair view of, the financial position of the Company as at 31 December 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). In all other respects, in our opinion the financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Adverse Opinion

The Company's financing arrangements expired and the amount outstanding was payable on 31 December 20X1. The Company has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.

2.7.3 Management unwilling to make or extend its assessment

HKSA 570.A35

In certain circumstances, the auditor may believe it necessary to **request management to make or extend its assessment**. If management is unwilling to do so, a **qualified opinion** or a **disclaimer of opinion** in the auditor's report may be appropriate, on the grounds of an inability to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements.

2.7.4 Preparation of financial statements on an alternative basis

HKSA 570.A27

When the use of the going concern basis of accounting is not appropriate in the circumstances, the entity's management is required or may elect to prepare financial statements on an **alternative basis,** such as liquidation basis. The auditor can still perform the audit provided that the auditor determines the alternative basis of accounting is an acceptable financial reporting framework in the circumstances.

The auditor can still express an **unmodified opinion** on those financial statements if adequate disclosure about the basis of accounting has been made but may consider to include an **Emphasis of Matter paragraph** in the auditor's report to draw readers' attention to that alternative basis of accounting and the reasons for its use.

Insert the following sections after section 2.7.6

2.8 Communication with those charged with governance

HKSA 570.25

Unless all those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. This communication must include:

- Whether the events or conditions constitute a material uncertainty
- Whether the use of the going concern basis of accounting is appropriate in the preparation of the financial statements
- The adequacy of related disclosures in the financial statements
- Where applicable, the implications for the auditor's report

2.9 Significant delay in the approval of financial statements

HKSA 570.26

When there is a significant delay in approving the financial statements, the auditor shall enquire as to the reasons for the delay. If the auditor believes that the delay could be related to events or conditions relating to the going concern basis of accounting, the auditor shall perform those additional audit procedures necessary, as well as consider the effect on the auditor's conclusion regarding the existence of a material uncertainty.

---

3 Written representations

Add the following to the table in section 3.2.

HKSA 720.13	HKSA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*	Requires that when some or all of the document(s) determined to comprise the annual report will not be available until after the date of the auditor's report, the auditor must request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required.

6 Other Information

In August 2015, HKICPA issued HKSA 720 (Revised) *The Auditor's Responsibilities to Other Information*. The key changes are a clarification of the definition of 'other information', an enhancement of the work carried out by the auditor and a requirement for including in the auditor's report a separate Other Information section when other information exists. *As a result of these changes, section 6 of Chapter 16 is replaced as follows, except sections 6.3.1 and 6.5.*

Topic highlights

Having read the other information, the auditor shall consider whether there is a material inconsistency between (i) the other information and the financial statements; and (ii) the other information and the auditor's knowledge obtained in the audit, and respond and report appropriately under HKSA 720 (Revised).

6.1 What is Other Information?

HKSA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information* sets out the requirements of the auditor with respect to other information. Having read the other information, the auditor shall consider whether there is a material inconsistency between (i) the other information and the financial statements; and (ii) the other information and the auditor's knowledge obtained in the audit, and respond and report appropriately under HKSA 720 (Revised).

Key terms

HKSA 720.12

An **annual report** is a document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters.

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

A **misstatement of the other information** exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information).

Here are some examples of other information, i.e. information in the annual report:

- A report by management or the board of directors on operations
- Financial summaries or highlights
- Planned capital expenditures
- Financial ratios
- Selected quarterly data

Auditors have no responsibility to report that other information is properly stated because an audit is only an expression of opinion on the truth and fairness of the financial statements. However, the auditors may be engaged separately, or required by statute, to report on elements of other information. In any case, the auditors should give consideration to other information as inconsistencies with the audited financial statements may undermine their opinion.

6.2 Accessing other information

HKSA 720.13

Timely access to other information will be required. The auditors shall therefore make appropriate arrangements with management to obtain such information prior to the date of the auditor's report.

If the other information is not received until after the date of the auditor's report, then the auditor is not required to update the procedures performed in accordance with paragraphs 6 and 7 of HKSA 560 *Subsequent Events*.

6.3 Reading and considering the other information

HKSA 720.14-15

The auditor shall read the other information and consider whether there are:

- Material inconsistencies between the other information and the financial statements; and
- Material inconsistencies between the other information and the auditor's knowledge obtained in the audit.

The auditor shall 'remain alert' for indications of material misstatements in the other information that is not related to the audit.

6.4 Material misstatements

HKSA 720.16

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

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

The auditor's responses are summarised as follows if a material misstatement is discovered.

Material misstatement exists	
Revision needed to	**Action**
Financial statements	Respond in line with other HKSAs, i.e. further procedures if necessary. Consider the implication on the auditor's report.
Other information	Ask management to correct other information. If management refuses, communicate the matter with those charged with governance. If still refusing to correct, consider the implication on the auditor's report or withdraw from the engagement.
Auditor's understanding of the entity and its environment	Respond in line with other HKSA (HKSA 315 (Revised 2016))

6.4.1 Revision needed to financial statements

HKSA 720.A51

If it appears to be the financial statements which are misstated, then the auditor shall obtain evidence about the misstatement by performing further procedures. This may involve obtaining a better understanding of the entity in line with HKSA 315 (Revised 2016). The misstatement would then be evaluated in line with HKSA 450 *Evaluation of Misstatements Identified during the Audit*.

If the financial statements are materially misstated then this is treated in the same way as any other material misstatement. If the financial statements are not amended, then the auditor's opinion would be modified as appropriate in line with HKSA 700 (Revised) *Forming an Opinion and Reporting on Financial Statements* (see Chapter 17).

6.4.2 Revision needed to other information

HKSA 720.A44

If the other information is not corrected after communicating with those charged with governance, the auditor will consider the implication for the auditor's report or withdraw from the engagement. The exact course of action will be down to the auditor's professional judgment**.** The auditor may consider whether the rationale of management and those charged with governance for not making the correction implies a lack of management integrity. The auditor may wish to obtain legal advice.

6.6 Auditor's report

The auditor's report always includes a separate Other Information section when the auditor has obtained some or all of the other information as of the date of the auditor's report. For listed entities, this section is also included if other information is expected to be received after the date of the auditor's report.

Where an **unmodified opinion** is expressed and the **other information is not materially misstated**, the standard unmodified Other Information section is placed after the Key Audit Matters section (see Chapter 17), as follows (the 'X report' means the report where the other information is stated, for example the directors' report or the chairman's statement.):

> **Other Information**
>
> The directors are responsible for the other information. The other information comprises the [information included in the X report, but does not include the financial statements and our auditor's report thereon.]
>
> Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.
>
> In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

The auditor may only have obtained part of the other information, and HKSA 720 (Revised) covers various possible scenarios.

The following example is for an **unmodified opinion** when **no other information has been received prior to the date of the auditor's report**:

> **Other Information**
>
> Management is responsible for the other information. The other information comprises the [information included in the X report, but does not include the financial statements and our auditor's report thereon]. The X report is expected to be made available to us after the date of this auditor's report.
>
> Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.
>
> In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

The following example is for an **unmodified opinion**, when the auditor has obtained **all of the other information prior to the date of the auditor's report** and has concluded that **a material misstatement of the other information exists**. In this case, the Other Information section is placed immediately after the Basis for Opinion section, i.e. it moves up above the Key Audit Matters section:

Other Information

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

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described below, we have concluded that such a material misstatement of the other information exists.

[Description of material misstatement of the other information]

The following example is for a **qualified opinion** when the auditor has obtained **all of the other information prior to the date of the auditor's report** and there is a **limitation of scope** with respect to a material item in the consolidated financial statements which also affects the other information:

Other Information

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

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described in the Basis for Qualified Opinion section above, we were unable to obtain sufficient appropriate evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year. Accordingly, we are unable to conclude whether or not the other information is materially misstated with respect to this matter.

The following example is for an **adverse opinion** when the auditor has obtained **all of the other information prior to the date of the auditor's report** and the adverse opinion on the consolidated financial statements also affects the other information.

Other Information

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

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described in the Basis for Adverse Opinion section above, the Group should have consolidated DEF Company and accounted for the acquisition based on provisional amounts. We have concluded that the other information is materially misstated for the same reason with respect to the amounts or other items in the X report affected by the failure to consolidate DEF Company.

The following is an example of an auditor's report of **any entity incorporated in Hong Kong**, whether listed or other than listed, containing an **unmodified opinion** when the auditor has obtained **all of the other information prior to the date of the auditor's report** and has concluded that a **material misstatement of the other information exists** and has identified an **inconsistency between the information in the directors' report and the financial statements**.

Other Information

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

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact . As described below, we have concluded that such a material misstatement of the other information exists.

