

Audit Practice Introduced by HKSA

(HKSA 230, 300, 315, 330 and 500) – Part 2

1 September 2008



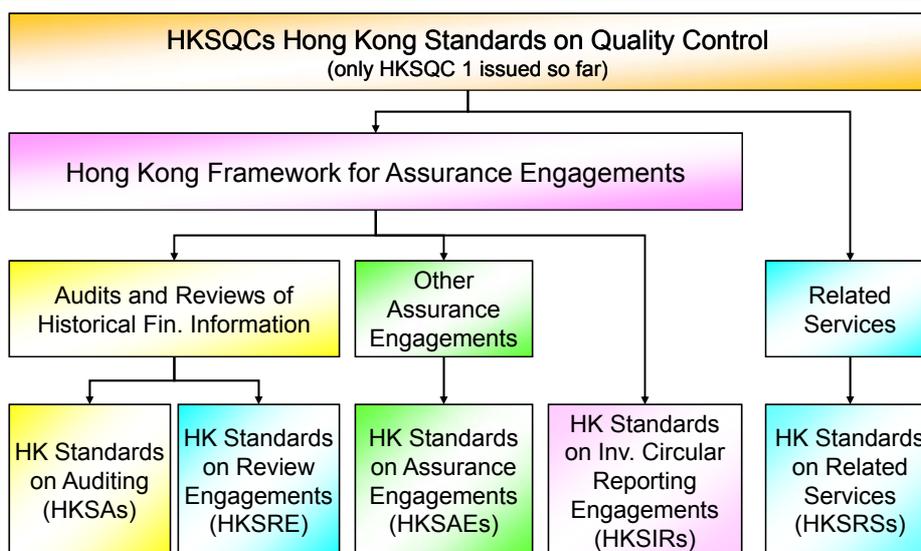
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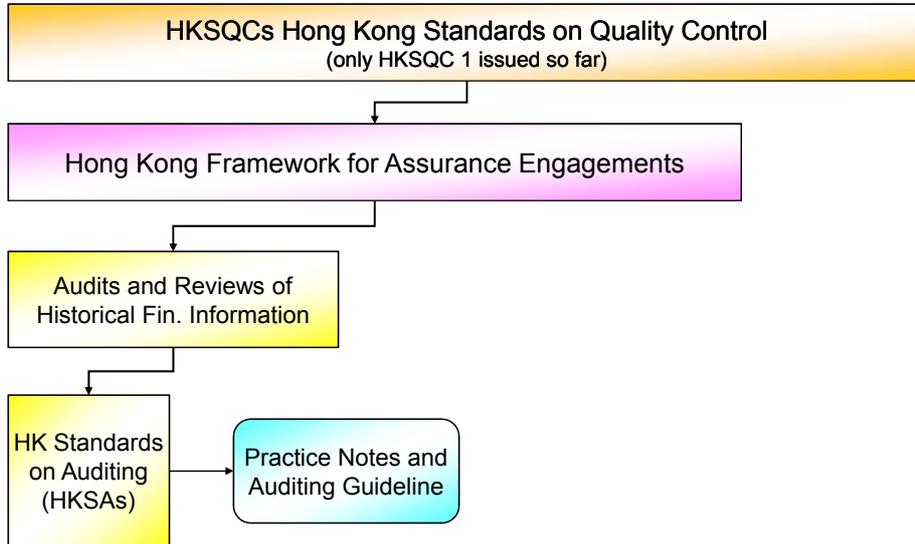
Overview



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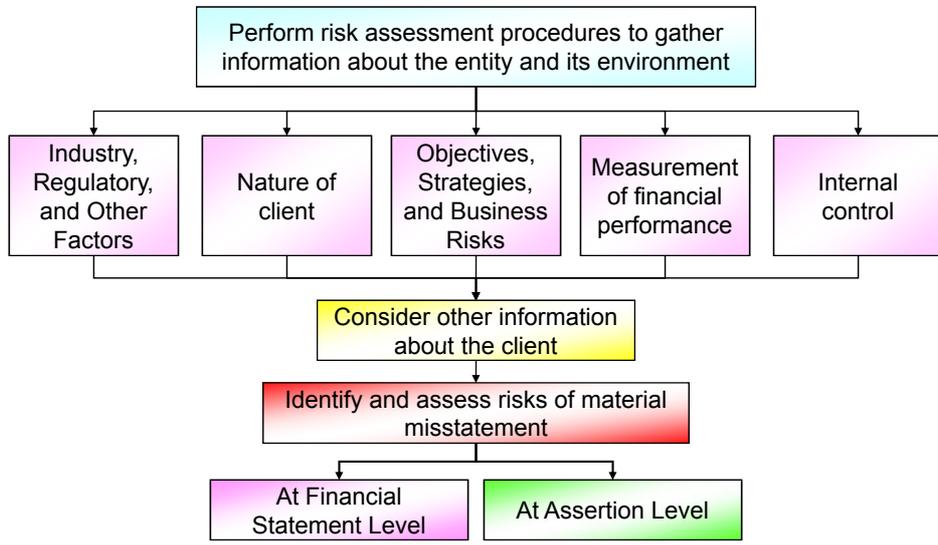
HKSQC and HKSA's



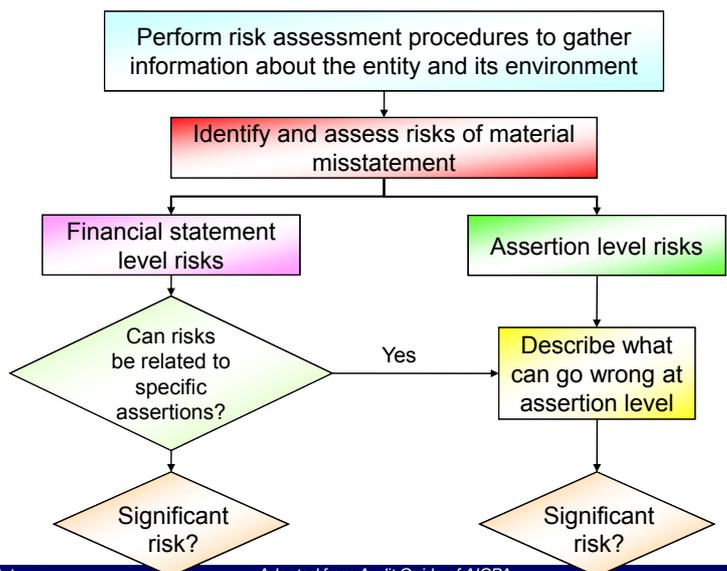
Audit Process Overview



Assessing the Risks



Assessing the Risks



Agenda for Part 1 and Part 2



Planning (HKSA 300)

Understanding the Entity and its Environment (HKSA 315)

Assessing the Risks of Material Misstatement (HKSA 315)

The Auditor's Procedures in Response to the Assessed Risks (HKSA 330)

