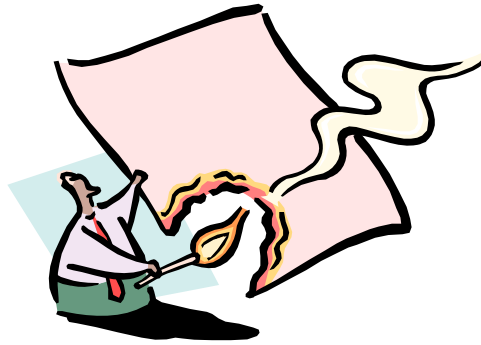


# Audit Standards Update

20 July 2007



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## What is Your Expectation?



Per your flyer

- Overview on HKSQC 1 and the critical HKSA's
- Recap of risk assessment standards
  - Including HKSA 315 and 330
- Update of the new auditing standards
  - Including HKSA 700 and 701

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# Today's Agenda



Simple but  
Comprehensive

Critical and New  
Issues

Templates and  
Examples

Overview

HKSQC 1 and Critical HKSA's

Risk Assessment and Response to  
Assessed Risks

Audit Evidence – Assertions

Update (Reporting and HKSREs)

# Today's Agenda



Overview

## New Terms, New Approach .....

- Consultation on difficult or contentious matters (HKSA 315 & 330)
- 60-day rule (HKSQC 1 & HKSA 230)
- Engagement quality control review (EQCR) (HKSQC 1 & HKSA 220)
- Monitoring and Quality Assurance Review (QAR) (HKSQC 1)
- 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)