[Description of material misstatement of the other information]

HKSA 720.A58

When the auditor disclaims an opinion on the financial statements, providing further details about the audit, including a section to address other information may overshadow the disclaimer of opinion on the financial statements as a whole. Accordingly, in those circumstances, as required by HKSA 705 (Revised), the auditor's report does not include a separate Other Information section as required by HKSA 720 (Revised).

7 Communicating with those charged with governance

HKSA 260 (Revised) *Communication with Those Charged with Governance* was published in August 2015 as part of the project to update auditor reporting standards. *As a result, the following changes are made to section 7 of Chapter 16.*

Topic highlights

Auditors shall **communicate** specific matters to **those charged with governance** and HKSA 260 (Revised) provides guidance to auditors in this area.

7.1 The importance of communicating with those charged with governance

HKSA 260.6

HKSA 260 (Revised) *Communication with those Charged with Governance* sets out guidance for auditors on the communication of audit matters arising from the audit of the financial statements of an entity with those charged with governance. However, auditors do not have to perform specific procedures to identify any other matters for the communication.

Key terms

HKSA 260.10 **Those charged with governance** are the person(s) or organisation(s) (e.g. 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.

Other than the above amendments, the rest of section 7.1 is not changed.

7.2 Matters to be communicated by auditors to those charged with governance

The table in section 7.2 is replaced with the following table.

The auditor's responsibilities in relation to the financial statements audit	Including that the auditor is responsible for forming and expressing an opinion on the financial statements and that the audit does not relieve management or those charged with governance of their responsibilities. This can be done by providing those charged with governance with a copy of the engagement letter.
Planned scope and timing of the audit	Including: • How the auditor proposes to address the significant risks of material misstatement from fraud or error • The auditor's approach to internal control relevant to the audit • Application of materiality in the audit • The nature and extent of audit procedures that will be required for specialist skills, including using an auditor's expert • The auditor's views about matters that may be key audit matters
Significant findings from the audit	The auditor shall communicate the following: • The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties encountered during the audit • Significant matters arising from the audit that were discussed or subject to correspondence with management • Written representations requested by the auditor • Any circumstances that affect the form and content of the auditor's report • Other matters that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process
Auditor independence	The auditor shall communicate the following for **listed entities**: • A statement that the engagement team and others in the firm, the firm, and network firms have complied with relevant ethical requirements regarding independence • All relationships between the firm, network firms, and the entity that may reasonably be thought to bear on independence • Related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level

8 Evaluation of misstatements identified during the audit

HKSA 450 *Evaluation of Misstatements Identified During the Audit* was amended in August 2015 as part of the project to update auditor reporting standards and again in January 2016 as a result of the disclosures project. *As a result, the following changes are made to section 8 (except sections 8.2 and 8.4 to 8.6) of Chapter 16.*

Topic highlights

The auditor is required to evaluate the effect of identified misstatements on the audit and the effect of uncorrected misstatements on the financial statements.

Key terms

HKSA 450.4

Misstatement is a difference between the reported amount, classification, presentation, or disclosure of a 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.

Uncorrected misstatements are misstatements that the auditor has accumulated during the audit and that have not been corrected.

HKSA 450.A1

Misstatements can arise from the following situations:

- Inaccurate gathering or processing data from which the financial statements are prepared
- Omitting an amount or disclosure, including inadequate or incomplete disclosures, and those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable
- Overlooking an accounting estimate or misinterpreting a fact
- Judging wrongly an accounting estimate due to unreasonable selection and application of accounting policies
- An inappropriate classification, aggregation or disaggregation, of information
- For financial statements prepared in accordance with a fair presentation framework, the omission of a disclosure necessary for the financial statements to achieve fair presentation beyond disclosures specifically required by the framework

HKSA 450 *Evaluation of Misstatements Identified during the Audit* deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. The auditor's conclusion takes into account the auditor's evaluation of uncorrected misstatements and the materiality level before issuing the auditor's report.

HKSA 450.3

The objectives of the auditor are to evaluate:

(a) The effect of identified misstatements on the audit; and
(b) The effect of uncorrected misstatements, if any, on the financial statements.

8.1 Accumulation of identified misstatements

HKSA 450 requires that the auditor **shall accumulate misstatements identified** during the audit other than those that are clearly trivial.

HKSA 450.A2

'**Clearly trivial**' is not another expression for 'not material'. Misstatements that are clearly trivial will be of a wholly different (smaller) order of magnitude, or of a wholly different nature than those that would be determined to be material, and will be misstatements 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 misstatement is considered not to be clearly trivial.

HKSA 450 requires the auditor shall accumulate misstatements other than those which are clearly trivial identified during the audit. It is necessary to distinguish misstatements as follows:

Factual misstatements	Judgment misstatements	Projected misstatements
Misstatements without doubt	Differences with judgments of management including those concerning recognition, measurement, presentation and disclosure in the financial statements that the auditor considers as unreasonable or inappropriate Inappropriate accounting policies	Auditor's best estimate of misstatements in populations (Refer to audit sampling in section 4 of Chapter 9)

HKSA 450.A2b **Misstatements in disclosures** may also be clearly trivial whether taken individually or in aggregate, and whether judged by any criteria of size, nature or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating the effect of such misstatements on the relevant disclosures and the financial statements as a whole.

There are no changes to section 8.2 Consideration of identified misstatements as the audit progresses. Section 8.3 is replaced with the following.

8.3 Evaluating the effect of uncorrected misstatements

Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with HKSA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.

In making this determination, the auditor shall consider:

- The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
- The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, accounts balances or disclosures, and the financial statements as a whole.

The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's financial statements. Auditors are advised to use the same evaluation approach for consistency.

HKSA 450.A13a In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosure(s), as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement(s) in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples where such misstatements may be material include:

- Inaccurate or incomplete descriptions of information about the objectives, policies and processes for managing capital for entities with insurance and banking activities.
- The omission of information about the events or circumstances that have led to an impairment loss (e.g., a significant long-term decline in the demand for a metal or commodity) in an entity with mining operations.
- The incorrect description of an accounting policy relating to a significant item in the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows.
- The inadequate description of the sensitivity of an exchange rate in an entity that undertakes international trading activities.

HKSA 450.A13b

In determining whether uncorrected misstatements by nature are material, the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually, or when taken in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider whether:

- Identified errors are persistent or pervasive; or
- A number of identified misstatements are relevant to the same matter, and considered collectively may affect the users' understanding of that matter.

The remainder of section 8 remains the same.

Chapter 17 Audit reporting

Audit reporting is a topical area. The HKSAs in this area were revised in August 2015 and there is also a new auditing standard issued in August 2015 - HKSA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* which requires auditors to report on 'key audit matters'.

Auditor's reports are covered by the following HKSAs.

- HKSA 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*
- HKSA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*
- HKSA 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report*
- HKSA 706 (Revised) *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

The IAASB believes that the revisions are 'essential to the continued relevance of the audit profession globally'. The aims of the revisions are to respond to feedback from users of the financial statements that:

- The audit opinion is valued, but could be more informative
- More relevant information is needed about the entity and the audit

The main response is to include **Key Audit Matters** in the middle of the auditor's report. The **order of the report has been changed**, with the audit opinion now placed at the start of the report. There is also a more detailed description of the auditor's responsibilities and the key features of an audit.

As a result of these changes in audit reporting, the following replacements are made in Chapter 17.

Section 1.2 is replaced with the following material.

HKSA 700 (Revised) *Forming an Opinion and Reporting on Financial Statements* establishes standards and provides guidance on the form and content of the auditor's report issued as a result of an audit performed by an independent auditor on the financial statements of an entity. The auditor must review and assess the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements.

This evaluation involves considering whether the financial statements have been **prepared** in accordance with an **applicable financial reporting framework**, being HKASs and HKFRSs and the Hong Kong Companies Ordinance. HKSA 700 (Revised) states that the objectives of the auditor are to:

HKSA 700.6

(a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained, and

(b) To express clearly that opinion through a written report.

The table in section 1.4 is replaced with the following table.

Basic elements of auditor's report	Explanation
Title	The title should indicate that the report is by an independent auditor to confirm all the relevant ethical standards regarding independence have been met. This helps readers to identify the auditor's report and to easily distinguish it from reports that might be issued by others.
Addressee	The auditor's report shall be addressed as required by the circumstances of the engagement, but is likely to be the shareholders or board of directors.