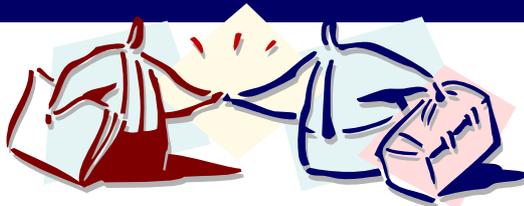
Audit Documentation (HKSA 230)

Simple but Comprehensive

Critical and New Issues

Templates and Examples

Today's Agenda



The Auditor's Procedures in Response to the Assessed Risks (HKSA 330)

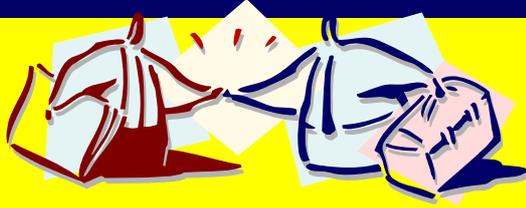
Audit Documentation (HKSA 230)

Simple but Comprehensive

Critical and New Issues

Templates and Examples

Today's Agenda

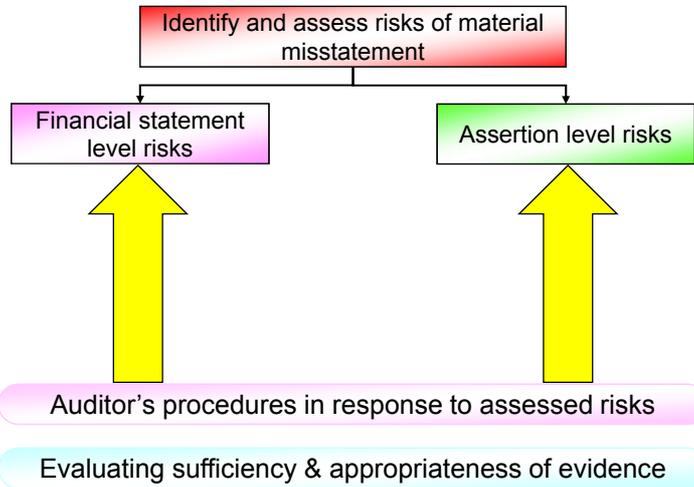


The Auditor's Procedures in Response to the Assessed Risks (HKSA 330)

Audit Process Overview



Responses to Assessed Risks



Responses to Assessed Risks

Activity

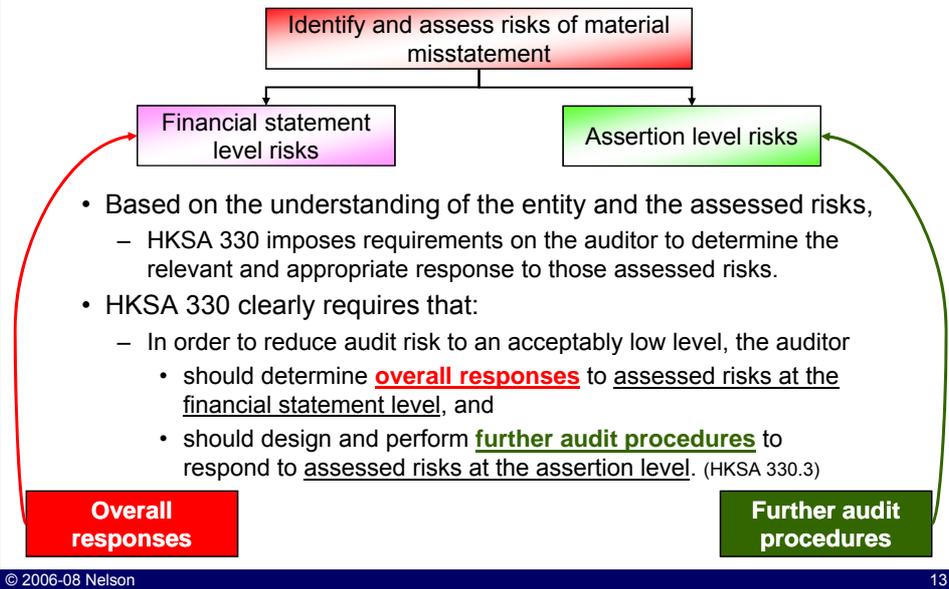


Activity 5 – Audit Response

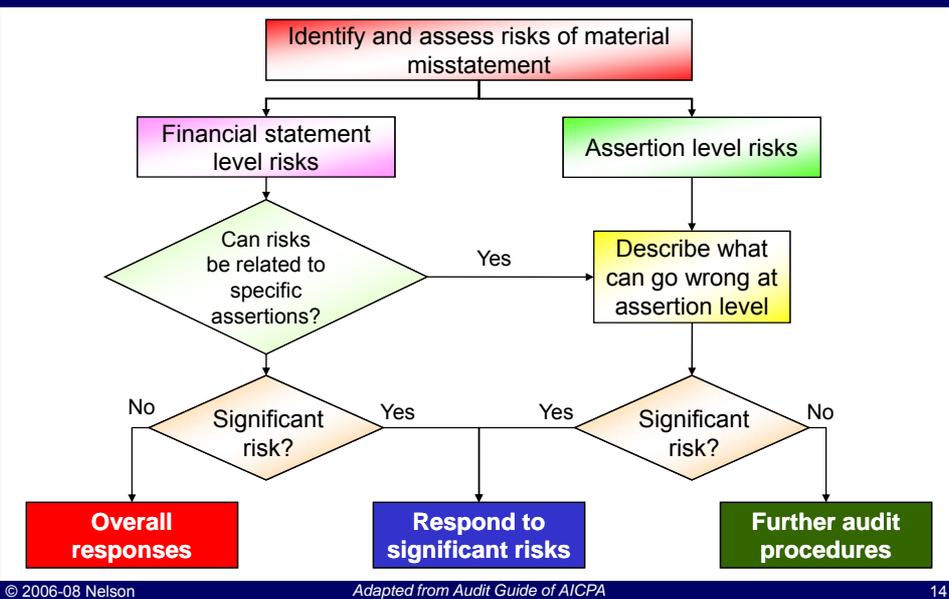
- Referring to Activity 3 and based on the Case of ABC and the assessment on the risks of material misstatements at the financial statement level
 - Determine the appropriate responses to the assessed risks.

Auditor's procedures in response to assessed risks

Responses to Assessed Risks



Responses to Assessed Risks



Overall Responses

- The auditor should determine **Overall Responses** to address the risks of material misstatement at the financial statement level. (HKSA 330.4)

- Overall responses may include:
 - emphasizing to the audit team the need to maintain professional skepticism in gathering and evaluating audit evidence,
 - assigning more experienced staff or those with special skills or using experts,
 - providing more supervision, or
 - incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
 - making general changes to the nature, timing, or extent of audit procedures as an overall response, for example, performing substantive procedures at period end instead of at an interim date.

Overall responses

Overall Responses

- The assessment of the risks of material misstatement at the financial statement level is affected by the auditor's understanding of the control environment.
 - An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example,
 - allow the auditor to conduct some audit procedures at an interim date rather than at period end.