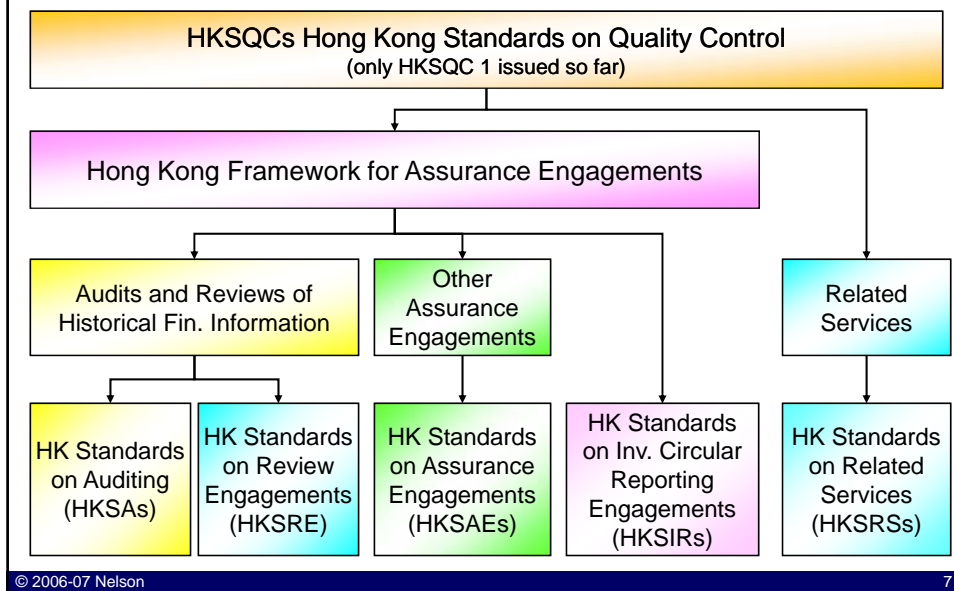


## Overview

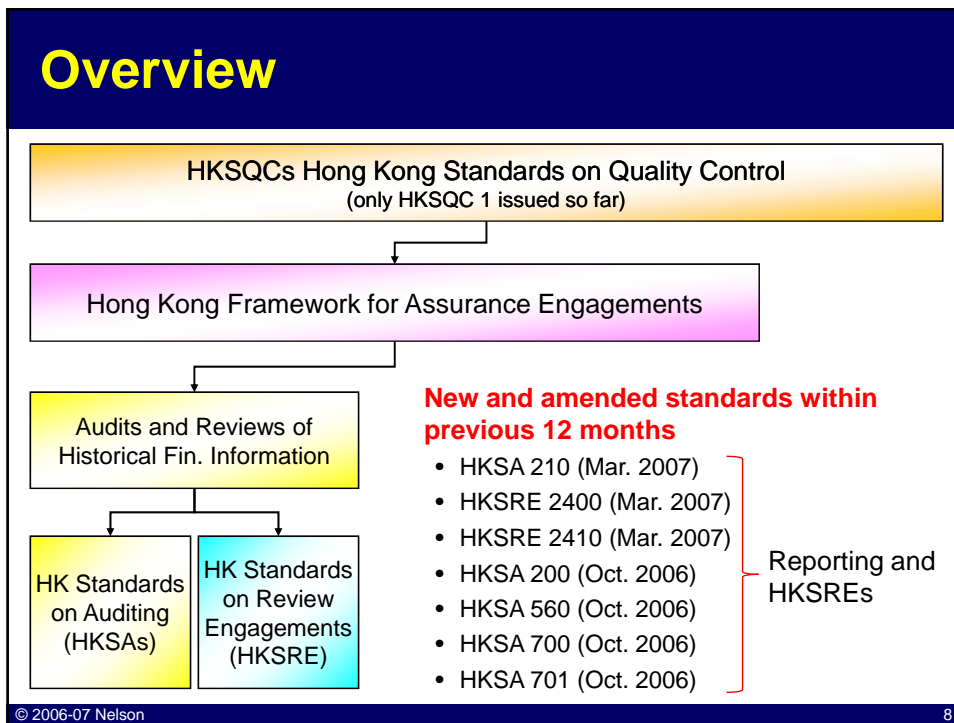
- Auditing standards have been re-structured since 2004
  - Become part of the standards under standards on quality control, auditing, assurance and related services
  - Standards on quality control apply on a firm-wide basis
  - HKSQC 1 was issued in 2004 and become effective as of 15 June 2005
  - HKSA and other standards aligned with ISAs and other international standards
  - All SASs are being replaced by HKSA
  - Only one SAS (SAS 510) remains in HK (up to July 2007)
- IAASB is in the process to improve the clarity of its ISAs .....



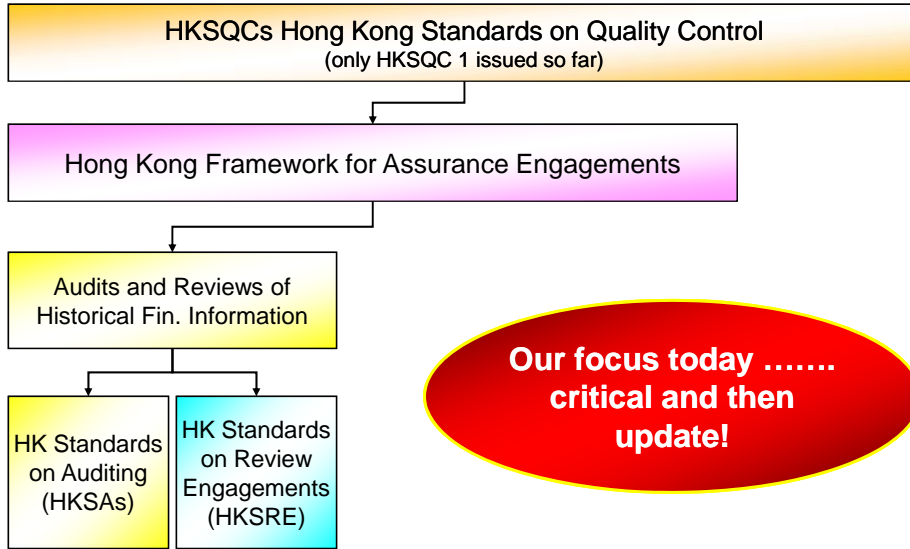
# Overview



# Overview



# Overview



**Our focus today .....  
critical and then  
update!**

# Today's Agenda



HKSQC 1 and Critical HKSA

# HKSQC 1

HKSQCs Hong Kong Standards on Quality Control  
(only HKSQC 1 issued so far)

HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagement*

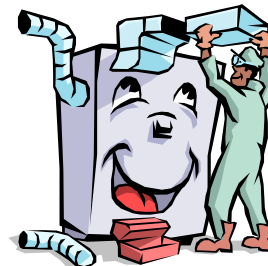
- to establish basic principles and essential procedures and to provide guidance
  - regarding a firm's responsibilities for its system of quality control
    - for audits and reviews of historical financial information, and
    - for other assurance and related services engagements.



# HKSQC 1

HKSQC 1 requires:

- The firm should establish a system of quality control designed to provide it with reasonable assurance
  - that the firm and its personnel comply with professional standards and regulatory and legal requirements, and
  - that reports issued by the firm or engagement partners are appropriate in the circumstances.