Basic elements of auditor's report	Explanation
Auditor's opinion	The auditor's report shall include a section with the heading 'Opinion'. If the auditor concludes that the financial statements give a true and fair view, the auditor shall express an unmodified opinion which states that the financial statements give a true and fair view or present fairly, in all material respects, in accordance with the applicable financial reporting framework.
Basis for opinion	The basis for opinion section will (i) state that the audit was conducted in accordance with HKSAs, (ii) includes a statement that the auditor has fulfilled their ethical responsibilities and (iii) states whether the auditor believes that the audit evidence obtained is sufficient and appropriate to provide a basis for the opinion.
Going concern	Included where applicable under HKSA 570 (Revised) *Going Concern* (i.e. when material uncertainty exists).
Key audit matters	See section 2.1 of this Chapter.
Other information	Included where applicable under HKSA 720 (Revised) *The Auditor's Responsibilities relating to Other Information.*
Responsibilities for the financial statements	There must be a heading 'Responsibility of management [or those charged with governance] for the financial statements'. This section describes management's responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, and for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement whether due to fraud or error. It also describes management's responsibility for assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate.
Auditor's responsibilities	The auditor's report shall include a section with the heading 'Auditor's responsibilities for the audit of financial statements'. The report shall state that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and issue an auditor's report that includes the auditor's opinion. The report should state that the auditor's responsibilities are: • To exercise professional judgment and maintain professional scepticism throughout the audit • To identify and assess the risks of material misstatement of the financial statements and design and perform procedures in response to those risks • To obtain an understanding of internal control relevant to the audit in order to design audit procedures but not to enable the auditor to express an opinion on the effectiveness of the entity's internal control

Basic elements of auditor's report	Explanation
	• To evaluate the appropriateness of the accounting policies used, the reasonableness of estimates and the related disclosures in the financial statements • To conclude on the appropriateness of management's use of the going concern basis of accounting and whether any material uncertainties exist • To evaluate if the overall presentation, structure and content of the financial statements, including disclosures, are prepared in accordance with the fair presentation framework (where applicable) • To describe responsibilities in a group audit engagement (where applicable e.g. obtain sufficient appropriate audit evidence within the group and express an opinion on the group financial statements) • In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control • To communicate applicable matters (e.g. the planned scope and timing of the audit and significant audit findings, a statement that the auditor has complied with relevant ethical requirements regarding independence and where relevant, related safeguards and key audit matters) with those charged with governance
Other reporting responsibilities	If the auditor is required by law to report on any other matters, this should be done in an additional paragraph. The paragraph should be titled as 'Report on Other Legal and Regulatory Requirements' or otherwise as appropriate to the content of the section.
Name of the engagement partner	The name of the audit engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities.
Auditor's signature	The report shall contain the auditor's signature, whether this is the auditor's own name or the audit firm's name. Under section 409 of the new Companies Ordinance, an auditor's report must be signed: (a) If the auditor is a natural person, by the auditor; or (b) If the auditor is a firm or body corporate, by a natural person authorized to sign the auditor's name on the auditor's behalf. An auditor's report shall state the auditor's name.
Auditor's address	The location where the auditor practises shall be included. This is usually the city where the auditor has his office.

Basic elements of auditor's report	Explanation
Date of the report	The report shall be dated. This informs the reader that the auditor has considered the effect on the financial statements and on his report of events or transactions about which he became aware that occurred up to that date. The date should not be earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements.

Section 1.6 is deleted as this is now covered by HKSA 720 (Revised) The Auditor's Responsibilities Relating to Other Information. *This is dealt with in section 6 of Chapter 17.*

The auditor's report for a listed entity in section 2 is replaced with the following.

INDEPENDENT AUDITOR'S REPORT

To the members of ABC Ltd

(Incorporated in Hong Kong with limited liability)

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ABC Limited (the Company) set out on pages 10 to 40, which comprise the statement of financial position as at 31 December 20X1, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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

Other Information

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

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

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

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

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

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

(The shaded material below can be located in an Appendix to the auditor's report. When law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.)

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

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

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

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

The following section on key audit matters is newly inserted in section 2.

2.1 Key audit matters (KAMs)

Topic highlights

Listed company auditor's report includes a description of the key audit matters.

2.1.1 Key audit matters

HKSA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* sets out the auditor's responsibility to communicate KAMs.

HKSA 701.8 **Key audit matters** are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

HKSA 701.2 Reporting on KAMs aims to improve transparency by helping users to understand the most significant issues the auditor faced. This should enhance the communicative value of the auditor's report.

HKSA 701.5 KAMs are part of every listed company auditor's report. They must also be included where the auditor is required by law or regulation to communicate key audit matters in the auditor's report.

HKSA 701.4 KAMs do not constitute a modification of the report or of the opinion. They are a part of the standard report which must be tailored to each company's circumstances. KAMs are not a substitute for disclosures, for reporting a material uncertainty exists that may cast significant doubt on an entity's ability to continue as a going concern, for Emphasis of Matter (EoM) or Other Matter (OM) paragraphs, nor for modified opinions.

The auditor's objectives are as follows.

HKSA 701.7 The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

KAMs are communicated after the opinion. This is because the reported KAMs do not include matters which have resulted in a modified opinion – any explanations in relation to these issues would already have been included in the 'Basis for' modified opinion paragraph.

The auditor must do four main things:

- Determine the matters which should be described as KAMs
- Communicate the KAMs in the auditor's report
- Communicate the KAMs to those charged with governance
- Keep appropriate audit documentation

HKSA 701.9

2.1.2 Determining KAMs

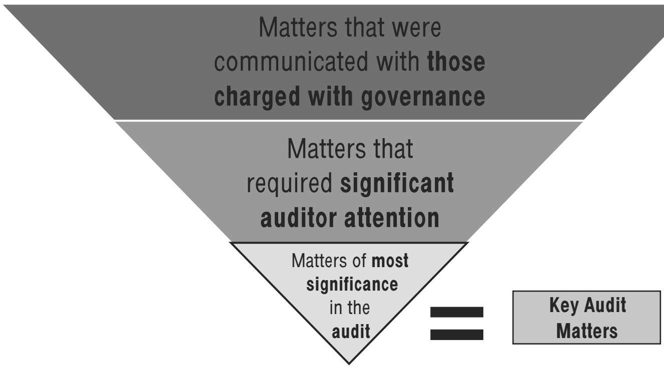
KAMs should be selected from the matters communicated to those charged with governance, and they should represent the issues which have required significant auditor attention during the audit. In working out which matters to report as KAMs, the auditor takes into account:

- Areas of higher risk of material misstatement, or 'significant risks' identified in line with HKSA 315 (Revised 2016) (e.g. at the planning stage)
- Significant auditor judgments in relation to areas where management made significant judgments
- The effect of significant events or transactions on the audit

The key part of the definition of KAMs above is that these are the most significant matters, and are more significant than the other matters communicated to those charged with governance. In other words, the auditor must edit out the less significant issues, and only include the really important ones in the auditor's report. This involves using the auditor's professional judgment.

It should be obvious that KAMs are audit matters, not just difficult areas of financial reporting.

The decision-making framework is as follows. (*Source: IAASB* The New Auditor's Report, slide presentation, March 2015)



This approach begins with the audit matters communicated to those charged with governance, and to pick the key matters from those.

HKSA 701 notes that these 'matters of most significance' may be the ones that there has been most discussion with management about. Other things to consider when determining KAMs include:

HKSA 701.A29

- The importance of the matter to intended users' understanding, including materiality
- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved
- Any misstatements related to the matter, and the nature and materiality of the misstatements
- The nature and extent of audit effort needed to address the matter (including the need for specialised knowledge and for consultations outside the audit engagement team)
- The nature and severity of difficulties in applying audit procedures, obtaining evidence or forming conclusions, in particular as the auditor's judgments become more subjective
- The severity of any control deficiencies
- Whether several separate issues interacted, e.g. if a long-term contract had repercussions in several areas (revenue recognition, litigation or contingencies)

How many KAMs should the auditor report? This is a matter of judgment and depends on the circumstances, but the auditor should not just report everything. They are key matters, and by definition not everything is 'most significant'.

2.1.3 Choosing not to include a KAM

The auditor may choose not to communicate a matter identified as a KAM, but only under specific circumstances:

> **HKSA 701.14**
>
> The auditor shall describe each key audit matter in the auditor's report unless:
>
> (a) Law or regulation precludes public disclosure about the matter; or
>
> (b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

An example of this is where the auditor suspects money laundering. In some jurisdictions, regulations prohibit communications which might prejudice an investigation – so including suspicions of money laundering as a KAM would be tipping off.

2.1.4 Communicating KAMs

KAMs are communicated in a separate subsection of the auditor's report. There is a general introduction first, and then each KAM is presented in detail. The general introduction states that:

HKSA 701.11

- These are the 'matters of most significance' in the auditor's professional judgment; and
- No separate opinion is provided on them because they are addressed in the context of the audit of the financial statements as a whole and the audit opinion.

The description of each KAM then provides two main pieces of information:

> **HKSA 701.13**
>
> The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:
>
> (a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and
>
> (b) How the matter was addressed in the audit.