Overall responses

Overall Responses

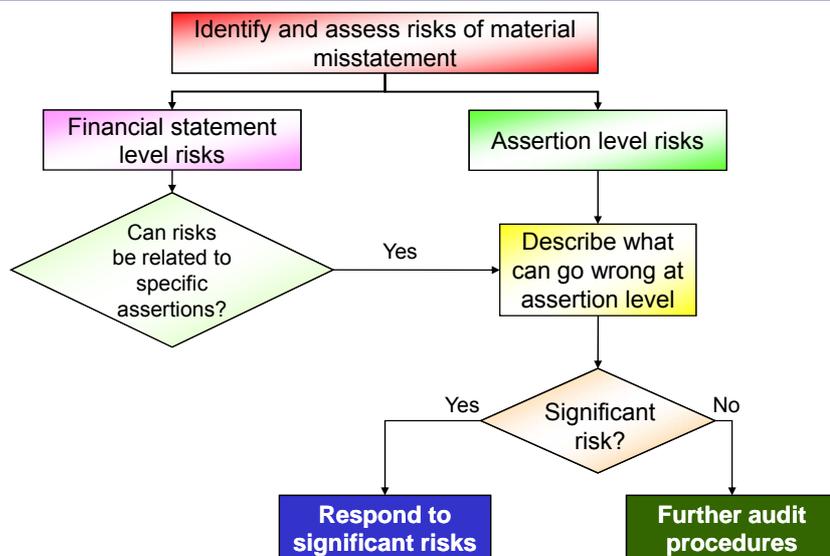
Example

- If there are weaknesses in the control environment, how would they affect the auditor's overall response?

- If there are weaknesses in the control environment, the auditor ordinarily
 - conducts more audit procedures as of the period end rather than at an interim date,
 - seeks more extensive audit evidence from substantive procedures,
 - modifies the nature of audit procedures to obtain more persuasive audit evidence, or
 - increases the number of locations to be included in the audit scope.
- It may also have a significant bearing on the auditor's general approach, for example,
 - an emphasis on substantive procedures (**substantive approach**), or
 - an approach that uses tests of controls as well as substantive procedures (**combined approach**).

Overall response

Risks at Assertion Level



Risks at Assertion Level

- ISA 500 requires the auditor to use assertions for
 - classes of transactions,
 - account balances, and
 - presentation and disclosures

Assertion level risks

in sufficient detail to form a basis for

- the assessment of risks of material misstatement and
- the design and performance of further audit procedures. (HKSA 500.16)

Class of Transactions

Account Balances

Presentation and Disclosure

Further audit procedures

Risks at Assertion Level

- Assertions used by the auditor fall into the following categories:
 - About Classes of Transactions and Events for the period under audit
 - Occurrence
 - Completeness
 - Accuracy
 - Cutoff
 - Classification
 - About Account Balances at the period end
 - Existence
 - Rights and obligations
 - Completeness
 - Valuation and allocation
 - About Presentation and Disclosure
 - Occurrence and rights and obligations
 - Completeness
 - Classification and understandability
 - Accuracy and valuation

Class of Transactions

Account Balances

Presentation and Disclosure



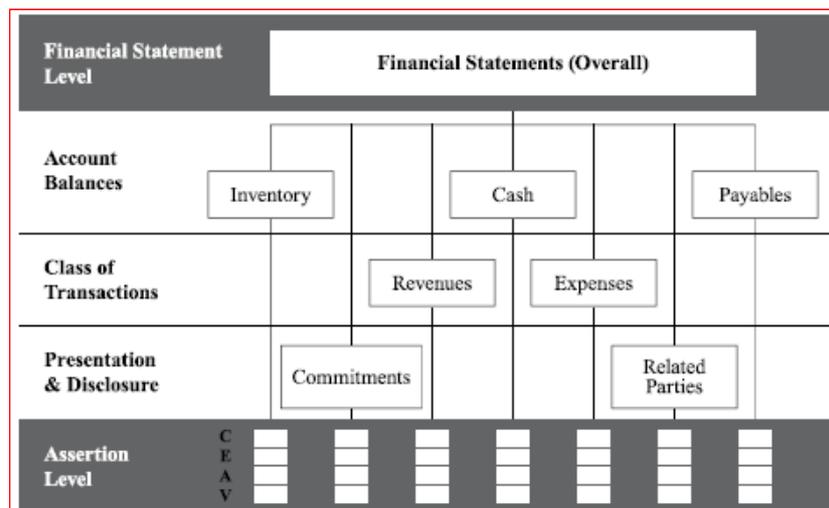
Risks at Assertion Level

- Guide to Using International Standards on Auditing in the Audits of Small- and Medium-sized Entities (IFAC SMPC):
 - To make the use of assertions a little easier to apply to smaller entities, the Guide has combined a no. of the assertions. The 4 combined assertions and the assertions they address are illustrated in the exhibit below.

Combined Assertions	Classes of Transactions	Account Balances	Presentation and Disclosure
Completeness	Completeness	Completeness	Completeness
Existence	Occurrence	Existence	Occurrence
Accuracy and Cut-off	Accuracy Cut-off Classification	Rights and obligations	Accuracy Rights and obligations Classification and understandability
Valuation		Valuation and allocation	Valuation

- When the auditor uses combined assertions, it is important to remember that the accuracy and cut-off assertion also include classification and rights and obligations.

Risks at Assertion Level



Further Audit Procedures (FAP)

Activity

Identify and assess risks of material misstatement

Assertion level risks

Activity 6 – Risk at Assertion Level and Audit Response

- Based on the Case of ABC in Activity 3 and 6 and regarding the consignment sales of ABC:
 - a. Identify the major audit issues in ABC's consignment sales recognition for the purpose of assessing the risk of material misstatement at the assertion level.
 - b. Describe the procedures (including risk assessment and further audit procedures) you would perform in relation to the consignment sales.

Further Audit Procedures (FAP)

- The auditor should design and perform **further audit procedures** whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the assertion level. (HKSA 330.7)
 - The purpose is to provide a clear linkage between
 - the nature, timing, and extent of the auditor's further audit procedures and
 - the risk assessment.

Nature

Timing

Extent

Further audit procedures



Further Audit Procedures (FAP)

- In designing further audit procedures, the auditor considers such matters as the following:
 - The significance of the risk.
 - The likelihood that a material misstatement will occur.
 - The characteristics of the class of transactions, account balance, or disclosure involved.
 - The nature of the specific controls used by the entity and in particular whether they are manual or automated.
 - Whether the auditor expects to obtain audit evidence to determine if the entity's controls are effective in preventing, or detecting and correcting, material misstatements.
- The nature of the audit procedures
 - is of most importance in responding to the assessed risks.