# HKSQC 1

HKSQC 1 requires:

- The firm's system of quality control should include policies and procedures addressing each of the following elements:
  - a) Leadership responsibilities for quality within the firm
    - Quality Manual
  - b) Ethical requirements
    - Promote internal culture
    - CEO or Managing partner(s) assume ultimate responsibility
  - c) Acceptance and continuance of client relationships and specific engagements
    - Integrity of the client
    - Competent to perform the job
    - Comply with ethical requirement
  - d) Human resources
    - Sufficient and competent personnel committed to ethics
    - Each job with appropriate staff
  - e) Engagement performance
  - f) Monitoring
    - Significant new requirements

# HKSQC 1 – Engagement Performance

- The firm's policies and procedures on engagement performance should include:

Consultation

Engagement Quality Control Review

Documentation

- Consultation policies and procedures should be established and designed to provide it with reasonable assurance that:
  - a) Appropriate consultation takes place on difficult or contentious matters;
  - b) Sufficient resources are available to enable appropriate consultation to take place;
  - c) The nature and scope of such consultations are documented; and
  - d) Conclusions resulting from consultations are documented and implemented.



## HKSQC 1 – Engagement Performance

- The firm's policies and procedures on engagement performance should include:

### Engagement Quality Control Review

- The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review
  - that provides an objective evaluation of
    - the significant judgments made by the engagement team and
    - the conclusions reached in formulating the report.

## HKSQC 1 – Engagement Performance

- The firm's policies and procedures on engagement performance should include:

### Engagement Quality Control Review

- Require an EQC Reviewer
- Similar to a 2nd partner to have 2nd review
- For all audits of financial statements of **listed entities** (set criteria for other audits)
- **Not to issue** auditor's report until the completion of EQC Review

- Such policies & procedures should:
  - a) Require an engagement quality control review for all audits of financial statements of listed entities;
  - b) Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and
  - c) Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).



## HKSQC 1 – Engagement Performance

- The firm's policies and procedures on engagement performance should include:

### Engagement Quality Control Review

- The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:
  - a) The technical qualifications required to perform the role, including the necessary experience and authority; and
  - b) The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.

## HKSQC 1 – Engagement Performance

- The firm's policies and procedures on engagement performance should include:

### Documentation

- To complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized
  - Observe local laws and regulations
  - In or audit, **no more than 60 days** after the date of auditor's report
- For the retention of documentation for a period sufficient to meet the needs of the firm or as required by law or regulation
  - the retention period ordinarily is **no shorter than 5 years** from the date of the auditor's report, or, if later, the date of the group auditor's report

## HKSQC 1 – Monitoring

- Policies and procedures for monitoring should include
  - an ongoing consideration and evaluation of the firm's system of quality control, including
    - a periodic inspection of a selection of completed engagements.

Ongoing Evaluation

Quality Assurance Review (QAR)



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## HKSQC 1 – Monitoring

- Periodic inspection of a selection of completed engagement
  - Termed as Quality Assurance Review (QAR) in Practice Review Self-assessment Questionnaire
  - Ordinarily performed on a cyclical basis
  - Engagements selected for inspection include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years
  - Includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team
  - Those inspecting the engagements (“the monitor”) are not involved in performing the engagement or the engagement quality control review (EQCR)

- Small firm may wish to use a qualified external person or another firm to carry out that QAR

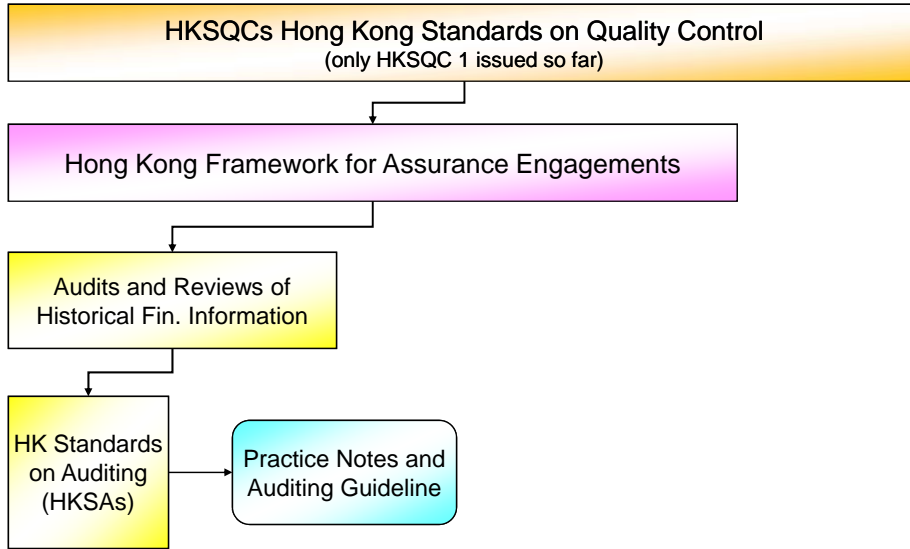
Quality Assurance Review (QAR)