2.1.5 Original information

HKSA 701.A35

Original information is any information about the entity that has not otherwise been made publicly available by the entity (e.g., has not been included in the financial statements or other information available at the date of the auditor's report, or addressed in other oral or written communications by management or those charged with governance, such as a preliminary announcement of financial information or investor briefings).

It is not appropriate for KAMs to give original information about the entity. If something is not disclosed but the auditor thinks it should be, then the auditor should ask management to disclose it.

2.1.6 No KAMs?

HKSA 701.A59

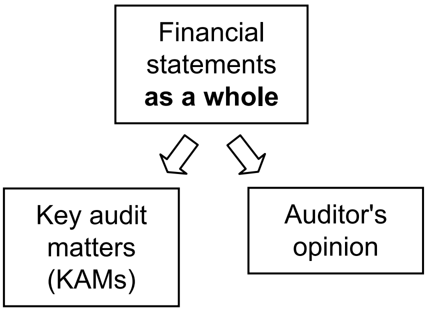
It is possible that there are no KAMs to communicate. HKSA 701 does allow for this possibility, but only under extremely rare circumstances, e.g. for a listed entity which has very limited operations (e.g. if it has not traded during the period).

HKSA 701.16

In this case, the auditor's shall include a statement to communicate this effect in a separate section of the auditor's report.

2.1.7 Relationship with the auditor's opinion

The basic relationship:



The KAMs are the key matters for the audit of the whole financial statements. They do not separate auditor's opinions for each little part of the financial statements, but provide further information on the process that led to the opinion on the financial statements as a whole. Likewise, the auditor's opinion refers to the financial statements as a whole: as a whole they may give a true and fair view, or as a whole they may be true and fair but 'except for' one area (and so on).

HKSA 701.15 If the auditor is going to express a modified opinion, then logically the matter giving rise to the modification is a key audit matter. However, the description of the matter will be given in the 'Basis for Modified Opinion' paragraph, so it is not included as a KAM in the report. The auditor should include a reference to the Basis for Modified Opinion paragraph in the KAM section instead.

HKSA 701.15 HKSA 701 also makes special mention of going concern issues. Where there is a material uncertainty in relation to going concern, the matter should not be described as a KAM, but should be discussed in the 'Material Uncertainty in Relation to Going Concern' paragraph instead.

2.1.8 Relationship with Emphasis of Matter and Other Matter paragraphs

Key Audit Matters do not overlap with Other Matter paragraphs because KAMs shall refer to issues present in the financial statements, whereas Other Matter paragraphs do not by definition.

HKSA 706.8 An Emphasis of Matter (EoM) paragraph is not a substitute for a description of individual KAMs. There may be a matter that is not determined to be a KAM in accordance with HKSA 701 (i.e., because it did not require significant auditor attention), but which, in the auditor's judgment, is fundamental to users' understanding of the financial statements (e.g., a subsequent event). If the auditor considers it necessary to draw users' attention to such a matter, the matter is included in an EoM paragraph in the auditor's report.

2.1.9 Communication with those charged with governance

HKSA 701.17 & HKSA 701.A62 The auditor shall communicate with those charged with governance:

- Those matters that have been determined to be the KAMs; or
- If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report (including under extremely rare circumstances in which a matter determined to be a key audit matter but is not communicated in the auditor's report).

2.1.10 Documentation

HKSA 701.18 The audit documentation shall include the 'significant audit matters' from which the KAMs were selected, together with the auditor's reasons for selecting the KAMs.

If no KAMs are communicated, then the reasons for the auditor's determination shall be documented. Likewise if a matter determined to be a KAM is not communicated (e.g. to avoid 'tipping off' in relation to money laundering), this shall be documented.

Section 3.2 Matters that affect the auditor's opinion

Replace 'PN 600.1 *Reports by auditors under the Hong Kong Companies Ordinance' with* 'PN 600.1 (Revised) *Reports by the Auditor under the Hong Kong Companies Ordinance (Cap. 622)'.*

3.2.1 Inability to obtain sufficient appropriate audit evidence

The examples of the auditor's reports in section 3.2.1 are replaced with the following.

Qualified Opinion: Auditor's inability to obtain sufficient appropriate audit evidence regarding a foreign associate (listed entity)

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(Incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group) set out on pages 10 to 40, which comprise the consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

Basis for Qualified Opinion

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

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

Other Information

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

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described in the *Basis for Qualified Opinion* section above, we were unable to obtain sufficient appropriate evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year. Accordingly, we are unable to conclude whether or not the other information is materially misstated with respect to this matter.

Key Audit Matters

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

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

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

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

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

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

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

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate as described in the *Basis for Qualified Opinion* section of our report above:

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

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

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Disclaimer of Opinion: Auditor's inability to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements (non-listed entity)

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(Incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Disclaimer of Opinion

We were engaged to audit the consolidated financial statements of ABC Company and its subsidiaries (the Group) set out on pages 10 to 40, which comprise the consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

Basis for Disclaimer of Opinion

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

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

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

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

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

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

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

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

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

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Disclaimer of Opinion: Auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements (non-listed entity)

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)

Report on the Audit of the Financial Statements

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company (the Company) set out on pages 10 to 40, which comprise the statement of financial position as at 31 December 20X1, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31 December 20X0 and 20X1, which are stated in the statements of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerised accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the statement of financial position at a total amount of xxx as at 31 December 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows.

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

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

In respect alone of the inability to obtain sufficient appropriate audit evidence about the inventories and accounts receivable as described in the *Basis for Disclaimer of Opinion* section of our report above:

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

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

3.2.2 Nature of material misstatement

The examples of the auditor's reports in section 3.2.2 are replaced with the following.

Qualified Opinion due to a material misstatement of the financial statements (listed entity)

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)

Report on the Audit of the Financial Statements

Qualified Opinion

We have audited the financial statements of ABC Company (the Company) set out on pages 10 to 40, which comprise the statement of financial position as at 31 December 20X1, the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

Basis for Qualified Opinion

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

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

Other Information

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

Key Audit Matters

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

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

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

Report on Other Legal and Regulatory Requirements

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

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

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Adverse Opinion due to a material misstatement of the consolidated financial statements (listed entity)

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group) set out on pages 10 to 40, which comprise the consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion* section of our report, the consolidated financial statements do not give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary DEF Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under HKFRSs, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had DEF Company been consolidated, many elements in the consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

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

Other Information

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised) – see Illustration 7 in Appendix 2 of HKSA 720 (Revised).]

Key Audit Matters

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

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

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

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

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

Report on Other Legal and Regulatory Requirements

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

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

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

3.3 Form and content of the auditor's report when the opinion is modified

Section 3.3 is replaced with the following.

3.3.1 Basis for modification of opinion

HKSA 705.20

The auditor shall **add a paragraph immediately after the Opinion paragraph** in addition to the specific elements required by HKSA 700 (Revised) in the auditor's report and use the heading 'Basis for Qualified Opinion', 'Basis for Adverse Opinion', or 'Basis for Disclaimer of Opinion', as appropriate when the auditor decides to modify the opinion on the financial statements. This paragraph provides a **description of the matter** giving rise to the modification.

3.3.2 Quantitative disclosures

HKSA 705.21

The auditor shall include in the Basis for Opinion paragraph a description and **quantification of the financial effects** of the material misstatement that relates to specific amounts in the financial statements. The auditor must state in the basis for opinion when quantification of the financial effects is impracticable.

3.3.3 Qualitative disclosures and non-disclosure of information

HKSA 705.22-24

If there is a material misstatement of the financial statements that relates to qualitative disclosures, the auditor shall include in the Basis for Opinion paragraph an explanation of how the disclosures are misstated.

If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:

(a) Discuss the non-disclosure with those charged with governance;

(b) Describe in the Basis for Opinion section the nature of the omitted information; and

(c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

If the modification results from an inability to collect sufficient and appropriate audit evidence, the auditor shall include in the Basis for Opinion paragraph the reasons for that inability.

3.3.4 Opinion paragraph

(a) **Heading**

The auditor shall use the heading 'Qualified Opinion', 'Adverse Opinion', or 'Disclaimer of Opinion', as appropriate, for the Opinion paragraph for modification of opinion.

(b) **Qualified opinion: material misstatement**

HKSA 705.17

For material misstatement in the financial statements, the auditor shall state in the Opinion paragraph that, in the auditor's opinion, **except for** the effects of the matter(s) described in the Basis for Qualified Opinion section:

(i) The accompanying financial statements present fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework.

(ii) The accompanying financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

HKSA 705.17

(c) **Qualified opinion: inability to obtain sufficient appropriate evidence**

The auditor shall use the corresponding phrase ..'**except for** the possible effects of the matter(s)…'

The auditor shall include in the Basis for Opinion paragraph the reasons for that inability to obtain sufficient appropriate audit evidence.