Nature

Timing

Extent

Further audit procedures

Further Audit Procedures (FAP)

- The auditor's assessment of the identified risks at the assertion level
 - provides a basis for considering the appropriate audit approach for designing and performing further audit procedures.
- Often the auditor may determine that a combined approach is an effective approach, such approach would use
 - tests of the operating effectiveness of controls and
 - substantive procedures.

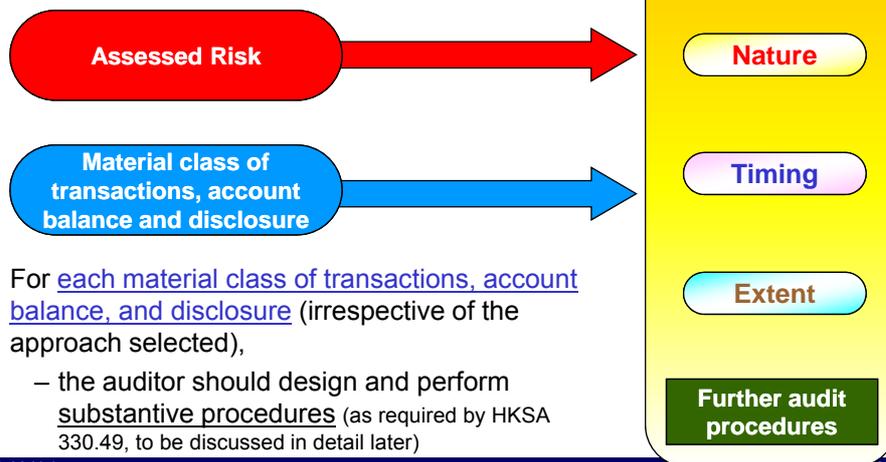
- In some cases, only performing tests of controls may achieve a good response to the assessed risk at an assertion.
- In other cases, performing only substantive procedures is appropriate for an assertions and the relevant control is not considered in risk assessment (say, no relevant effective controls have been identified or such test of control may be inefficient)

Extent

Further audit procedures

Further Audit Procedures (FAP)

- The auditor's **assessment of the identified risks** at the assertion level



- For **each material class of transactions, account balance, and disclosure** (irrespective of the approach selected),
 - the auditor should design and perform **substantive procedures** (as required by HKSA 330.49, to be discussed in detail later)

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FAP – Nature, Timing and Extent

The nature, timing and extent of FAPs

- **Nature** refers to their purpose and their type
 - Purpose:
 - tests of controls or substantive procedures
 - Type:
 - inspection, observation, inquiry, confirmation, recalculation, re-performance, or analytical procedures
- **Timing** refers to
 - When audit procedures are performance (at interim date, at period end, or after period end), or
 - The period or date to which the audit evidence applies
- **Extent** refers to
 - The quantity of a specific audit performance to be performed

Nature

Timing

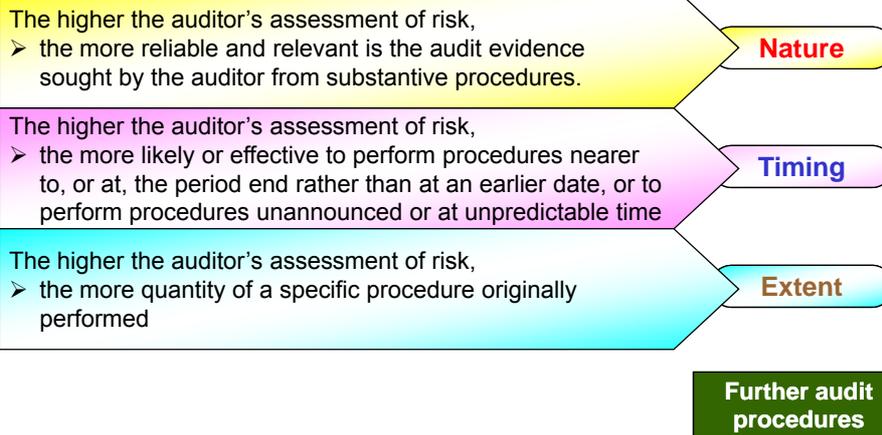
Extent

Further audit procedures

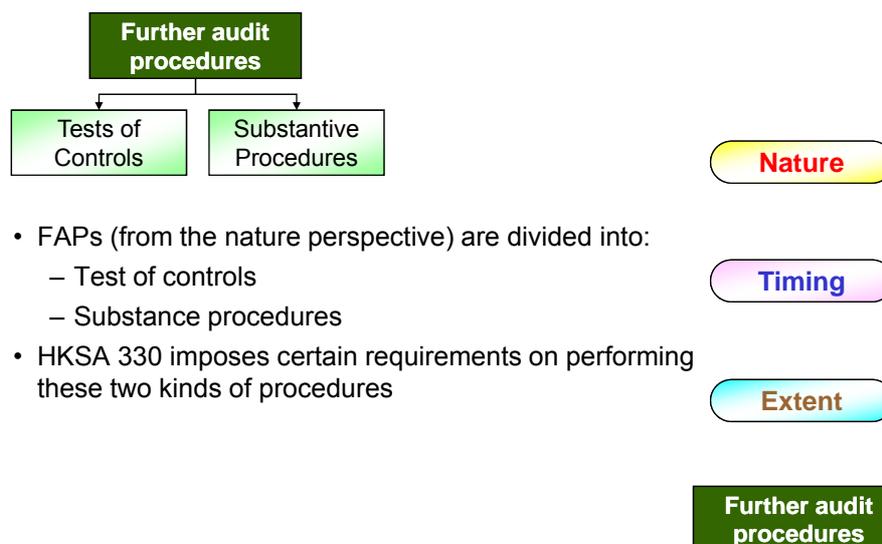
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FAP – Nature, Timing and Extent



FAP under HKSA 330



FAP – Tests of Controls

Tests of Controls

Expectation of Effective Controls

Substantive Procedures Alone Ineffective

- The auditor is required to perform tests of controls
 1. when the auditor's risk assessment includes an expectation of the operating effectiveness of controls or
 2. when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level.



FAP – Tests of Controls

Tests of Controls

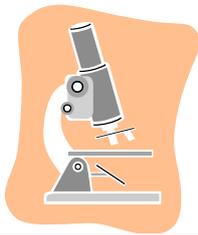
Expectation of Effective Controls

Substantive Procedures Alone Ineffective

- When the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that controls are operating effectively,
 - the auditor should perform tests of controls to obtain sufficient appropriate audit evidence that the controls were operating effectively at relevant times during the period under audit. (HKSA 330.23)
- When the auditor has determined that it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures,
 - the auditor should perform tests of relevant controls to obtain audit evidence about their operating effectiveness. (HKSA 330.25)

FAP – Tests of Controls

Tests of Controls



- Testing the operating effectiveness of controls
 - is different from obtaining audit evidence that controls have been implemented.
- When obtaining audit evidence of implementation by performing risk assessment procedures,
 - the auditor determines that the relevant controls exist and that the entity is using them.
- When performing tests of the operating effectiveness of controls,
 - the auditor obtains audit evidence that controls operate effectively, including evidence about
 - how controls were applied at relevant times during the period under audit,
 - the consistency with which they were applied, and
 - by whom or by what means they were applied.