HKSA 705.18

(d) **Adverse opinion**

The auditor shall state in the Opinion paragraph that, in the auditor's opinion, because of the **significance** of the matter(s) described in the Basis for Adverse Opinion section:

(i) The accompanying financial statements **do not present fairly** (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework.

(ii) The accompanying financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

HKSA 705.19

(e) **Disclaimer of opinion**

When the auditor **disclaims an opinion** due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

(i) State that the auditor does not express an opinion on the accompanying financial statements;

(ii) State that because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor **has not been able to obtain sufficient appropriate audit evidence** to provide a basis for an audit opinion on the financial statements; and

(iii) Amend the statement required by paragraph 24(b) of HKSA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

HKSA 705.28

When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities to include only the following:

(i) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Hong Kong Standards on Auditing and to issue an auditor's report;

(ii) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and

(iii) The required statement about auditor independence and other ethical responsibilities.

HKSA 705.29 Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section or an Other Information section.

HKSA 705.15 HKSA 705 (Revised) requires that when an auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement.

To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

Section 4 is replaced with the following.

4 Emphasis of matter and other matter paragraphs

Topic highlights

An **Emphasis of Matter paragraph** is used by the auditor to **highlight** an issue affecting the financial statements which the readers should know about but which does not give rise to a modified opinion.

Key terms

HKSA 706.7 **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.

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.

4.1 Emphasis of Matter

HKSA 706.A5 The Emphasis of Matter (EoM) paragraph is used where the auditor considers it necessary to do so, as long as the matter referred to is adequately disclosed, and sufficient appropriate audit evidence has been obtained. Examples include: an uncertain future outcome to exceptional litigation or regulatory action; early application (where permitted) of an accounting standard that has a material effect on the financial statements in advance of its effective date; or a major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

HKSA 706.A4 In certain circumstances, however, it shall be used:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation
- To alert users that the financial statements are prepared in accordance with a special purpose framework
- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e. subsequent events)

Note that an EoM paragraph is not a substitute for a key audit matter. The auditor shall determine whether a matter is a key audit matter, or whether an EoM paragraph is more appropriate.

A change was recently made to HKSA 706 in relation to going concern. EoM paragraphs are no longer used in relation to going concern. They were previously used where there was a 'materiality uncertainty' that was appropriately disclosed, but now the auditor uses a 'Material uncertainty related to going concern' paragraph instead in accordance with HKSA 570 (Revised) which is covered in Chapter 16, section 2 of the Supplement.

The EoM paragraph should be positioned immediately after the Basis for Opinion paragraph in the auditor's report and should be clearly identified as an Emphasis of Matter. If there is a Key Audit Matters section in the report, then it is up to the auditor's judgment as to the relevance and significance of the information included in it in deciding whether to place the EoM before this (i.e. straight after the Basis for Opinion) or after it.

Certain HKSAs contain specific requirements for an Emphasis of Matter paragraph. These are:

HKSA 210 *Agreeing the Terms of Audit Engagements*	The auditor shall draw users' attention to the additional disclosures in the financial statements that is required to avoid the financial statements being misleading when the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable.
HKSA 560 *Subsequent Events*	If, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, and if management amends the financial statements, the auditor shall include in the new auditor's report an Emphasis of Matter paragraph or Other Matter paragraph referring to a note to the financial statements that more extensively discusses the reason for amendment.
HKSA 800 (Clarified) *Special Considerations–Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*	The auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.

The following is an **example** of an Emphasis of Matter paragraph, taken from the Appendix to HKSA 706 (Revised).

Emphasis of Matter

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

4.2 Other Matter paragraph

HKSA 710.13-14

There are specific circumstances where the Other Matter paragraph **shall** be used:

(a) Where **prior period** financial statements were audited by the **predecessor auditor**

(b) Where **prior period** financial statements were **not audited** (note that this does not relieve the auditor of the obligation to obtain sufficient appropriate audit evidence on opening balances)

(c) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the predecessor auditor previously expressed

Previously, an Other Matter paragraph was used in line with HKSA 720 (Revised) where other information was materially misstated. This is no longer the case. Instead of using an Other Matter paragraph, the auditor describes the misstatement in the Other Information section of the auditor's report (see Chapter 17).

The Other Matter paragraph can also be used whenever the auditor thinks it is necessary. Examples include:

HKSA 706. A10-11, A13-14

- The auditor is unable to withdraw from the engagement and yet is unable to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive.
- An entity may engage the auditor to report on both sets of financial statements under two general purpose frameworks (i.e. Hong Kong Financial Reporting Standards and the International Financial Reporting Standards). The auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with **another general purpose framework** and that the auditor has issued a report on those financial statements.
- The auditor has been requested to report on other matters or to provide more clarifications in line with the legal jurisdiction of the country.
- When the auditor's report is **intended for specific users**, the auditor may consider it necessary to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

HKSA 706.10(b)

An Other Matter paragraph does not refer to something that has been included as a key audit matter.

The following is an example of an Other Matter paragraph, taken from Appendix 3 of HKSA 706 (Revised).

Other Matter
The financial statements of ABC Company for the year ended 31 December 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.

HKSA 706.A16

The Other Matter paragraph is included after the Basis for Opinion paragraph, after any Emphasis of Matter paragraph and after any Key Audit Matters section (or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section).

In certain circumstances, a statement is required in **either an Emphasis of Matter or Other Matter paragraph**. These are required under HKSA 560:

(a) Where law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent event or events causing that amendment and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events to that amendment

(b) Where a reference is required referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditors

The following section is newly inserted after section 4 Emphasis of Matter and Other Matter paragraphs. Self-test question 3 has been moved to the end of this section and this has been amended in line with the new reporting standards.

4.3 Going concern

Various situations can arise in relation to going concern (referred to as 'GC' thereafter). There are two main ways things can go wrong here: either the GC basis of accounting is appropriate but there is a material uncertainty, or the GC basis of accounting is inappropriate.

The following table shows the effects on the auditor's report of each of these situations giving rise to a modification of the auditor's report.

Is going concern basis of accounting appropriate?	Are treatment and disclosures adequate?	Implication on auditor's report
Appropriate	Adequate	• Standard unmodified report, which describes both management's and the auditor's responsibilities in relation to going concern
Appropriate, but material uncertainty exists	Adequate	• Unmodified opinion • Include a separate section headed 'Material Uncertainty Related to Going Concern' • Refer to the disclosures in the financial statements • State that opinion is not modified
Appropriate, but material uncertainty exists	Inadequate	• Qualified or adverse opinion • Statement in the 'Basis for Qualified/Adverse Opinion' paragraph that material uncertainty exists and disclosures in the financial statements are inadequate
Inappropriate	Financial statements inappropriately prepared using the going concern basis of accounting, regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting	• Adverse opinion • Description of circumstances in the 'Basis for Adverse Opinion' paragraph
Inappropriate	Adequately disclosed that the financial statements are prepared on an alternative basis, e.g. liquidation basis	• Unmodified opinion • Consider including an Emphasis of Matter paragraph to draw attention to alternative basis of accounting

Here is an example of an auditor's report where there is a **material uncertainty**, with **adequate disclosure**. The opinion is unmodified and this new paragraph is placed straight after the 'Basis for Opinion' section:

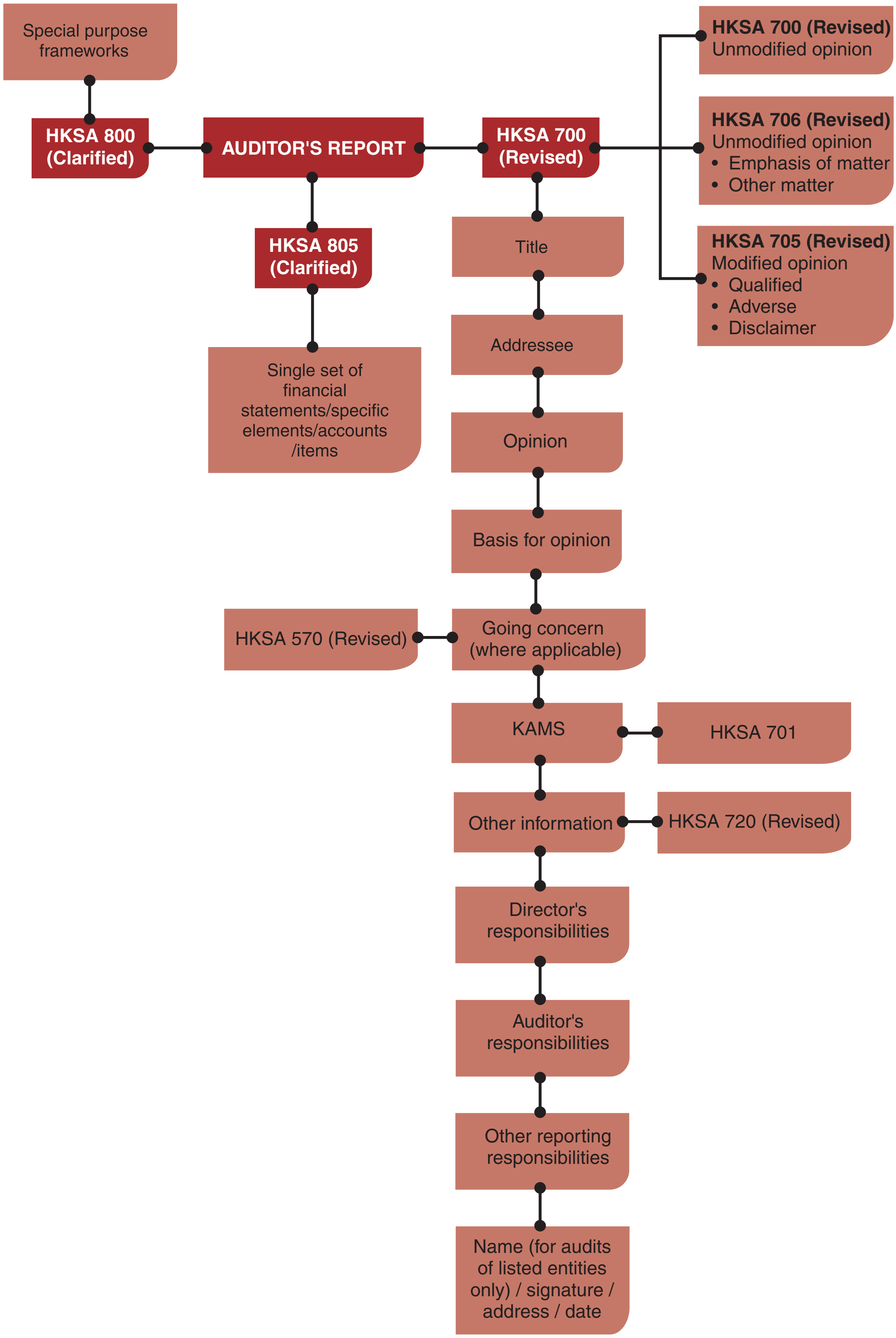
Material Uncertainty Related to Going Concern

We draw attention to Note 6 in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended 31 December 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note 6, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

This replaces the use of an Emphasis of Matter paragraph, which was used to be applied in this situation.

The inclusion of this paragraph means that going concern is not disclosed as a 'Key Audit Matter'.

Replace the topic recap with the following diagram.



Replace Self-test question 3 with the following.

Self-test question 3

You are the audit manager of Jackson CPA firm. You are responsible for the audit of the financial statements of a new client, Kristy Jewellery (Kristy), for the year ended 31 December 20Y0.

The auditor of Kristy's financial statements for the year ended 31 December 20X9 has included a Material Uncertainty Related to Going Concern paragraph in respect of Kristy's ability to continue as a going concern. Your assistant has suggested to you that this will not affect the audit work for the current year since the issue did not affect the reliability of individual items of information reported in the audited financial statements for the year ended 31 December 20X9.

Required

Do you agree with your audit assistant's view about the Material Uncertainty Related to Going Concern paragraph in the auditor's report for Kristy's financial statements for the year ended 31 December 20Y0 with regard to Kristy's going concern? Explain your views.

(The answer is at the end of the chapter.)

Replace Answer 3 with the following.

Answers to self-test questions

Answer 3

Possible existence of going concern indicators in the current year

The Material Uncertainty Related to Going Concern paragraph highlighted the existence of a fundamental uncertainty relating to the event or condition that may cast significant doubt on Kristy's ability to continue as a going concern.

Since this material uncertainty may continue to exist in the current year, we need to assess how such uncertainty may affect our audit work and reporting.

In planning our audit of Kristy's financial statements for the year ended 31 December 20Y0, we should assess whether any of the events or conditions that may cast significant doubt on the going concern of Kristy ('going concern indicators') mentioned by Kristy's predecessor auditor continue to exist.

During the course of our audit, we should also be alert to other going concern indicators not mentioned by Kristy's predecessor auditor.

Audit work if going concern indicators exist:

If these going concern indicators continue or new indicators are identified, we should:

(a) Ask Kristy to make an assessment of their ability to continue as a going concern, if this has not yet been made.

(b) Review management plan of Kristy for future actions based on its going concern assessment and assess the feasibility of this plan.

(c) Perform an analysis of any existing cash flow forecast including evaluating the reliability of the underlying data used to prepare the forecast and determining if there is adequate support for assumptions made.

(d) Consider whether any additional facts or information has become available since Kristy's management made their assessment.

(e) Seek written representations from Kristy's management regarding its plans for future action and feasibility of those plans.

2.1.6 Compliance audits

Replace 'PN810.1 Insurance brokers' compliance with Insurance Authority' *with* 'PN 810.1 (Revised) *Insurance Brokers – Compliance with the Minimum Requirements Specified by the Insurance Authority under Sections 69(2) and 70(2) of the Insurance Companies Ordinance'.*

3.1 Assurance engagements to report on the compilation of pro forma financial information included in a prospectus

This section is replaced with the following.

HKSAE 3420.1

HKSAE 3420 *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus* was revised in December 2015. This standard deals with reasonable assurance attestation engagements undertaken by a practitioner to report on a responsible party's compilation of pro forma financial information included in a prospectus. HKSAE 3420 applies where:

- Such reporting is required by securities law or the regulation of the securities exchange ('relevant law or regulation') in the jurisdiction in which the prospectus is to be used; or
- This reporting is generally accepted practice in such a jurisdiction.

HKSAE 3420.7

HKSAE 3420 expands on how HKSAE 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information and Related Conforming Amendments* is applied in this particular situation. Compliance with this standard also requires that the provisions of HKSAE 3000 (Revised) are also complied with.

Key terms

HKSAE 3420.11

A **prospectus** is 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. The term 'Prospectus' in this standard includes any document, including a circular to shareholders or similar document, issued by an issuer pursuant to the Hong Kong Listing Rules, the Hong Kong Takeover Code or the Hong Kong Companies (Winding Up and Miscellaneous Provisions) Ordinance relating to listed or unlisted securities on which it is intended that a third party would make an investment decision.

The other key terms in this section do not need to be updated.

4.1 Guidance for auditors

This section is replaced with the following.

PN 730.1-6

Practice Note (PN) 730 (Revised) *Guidance for Auditors Regarding Preliminary Announcements of Annual Results* provides guidance for auditors on their responsibilities with regard to preliminary announcements of results under the Main Board or GEM Listing Rules for the financial year. This Practice Note was revised in September 2015.

The directors have obligations under the Listing Rules that the preliminary announcement of results for the financial year shall have been agreed with the issuer's auditors before being published. PN 730 (Revised) dictates the auditor's procedures and reports on the outcome of such procedures to the directors. Auditors should perform an agreed-upon procedures engagement in accordance with HKSRS 4400 *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information*.

The listed company is also required to provide additional information to accompany its preliminary announcement of results. Auditors are not required to report on the additional information to accompany the preliminary announcement of results. However, the auditors' work in respect of the additional information accompanying the preliminary announcement of results would be carried out in accordance with the procedures set out in HKSA 720 (Revised) *The Auditor's Responsibility Relating to Other Information*, which would be similar to their reading of other information in the Annual Report.

6 Reporting on profit forecasts, statements of sufficiency and statements of indebtedness

Replace 'This is a new standard which was issued in April 2014 and is effective where the investment circular is dated on or after 1 July 2014.' *with* 'HKSIR 500 *Reporting on Profit Forecasts, Statements of Sufficiency of Working Capital and Statements of Indebtedness* was revised in December 2015 and is effective for reports dated on or after 15 December 2015.'

6.3 Reporting accountant's responsibilities: profit forecasts

Replace the bullet points under 'Reporting accountant's letter' *with the following.*

HKSIR 500.31

- A specific identification of the profit forecast and documents to which the letter refers
- The fact that the directors are solely responsible for the profit forecast
- That the firm of which the practitioner is a member applies HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1
- That the practitioner complies with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* (the Code), or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as the Code related to assurance engagements
- The fact that the reporting accountants have reviewed the accounting policies and calculations used in arriving at the profit forecast
- If, as will frequently be the case, the reporting accountants have not carried out an audit of results for expired periods, a statement to that effect
- Whether in the opinion of the reporting accountants the profit forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the bases and assumptions adopted by the directors, as set out in the document, and is presented on a basis consistent with the accounting policies normally adopted by the issuer

Answers to exam practice questions

Chapter 17 Audit reporting

Replace the answer to (a) with the following.

(a) The types of auditor's opinions that may be expressed in the auditor's report may be:

(i) Unmodified; or
(ii) Modified:

(1) Inability to obtain sufficient appropriate audit evidence.
(2) Financial statements are materially misstated.

The financial statements can reflect only the working assumptions of the management as to the financial outcome of inherent uncertainties (i.e. the value of the washing machines and dryers to the business is greater than $500,000 when the shop is profitable) and, where material, describe the circumstances giving rise to the uncertainties and their potential financial effect.

The auditors of QQ are required to consider the view given by the financial statements and the adequacy of any disclosures. Where the auditors are in agreement with the valuation given to the non-current assets and are satisfied that the level of any necessary disclosures is adequate, an unmodified audit opinion would be issued.

The auditors must consider whether there is any doubt regarding the management's use of the going concern basis of accounting. In accordance with HKSA 570 (Revised) where there is a material uncertainty about the management's use of the going concern basis of accounting which has not been adequately disclosed in the financial statements, a qualified or adverse opinion will be included in the auditor's report, as appropriate.

In addition, there will be a Basis for Qualified (or Adverse) Opinion paragraph immediately after the Opinion paragraph. This will state that a material uncertainty exists that may cast significant doubt on QQ's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Question bank - answers

Case study 1

Answer 3

(a) *Replace* 'Clarified' *with* 'Revised'

(b) *Delete* 'According to HKSA 706 (Clarified) *Emphasis of Matter Paragraph and Other Matter Paragraphs in the Independent Auditor's Report*, if the auditor agrees that it is still appropriate for the Management to use the going concern assumption, the auditor shall express in his report an unmodified opinion and include an Emphasis of Matter paragraph to disclose the legal claim and its impact. The Emphasis of Matter paragraph must also draw the user's attention to the related disclosure note in the financial statements and indicate that the auditor's opinion is not modified in respect of the matter emphasized.

In Cherry Group's case, the auditor should issue an unmodified opinion and include an Emphasis of Matter paragraph in his report.'

Insert the following in place of the above deleted text.

'According to HKSA 570 (Revised) *Going Concern*, if the auditor agrees that it is still appropriate for the management to use the going concern basis of accounting, the auditor shall express in his report an unmodified opinion and include a Material Uncertainty Related to Going Concern paragraph. This paragraph must draw the user's attention to the related disclosure note, state that events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

In Cherry Group's case, the auditor should issue an unmodified opinion and include an Material Uncertainty Related to Going Concern paragraph in their report.'

Case Study 4

Answer 4

Answer 4(b) is replaced with the following.

An adverse opinion is proposed as follows:

(b) Adverse Opinion

We have audited the consolidated financial statements of Happy Toy Ltd and its subsidiaries ('the Group') set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20Y2, the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, because of the omission of the information mentioned in the *Basis of Adverse Opinion* section of our report, the consolidated financial statements do not give a true and fair view of the consolidated financial position of the Group as at 31 December 20Y2, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA). In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Adverse Opinion

As explained in [note to the consolidated financial statements] as at 31 December 20Y2, the Group has bank borrowings of HK$300 million with maturity date due in September 20Y3 and cash balance of HK$30 million. The profit before tax of the Group for the year ended 31 December 20Y2 is HK$7 million. The Group is not able to provide sufficient evidence demonstrating that the Group will be able to repay is financial obligations in the coming 12 months from the end of the reporting period. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The consolidated financial statements do not adequately disclose this fact.

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

Case study 7

Answer 4

Answer 4(b) is replaced with the following.

(b) Independent Auditor's Report to the Unitholders of Dummy Real Estate Investment Trust (DREIT) (a collective investment scheme authorised under the Securities and Futures Ordinance)

Qualified Opinion

We have audited the financial statements of DREIT set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20Y0, the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the financial statements give a true and fair view of the financial position of DREIT as at 31 December 20Y0, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) and have been properly prepared in accordance with the relevant provisions of the Trust Deed and the relevant disclosure requirements set out in Appendix C of the REIT Code.

Basis for Qualified Opinion

DREIT has a block of commercial premises in New Territories, part of which collapsed in December 20Y0. Evidence indicated that the collapse might have been caused by an unauthorised extension on the premises, and the losses might not be recoverable under the group insurance policy. The Manager has not set aside any provisions for the possible losses. If a provision is made, DREIT's net income and unitholders' equity would have been reduced by $xx.

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

Mr. Kwok
Mr. Kwok's CPA incorporated practice

[Auditor's address]

[Date of the auditor's report]

Technical Updates – Flashcards

Revised flashcards:

Chapter 2: Corporate governance reports and practice

Insert the following flashcard after page 15.

UK Corporate Governance Code | **CG in Hong Kong** | Board committees

Mandatory requirement for issuers to include a narrative statement about how they have complied with the Code provisions on risk management and internal control during the reporting period in their Corporate Governance Report. The statement includes:

- Whether the issuer has an internal audit function;
- How often the risk management and internal control systems are reviewed, the period covered, and where an issuer has not conducted a review during the year, an explanation why not; and
- A statement that a review of the effectiveness of the risk management and internal control systems has been conducted and whether the issuer considers them effective and adequate.
- Processes used by the issuer for identifying, evaluating and managing the significant risks faced
- Main features of the issuer's risk management and internal control systems
- Acknowledgement by the board that it is responsible for the risk management and internal control systems and reviewing their effectiveness. It should also explain that such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss
- Process used to review the effectiveness of the risk management and internal control systems and to resolve material internal control defects
- Procedures and internal controls for the handling and dissemination of inside information

Chapter 3: Internal assurance

Replace the flashcard on page 18 with the following.

Risk management and internal control effectiveness | Internal audit | Sarbanes-Oxley

Directors

Internal controls and risk management are very important in fulfiling directors' duties to the shareholders, which are:

- To safeguard the assets
- To prevent and detect fraud

Protect the investment of the shareholder

Therefore they:

- Set up systems of risk management and internal control
- Review effectiveness of such systems
- Should have an internal audit function. If not, reasons should be disclosed

Auditors

As part of their audit:

- Ascertain controls
- Review controls
- Evaluate controls
- Determine audit approach based on controls

Can also offer services as a function separate from audit:

- To review controls
- Report to shareholders

HKELC requires that a listed company's risk management and internal control system should be reviewed annually by management and the internal audit function.

Chapter 9: Audit evidence, procedures, audit methodologies and audit sampling

Replace the flashcard on page 64 with the following.

Audit evidence | **Financial statement assertions** | Audit methodologies | Sampling | Documentation

Financial statement assertions are the 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.

Assertions

- About **classes of transactions and events and related disclosures**
  (occurrence, completeness, accuracy, cut-off, classification, presentation)
- About **account balances and related disclosures** at the period-end
  (existence, rights and obligations, completeness, accuracy, valuation and allocation, classification, presentation)

Chapter 16: Overall audit review and finalisation

Replace the flashcard on page 136 with the following.

Subsequent events | **Going concern** | Written representations | Related parties | Overall review | Other information | Communication | Misstatements

Going concern basis of accounting

Under the going concern basis of accounting the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

Auditor responsibilities

The auditor's responsibility is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern and to report in accordance with HKSA 570 (Revised).

Risk assessment

When performing risk assessment procedures, the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (examples given below). If management has performed a preliminary assessment of the entity's ability to continue as a going concern, the auditor shall discuss it with management. The auditor shall remain alert throughout the audit for any factors which would indicate problems.

Replace the flashcard on page 138 with the following.

Subsequent events	**Going concern**	Written representations	Related parties	Overall review	Other information	Communication	Misstatements

Reporting

Is Going Concern basis of accounting appropriate?	Are treatment and disclosures adequate?	Impact on auditor's report
Appropriate	Adequate	▪ Standard unmodified report
Appropriate, but Material Uncertainty exists	Adequate	▪ Unmodified opinion ▪ Include a section headed 'Material Uncertainty Related to Going Concern' ▪ Refer to FS disclosures
Appropriate, but Material Uncertainty exists	Inadequate	▪ Qualified or adverse opinion ▪ State that disclosures in the FS are inadequate in the 'Basis for Qualified/Adverse Opinion' paragraph
Inappropriate	FS inappropriately prepared using going concern basis of accounting regardless of whether or not the inappropriateness are disclosed in the FS	▪ Adverse opinion ▪ Description of circumstances in the 'Basis for Adverse Opinion' paragraph
Inappropriate	Adequate FS prepared on alternative basis, eg liquidation basis	▪ Unmodified opinion ▪ Consider including an Emphasis of Matter paragraph to draw attention to alternative basis of accounting

Replace the flashcard on page 143 with the following.