FAP – Tests of Controls

Tests of Controls

Nature

- In respect of the nature of the test of controls, HKSA 330 strictly requires that:
 - The auditor should perform other audit procedures in combination with inquiry to test the operating effectiveness of controls. (HKSA 330.29)
- Since inquiry alone is not sufficient, the auditor is required to use a combination of audit procedures to obtain sufficient appropriate audit evidence regarding the operating effectiveness of controls.
 - Those controls subject to testing by performing inquiry combined with inspection or reperformance ordinarily provide more assurance than those controls for which the audit evidence consists solely of inquiry and observation.

FAP – Tests of Controls

Example

- For example, an auditor may inquire about and observe the entity's procedures for opening the mail and processing cash receipts to test the operating effectiveness of controls over cash receipts.
- Because an observation is pertinent only at the point in time at which it is made, the auditor
 - ordinarily supplements the observation with inquiries of entity personnel, and
 - may also inspect documentation about the operation of such controls at other times during the audit period in order to obtain sufficient appropriate audit evidence.

FAP – Tests of Controls

Tests of Controls

Timing



- The timing of tests of controls depends on the auditor's objective and determines the period of reliance on those controls.
 - If the auditor tests controls at a particular time,
 - the auditor only obtains audit evidence that the controls operated effectively at that time
e.g. physical inventory count at period end
 - If the auditor tests controls throughout a period
 - the auditor obtains audit evidence of the effectiveness of the operation of the controls during that period
e.g. inventory delivery control over the period

FAP – Tests of Controls

Tests of Controls

Timing

- HKSA 330 specifically requires that
 - When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period,
 - the auditor should determine what additional audit evidence should be obtained for the remaining period. (HKSA 330.37)
- The auditor obtains audit evidence about the nature and extent of any significant changes in internal control,
 - including changes in the information system, processes, and personnel that occur subsequent to the interim period.



FAP – Tests of Controls

Tests of Controls

Timing

- HKSA 330 also requires that
 - If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in prior audits,
 - the auditor should obtain audit evidence about whether changes in those specific controls have occurred subsequent to the prior audit.
 - by performing inquiry in combination with observation or inspection to confirm the understanding of those specific controls. (HKSA 330.39)

Controls Changed

Controls Not Changed

FAP – Tests of Controls

Tests of Controls

Timing



- HKSA 330 requires that
 - If the auditor plans to rely on controls that have changed since they were last tested,
 - the auditor should test the operating effectiveness of such controls in the current audit. (HKSA 330.40)
 - If the auditor plans to rely on controls that have not changed since they were last tested,
 - the auditor should test the operating effectiveness of such controls at least once in every third audit. (HKSA 330.41)

Test in current audit

Controls Changed

Controls Not Changed

Test once every third audit

FAP – Tests of Controls

Tests of Controls

Timing

- HKSA 330 requires that
 - When there are a number of controls for which the auditor determines that it is appropriate to use audit evidence obtained in prior audits,
 - the auditor should test the operating effectiveness of some controls each audit. (HKSA 330.43)

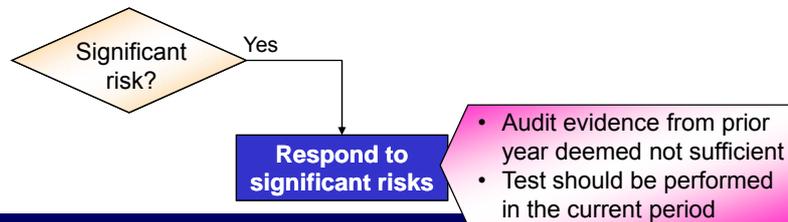


FAP – Tests of Controls

Tests of Controls

- HKSA 330 requires that
 - When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk and the auditor plans to rely on the operating effectiveness of controls intended to mitigate that significant risk,
 - the auditor should obtain the audit evidence about the operating effectiveness of those controls from tests of controls performed in the current period. (HKSA 330.44)

Timing



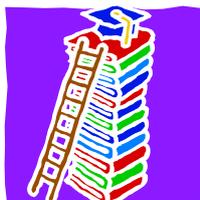
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FAP – Tests of Controls

Tests of Controls

- The more the auditor relies on the operating effectiveness of controls in the assessment of risk,
 - the greater is the extent of the auditor's tests of controls.
- In addition, as the rate of expected deviation from a control increases,
 - the auditor increases the extent of testing of the control.
- However, the auditor considers whether the rate of expected deviation indicates that the control will not be sufficient to reduce the risk of material misstatement at the assertion level to that assessed by the auditor.
 - If the rate of expected deviation is expected to be too high, the auditor may determine that tests of controls for a particular assertion may not be effective.

Extent

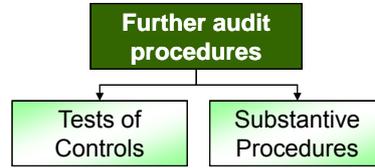


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FAP – Substantive Procedures

- Substantive procedures are performed in order to detect material misstatements at the assertion level, and include
 - tests of details of classes of transactions, account balances, and disclosures
 - substantive analytical procedures



FAP – Substantive Procedures

- HKSA 330 requires that the auditor always performs substantive procedures for each material class of transactions, account balance, and disclosure:
 - Irrespective of the assessed risk of material misstatement, the auditor should design and perform substantive procedures for each material class of transactions, account balance, and disclosure. (HKSA 330.49)
- This requirement reflects the fact that
 - the auditor's assessment of risk is judgmental and may not be sufficiently precise to identify all risks of material misstatement.
- Further, there are inherent limitations to internal control including management override.

Substantive Procedures



FAP – Substantive Procedures

- The auditor's substantive procedures should include the following audit procedures related to the financial statement closing process:
 - Agreeing or reconciling the financial statements with to the underlying accounting records; and
 - Examining material journal entries and other adjustments made during the course of preparing the financial statements. (HKSA 330.50)

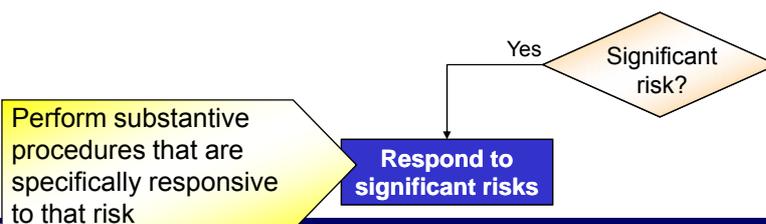
Substantive Procedures



FAP – Substantive Procedures

- When the auditor has determined that an assessed risk of material misstatement at the assertion level is a **significant risk**,
 - the auditor should perform substantive procedures that are specifically responsive to that risk. (HKSA 330.51)

Substantive Procedures



FAP – Substantive Procedures

Example

- The auditor identifies that the management is under pressure to meet earning expectation, discuss any implication on sales and suggest relevant substantive procedures.

- If the auditor identifies that management is under pressure to meet earnings expectations
 - there may be a risk that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment.
- In these circumstances,
 - the auditor may, for example, design external confirmations
 - not only to confirm outstanding amounts,
 - but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms.
 - In addition, the auditor may find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

FAP – Substantive Procedures

- Substantive analytical procedures
 - are generally more applicable to large volumes of transactions that tend to be predictable over time.
- Tests of details
 - are ordinarily more appropriate to obtain audit evidence regarding certain assertions about account balances, including existence and valuation.

Substantive
Procedures

Nature

- In some situations,
 - for example, the auditor may determine that performing only substantive analytical procedures is responsive to the assessed risk of material misstatement for a class of transactions where the auditor's assessment of risk is supported by obtaining audit evidence from performance of tests of the operating effectiveness of controls

FAP – Substantive Procedures



- HKSA 330 specifically requires that:
 - When substantive procedures are performed at an interim date,
 - the auditor should perform
 - further substantive procedures or
 - substantive procedures combined with tests of controls
- to cover the remaining period that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. (HKSA 330.56)

Substantive
Procedures

Timing

- In circumstances where the auditor has identified risks of material misstatement due to fraud,
 - the auditor's response to address those risks may include changing the timing of audit procedures, for example, extending audit procedures from an interim date to the period end.

FAP – Substantive Procedures

- The greater the risk of material misstatement, the greater the extent of substantive procedures.
 - However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.
- In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size, which is affected by the risk of material misstatement.
 - However, the auditor also considers other matters, including whether it is more effective to use
 - other selective means of testing, such as selecting large or unusual items from a population
 - as opposed to performing
 - representative sampling or
 - stratifying the population into homogeneous subpopulations for sampling.

Substantive
Procedures

Extent

Assessed Risks and FAP

Activity

Identify and assess risks of material misstatement

Assertion level risks

Activity 7 – Linkage between Assessed Risks and Auditor's Response

- Based on the answers of Activity 7, discuss whether the documentation for the risk of material misstatement assessed on consignment sales has met the requirements of HKSA 330.
- Suggest further documentation and amend, if any, the documentation to meet the requirement.

Further audit procedures

Presentation and Disclosure

Adequacy of Presentation and Disclosure

- HKSA 330 requires that:
 - The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, are in accordance with the applicable financial reporting framework. (HKSA 330.65)

Substantive Procedures



Audit Process Overview

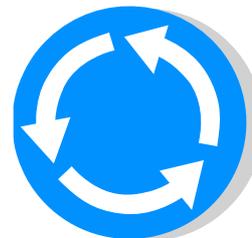


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Evaluate Sufficiency and Appropriateness

- HKSA 330 requires that:
 - Based on the audit procedures performed and the audit evidence obtained,
 - the auditor should evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate. (HKSA 330.66)
- An audit of financial statements is a cumulative and iterative process.
 - As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures.



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Evaluate Sufficiency and Appropriateness

Example

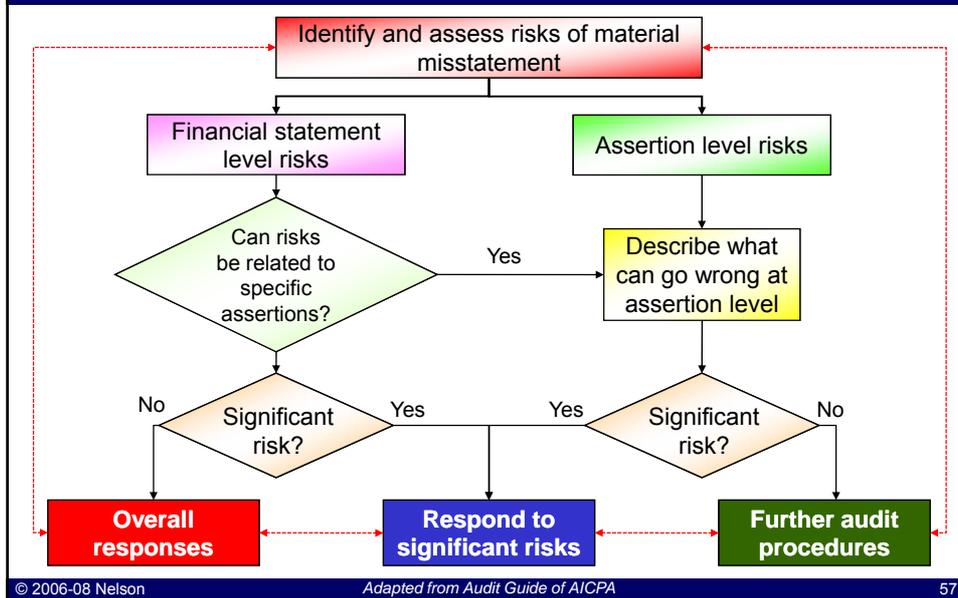
- The extent of misstatements that the auditor detects by performing substantive procedures
 - may alter the auditor's judgment about the risk assessments and
 - may indicate a material weakness in internal control
- Analytical procedures performed at the overall review stage of the audit
 - may indicate a previously unrecognized risk of material misstatement.
- In such circumstances, the auditor may need to reevaluate the planned audit procedures
 - based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions.

Evaluate Sufficiency and Appropriateness

- HKSA 330 requires that:
 - The auditor should conclude whether sufficient appropriate audit evidence has been obtained
 - to reduce to an acceptably low level the risk of material misstatement in the financial statements. (HKSA 330.70)
 - If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion,
 - the auditor should attempt to obtain further audit evidence.
 - If the auditor is unable to obtain sufficient appropriate audit evidence,
 - the auditor should express
 - a qualified opinion or
 - a disclaimer of opinion. (HKSA 330.72)



Responses to Assessed Risks



Documentation



- HKSA 330 requires that:
 - The auditor should document
 - **the overall responses** to address the assessed risks of material misstatement at the financial statement level and **the nature, timing, and extent of the further audit procedures**,
 - **the linkage of those procedures** with the assessed risks at the assertion level, and
 - **the results of the audit procedures**.

Documentation



- HKSA 330 requires that:
 - In addition, if the auditor plans to use audit evidence about the operating effectiveness of controls obtained in prior audits, the auditor should document
 - the conclusions reached with regard to relying on such controls that were tested in a prior audit. (HKSA 330.73)
 - The auditor's documentation should demonstrate that the financial statements agree or reconcile with the underlying accounting records. (HKSA 330.73a)

Overall Responses Linked to Risks

Example

Description of the issues identified	Risk resulted	Significant risk (Y/N)	Overall Responses

Overall Responses Linked to Risks

Example

Description of the issues identified	Risk resulted	Significant risk (Y/N)	Overall Responses
1. The entity is an owner-managed private entity and thus lacking formal internal control system.	The financial statements might have been prepared inaccurately.	Yes	<ul style="list-style-type: none"> The audit team is reminded to maintain professional scepticism in performing the engagement. More experienced audit staff is assigned to the engagement.
2. The computer in recording and preparing the financial information has been upgraded.	The financial information might have not been properly transferred to the new computer.	Yes (Non-routine)	<ul style="list-style-type: none"> Audit staff with experience and knowledge in computer data and source information transfer is assigned to the audit team.