Subsequent events	Going concern	Written representations	Related parties	Overall review	**Other information**	Communication	Misstatements

Other information

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

Examples

- Financial summaries/highlights
- Report by management/directors on operations
- Planned capital expenditures
- Financial ratios
- Selected quarterly data

The auditor shall obtain and read the other information to identify any material inconsistencies with the financial statements.

On discovery of a material inconsistency, the auditor shall conclude whether:

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

Insert the following new flashcard after page 143.

Subsequent events	Going concern	Written representations	Related parties	Overall review	**Other information**	Communication	Misstatements

Auditor's report

- The auditor's report always includes a separate Other Information section when the auditor has obtained some/all of the other information as of the date of the auditor's report.
- For listed entities, an Other Information section is also included if other information is expected to be received after the date of the auditor's report.

Opinion	Position of Other Information section
Unmodified and other information is not materially misstated	A standard unmodified Other Information section is placed after KAM section
Unmodified and other information is materially misstated	An Other Information section with description of material misstatements of the other information is placed after the Basis of Opinion section and after the KAM section

Replace the flashcard on page 144 with the following.

Subsequent events	Going concern	Written representations	Related parties	Overall review	Other information	**Communication**	Misstatements

Reporting to those charged with governance

Guidance on reporting to management and other stakeholders is given in HKSA 260 (Revised) *Communication With Those Charged With Governance.*

Those charged with governance are the person(s) or organisation(s) (e.g., 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.

Matters should be discussed with those charged with governance on a **sufficiently prompt basis** so that they can react to what the auditor has said. The auditor should determine who those charged with governance are.

If an **audit committee** exists, it is likely to be the appropriate body to report matters arising from the audit to. Such relevant matters are outlined below.

Replace the flashcard on page 146 with the following.

Subsequent events	Going concern	Written representations	Related parties	Overall review	Other information	Communication	**Misstatements**

Treatment of misstatements

A **misstatement** is a difference between the reported amount, classification, presentation or disclosure of a 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. Misstatement can arise from error or fraud.

Uncorrected misstatements are misstatements accumulated by the auditor during the audit which have not been corrected.

HKSA 450 *Evaluation of Misstatements Identified During the Audit* provides guidance.

Types of misstatements

- Factual (no doubt)
- Judgmental (management's judgment concerning the reasonableness and appropriateness of accounting estimates or accounting policies)
- Projected (auditor's best estimate)
- Misstatements in disclosures

HKSA 450

The auditor must communicate all misstatements accumulated during the audit to the appropriate level of management on a timely basis and request them to be corrected (except those which are clearly trivial).

The auditor must obtain a written representation that management believes the effects of uncorrected misstatements are immaterial to the financial statements as a whole.

Chapter 17: Audit Reporting

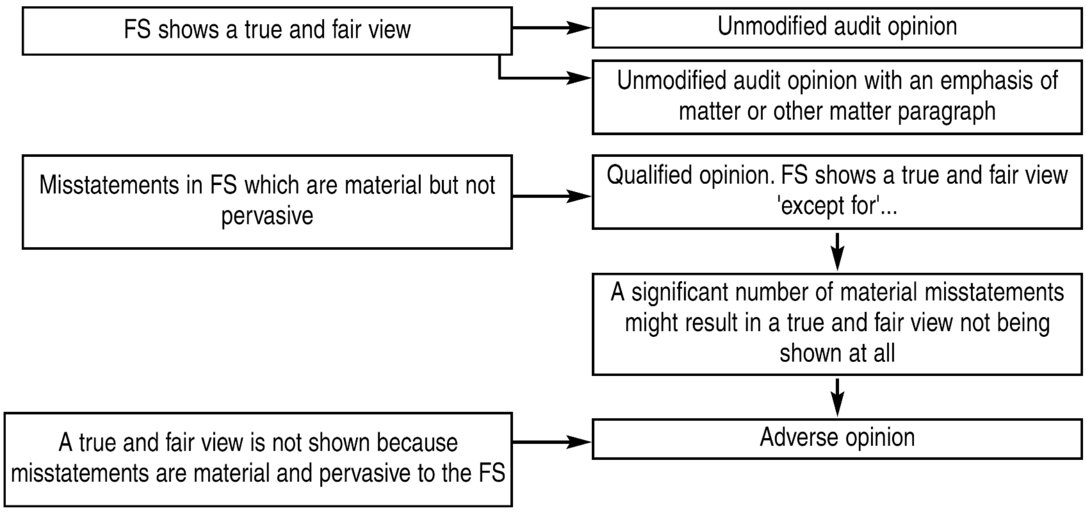
Replace all flashcards in Chapter 17 as follows.

17: Audit reporting

Topic List

- Auditor's report
- Unmodified reports
- Key audit matters
- Modified reports
- Emphasis of matter and other matter

The auditor's report is the final product of the audit process. You may be required to describe different types of modification in a knowledge or scenario question.



Auditor's report | Unmodified reports | Key audit matters | Modified reports | Emphasis of matter and other matter

The auditor cannot tell whether a true and fair view is given in respect of material item(s) due to an inability to obtain sufficient appropriate audit evidence → Qualified opinion. FS shows a true and fair view 'except for'...

Auditor cannot tell whether a true and fair view is given at all due to inability to obtain sufficient appropriate audit evidence → Disclaimer of opinion

Question 1

Have all the procedures necessary to meet auditing standards and to obtain all the information and explanations necessary for the audit been carried out?

Question 2

Have the financial statements been prepared in accordance with the applicable accounting requirements?

Question 3

Do the financial statements give a true and fair view?

Auditor's report | Unmodified reports | Key audit matters | Modified reports | Emphasis of matter and other matter

Basic elements of auditor's report

- Title
- Addressee
- Opinion paragraph
- Basis for opinion
- Going concern (only when material uncertainty exists)
- Key audit matters
- Other information
- Directors' responsibilities for the financial statements
- Auditor's responsibilities
- Other reporting responsibilities (if applicable)
- Name of the engagement partner (for audits of FS of listed entities only)
- Auditor's signature
- Auditor's address
- Date of the report

In an **unmodified** auditor's report, the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Opinion

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

In our opinion, the financial statements **give a true and fair view** of the financial position of the Company as at 31 December 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards, issued by the Hong Kong Institute of Certified Public Accountants and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Auditor's report	Unmodified reports	**Key audit matters**	Modified reports	Emphasis of matter and other matter

Key audit matters (KAMs)

Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

KAMs do not modify the audit opinion or report. They are part of the **standard unmodified auditor's report**.

KAMs are not separate audit opinions – the auditor expresses a view on a KAM, but this is only part of the opinion on the FS as a whole.

KAMs are less significant than Emphasis of Matter paragraphs.

The KAMs are **matters that are already disclosed** in the entity's financial statements. KAMs should not give original information about the entity.

The auditor should communicate the items selected as KAMs to those charged with governance.

Why?

KAMs aim to improve **communication** in the auditor's report.

KAMs are tailored to each audit, and disclose important information about the audit to users.

Choosing KAMs

Matters to consider when determining the key audit matters:

- **Importance** to users' understanding
- **Materiality**
- Degree of **complexity or subjectivity** of accounting policy
- Whether there are any **misstatements**
- The nature and extent of **audit effort** was needed
- **Difficulties** in applying audit procedures, degree of subjectivity involved
- Severity of any **control deficiencies**

KAMs have their own section in the auditor's report, which is after the Basis for Opinion section.

For each KAM, the auditor describes:

- **Why** the matter was determined to be a KAM; and
- **How** the matter was addressed in the audit.

Auditor's report	Unmodified reports	Key audit matters	**Modified reports**	Emphasis of matter and other matter

Modifications to the independent auditor's report

HKSA 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report* deals with situations where the auditor cannot issue an unmodified opinion.

There are two circumstances under which the auditor's opinion will be modified.

1. The auditor concludes that the financial statements as a whole are **not free from material misstatement** (qualified opinion or adverse opinion).
2. The auditor is **unable to obtain sufficient appropriate audit evidence** to conclude that the financial statements as a whole are free from material misstatement (qualified opinion or disclaimer of opinion).

Exam focus

For a matter to affect the auditor's opinion, it must be **material** or **pervasive** to the financial statements.

Emphasis of matter paragraphs and other matter paragraphs

An **emphasis of matter paragraph** is included in the auditor's report to refer to a matter already appropriately presented or disclosed in the financial statements which is of such importance that it is fundamental to users' understanding of the financial statements.

Emphasis of matter paragraphs – examples

- Uncertainty relating to future outcome of exceptional litigation or regulatory action
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the FS
- Major catastrophe that has a significant effect on the entity's financial position

An **other matter paragraph** is included in the auditor's report to refer to a matter other than those presented or disclosed in the financial statements which is relevant to users' understanding, or the auditor's responsibilities.

HKSA 706 (Revised) *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* provides guidance.