FAP Linked to Assessed Risks

Example

Issues and Risks identified	Relevant Assertions	Significant risk (Y/N)	Further Audit Procedures (Audit Responses)

FAP Linked to Assessed Risks

Example

Issues and Risks identified	Relevant Assertions	Significant risk (Y/N)	Further Audit Procedures (Audit Responses)
1. Property acquired in Shanghai during the year	Rights and Obligations	Yes (non-routine)	<ul style="list-style-type: none"> Land search performed in Shanghai Physical inspection and count on property, plant and equipment to be performed
2. No property has been acquired before and the owner and staff have no knowledge on accounting new property	Accuracy, Valuation, Classification	Yes (non-routine)	<ul style="list-style-type: none"> Consider the appropriateness of accounting policy on property adopted Check cost of acquisition to the sale and purchase agreement and match with the payment Verify the calculation of depreciation independently Review the entity's impairment review

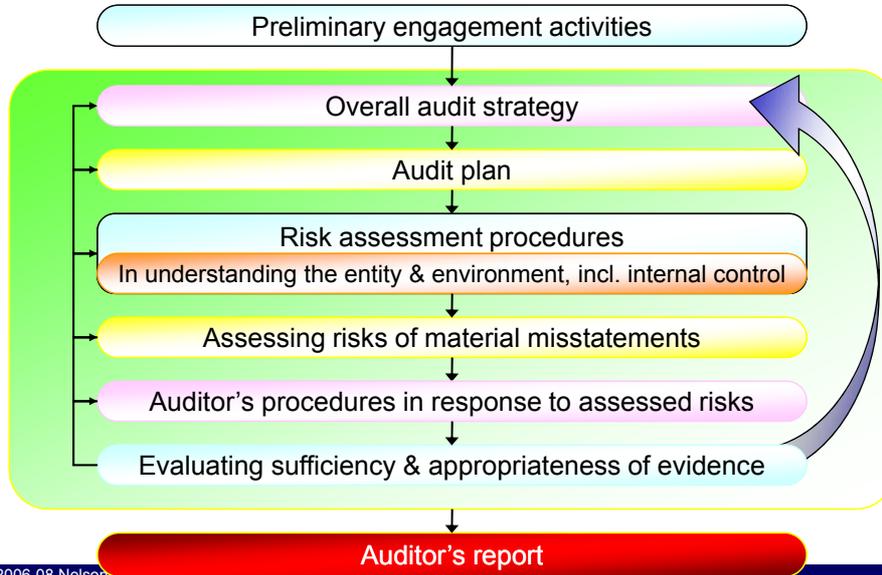
Documentation

Sample

Assessing Risks of Material Misstatement and Linkage to Auditor's Response (A. Financial Statement Level)

Assessing Risks of Material Misstatement and Linkage to Auditor's Response (B. Assertion level)

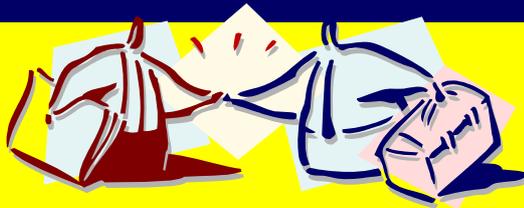
Audit Process Overview



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Today's Agenda



Audit Documentation (HKSA 230)

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The Requirements of HKSA 230

Activity

Activity 8 – Audit Documentation

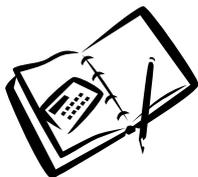
- You are an audit manager in a CPA firm and are briefing your colleagues on the new requirements of HKSA 230.
- One of the colleagues, June, is particularly interested in the following issues:
 1. What are the purposes of audit documentation?
 2. Which types of audit documentation are there?
 3. What is assembly of the final audit file?
 4. Who owns the audit documentation?
 5. Can a firm use a standard audit programme?
- Explain to June and other colleagues on the above issues.

The Requirements of HKSA 230

- The auditor should prepare, **on a timely basis, audit documentation** that provides:
 - a) A sufficient and appropriate record of the basis for the auditor's report; and
 - b) Evidence that the audit was performed in accordance with HKSAs and applicable legal and regulatory requirements. (HKSA 230.2)

Audit documentation" means the record of

- audit procedures performed,
- relevant audit evidence obtained, and
- conclusions the auditor reached
- also termed as "working papers" or "workpapers")



- Compliance with the requirements of HKSA 230 together with the specific documentation requirements of other relevant HKSAs is ordinarily sufficient to achieve the objectives in HKSA 230.2.

Nature of Documentation

- Audit documentation includes:
 - Overall audit strategy and audit plan
 - Audit programs
 - Analysis and analytical procedures worksheets
 - Internal control questionnaires and evaluation questionnaires
 - Issues memoranda
 - Summaries of significant matters
 - Letters of confirmation
 - Letters of representation
 - Checklists
 - Correspondence (including e-mail) concerning significant matters
 - Abstracts or copies of the entity's records



Form, Content and Extent

“Experienced auditor” means an individual (whether internal or external to the firm) who has a reasonable understanding of (i) audit processes, (ii) HKSAs and applicable legal and regulatory requirements, (iii) the business environment in which the entity operates, and (iv) auditing and financial reporting issues relevant to the entity's industry.

- The auditor should prepare the audit documentation so as to enable an experienced auditor, having no previous connection with the audit, to understand:
 - a) The nature, timing, and extent of the audit procedures performed to comply with HKSA's and applicable legal and regulatory requirements;
 - b) The results of the audit procedures and the audit evidence obtained; and
 - c) Significant matters arising during the audit and the conclusions reached thereon. (HKSA 230.9)



Form, Content and Extent



- The form, content and extent of audit documentation depend on factors such as:
 - The nature of the audit procedures to be performed;
 - The identified risks of material misstatement;
 - The extent of judgment required in performing the work and evaluating the results;
 - The significance of the audit evidence obtained;
 - The nature and extent of exceptions identified;
 - The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained; and
 - The audit methodology and tools used.

Form, Content and Extent

- It is, however, neither necessary nor practicable to document every matter the auditor considers during the audit.
- Oral explanations by the auditor, on their own
 - do not represent adequate support for the work the auditor performed or conclusions the auditor reached,
 - but may be used to explain or clarify information contained in the audit documentation.



Form, Content and Extent

- In documenting the nature, timing and extent of audit procedures performed, the auditor should record the **identifying characteristics** of the specific items or matters being tested. (HKSA 230.12)
- Recording the identifying characteristics serves a number of purposes, for example:
 - enables the audit team to be accountable for its work
 - facilitates the investigation of exceptions or inconsistencies.
- Identifying characteristics will vary with the nature of the audit procedure and the item or matter being tested.



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Form, Content and Extent

Example

List the identifying characteristics of the following audit procedures:

Audit procedures	Identifying characteristics (auditor may identify/record)
Test of entity's own purchase orders	→ The documents selected for testing by their dates and unique purchase order numbers
Review all items over a specific amount from a given population	→ The scope of the procedure and identify the population, e.g. all journal entries over a specified amount from the journal register
Systematic sampling from a population of documents	→ The documents selected by recording their source, the starting point and the sampling interval e.g. a systematic sample of shipping reports selected from the shipping log from 1 Apr. to 30 Sep., starting with report number 001234 and selecting every 25th report
Inquiries of specific entity personnel	→ The dates of the inquiries and the names and job designations of the entity personnel
An observation procedure	→ The process or subject matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out

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Form, Content and Extent

- The auditor should document discussions of **significant matters** with management and others on a timely basis. (HKSA 230.16)
 - Significant matters include, amongst others:
 - Matters that give rise to significant risks
 - Results of audit procedures indicating
 - a) that the financial information could be materially misstated, or
 - b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
 - Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
 - Findings that could result in a modification to the auditor's report.



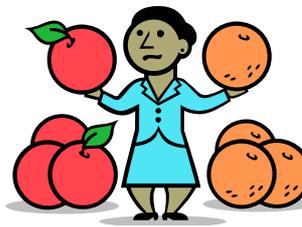
Form, Content and Extent

- If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusion regarding a significant matter,
 - the auditor should document how the auditor addressed the contradiction or inconsistency in forming the final conclusion. (HKSA 230.18)



Form, Content and Extent

- Where, in exceptional circumstances, the auditor judges it necessary to **depart from a basic principle or an essential procedure** that is relevant in the circumstances of the audit,
 - the auditor should document how the alternative audit procedures performed achieve the objective of the audit, and, unless otherwise clear, the reasons for the departure. (HKSA 230.21)



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Form, Content and Extent

- In documenting the nature, timing and extent of audit procedures performed, the auditor should record:
 - a) Who performed the audit work and the date such work was completed; and
 - b) Who reviewed the audit work performed and the date and extent of such review. (HKSA 230.21)



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Form, Content and Extent

- The audit documentation for a specific audit engagement is assembled in an audit file, which can be divided into:
 - a. Permanent file
 - b. Current file or current audit file
 - c. System file

Permanent File

Current File

System File



Assembly of Final Audit File

- HKSA 230 requires that
 - the auditor should complete the assembly of the final audit file on a timely basis after the date of the auditor's report (HKSA 230.25)
- HKSQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files, and
 - indicates that **60 days** after the date of the auditor's report is ordinarily an appropriate time limit for such requirement (HKSQC 1.73b)
- The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process
 - that does not involve the performance of new audit procedures or the drawing of new conclusions



Assembly of Final Audit File

- HKSA 230 has established a new requirement on retention of audit documentation and requires that
 - after the assembly of the final audit file has been completed, the auditor should not delete or discard audit documentation before the end of its **retention period** (HKSA 230.28)
- HKSQC 1 indicates:
 - the **retention period** for audit engagements ordinarily is **no shorter than five years** from the date of the auditor's report, or,
 - if later, the date of the group auditor's report (HKSQC 1.73j)

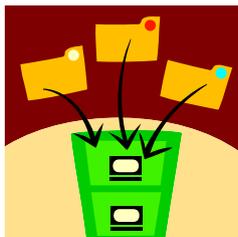


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Assembly of Final Audit File

- When the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed,
 - the auditor should, regardless of the nature of the modifications or additions, document:
 - a. When and by whom they were made, and (where applicable) reviewed;
 - b. The specific reasons for making them; and
 - c. Their effect, if any, on the auditor's conclusions. (HKSA 230.30)



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Changes in Exceptional Cases

- When exceptional circumstances arise after the date of the auditor's report that require the auditor to perform new or additional audit procedures or that lead the auditor to reach new conclusions, the auditor should document:
 - a) The circumstances encountered;
 - b) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached; and
 - c) When and by whom the resulting changes to audit documentation were made, and (where applicable) reviewed. (HKSA 230.31)



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Ownership of Documents

- No definite answers
- HKSQC 1 states that:
 - Unless otherwise specified by law or regulation, engagement documentation is the property of the firm.
 - The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel. (HKSQC1.731)



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Ownership of Documents

- General understanding depend on:
 1. Principal and principal relationship:
 - documents prepared, acquired or brought into being by the auditor solely for his own purpose as principal belong to the auditor
 2. Principal and agent relationship:
 - final documents specifically prepared for the client at his request belongs to the client
 - the auditor's drafts and office copy belong to the auditor



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Today's Agenda



Planning (HKSA 300)

Understanding the Entity and its Environment (HKSA 315)

Assessing the Risks of Material Misstatement (HKSA 315)

The Auditor's Procedures in Response to the Assessed Risks (HKSA 230)

Audit Documentation (HKSA 230)

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Summary of New Terms Covered

- Preliminary engagement activities (HKSA 300)
- Overall audit strategy (HKSA 300)
- Audit plan (HKSA 300)
- Risk assessment procedures (HKSA 315)
- Understanding the entity and its environment, including internal control (HKSA 315)
- Risk of material misstatement at financial statement level (HKSA 315)
- Risk of material misstatement at assertion level (HKSA 315)
- Significant risks (HKSA 315)
- Overall response (HKSA 330)
- Further audit procedures (HKSA 330)
- 60-day rule (HKSQC 1 & HKSA 230)



Sample File Structure

Planning, Control and Administration

Documentation required

- Financial statements & auditor's report
- Preliminary engagement activities
- Overall audit strategy and audit plan
- Subsequent event review and going concern review

In the past?

Understanding of the Entity

- An understanding of the entity
- An understanding of other aspects of an entity
- Consideration of law and regulations

Risk Assessment

- Assessing risks (at financial statement level and at assertion level)
- Linkage to overall response and further audit procedures

Further Audit Procedures

- Audit procedures divided into sections and include
 - Tests of control
 - Substantive procedures
- Audit procedures on impairment of assets, accounting estimates and fair value measurement

In the past?

Forthcoming Change in 2008 – 2009

Change Again

New Set of Clarified ISAs

- Since 2004
 - the International Auditing and Assurance Standards Board (IAASB) has begun a comprehensive program to enhance the clarity of its International Standards on Auditing (ISAs)
- This project would revise or redraft all ISAs and involve
 - 21 revised/updated and redrafted standards, and
 - 11 redrafted standards
- The IAASB remains committed to publish the entire suite of clarified ISAs in late 2008
- Current final effective date for these new clarified ISAs
 - **15 December 2009**



Audit Practice Introduced by HKSA

(HKSA 230, 300, 315, 330 and 500) – Part 2

1 September 2008

Full version of the slides can be found in
www.NelsonCPA.com.hk



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