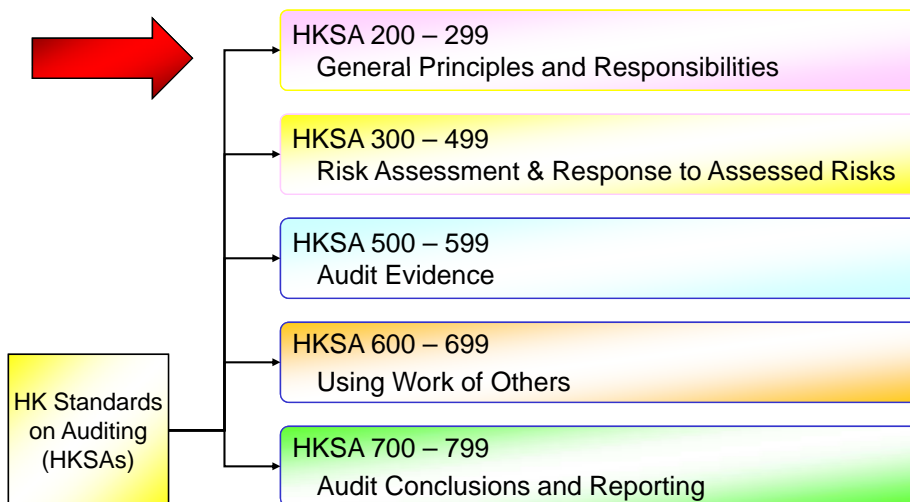
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# HKSQL and HKSA



# HKSQL and HKSA



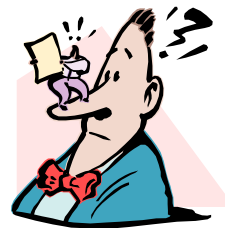
# General Principles and Responsibilities

## HKSA 200 – 299 General Principles and Responsibilities

- HKSA 200 Objective and General Principles Governing an Audit of Financial Statements
- HKSA 210 Terms of Audit Engagements
- HKSA 220 Quality Control for Audits of Historical Financial Information
- HKSA 230 Audit Documentation
- HKSA 240 The Auditor's Responsibilities to Consider Fraud in an Audit of Financial Statements
- HKSA 250 Consideration of Laws and Regulations in an Audit of Financial Statements
- HKSA 260 Communication of Audit Matters with Those Charged with Governance

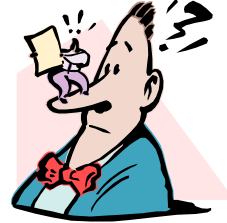
# General Principles and Responsibilities

- Generally, HKSAs 200 – 260 set out the general principles and responsibilities for a particular engagement on audit of historical financial information
- In particular, HKSA 220 sets out the quality control on a particular audit engagement
  - Similar to those set out in HKSQC 1
  - While HKSA 220 is tailored to an engagement on audit of historical financial information



## General Principles and Responsibilities

- Certain responsibilities must be taken by the engagement partner, including
  - Agree the terms of the engagement (HKSA 210.2)
  - Overall quality of the engagement (HKSA 220.6)
  - Comply with the ethical requirements (HKSA 220.8)
  - Conclude on compliance with independence requirements that apply to the audit engagement (HKSA 220.12)
  - Satisfy appropriate procedures regarding the acceptance and continuance of client relationships followed (HKSA 220.14)
  - Satisfy the engagement team collectively having appropriate capabilities, competence and time to perform the engagement (HKSA 220.19)
  - Take responsibility for the direction, supervision and performance of the audit engagement (HKSA 220.21)
  - Be responsible for the engagement team undertaking appropriate consultation on difficult or contentious matters (HKSA 220.30)

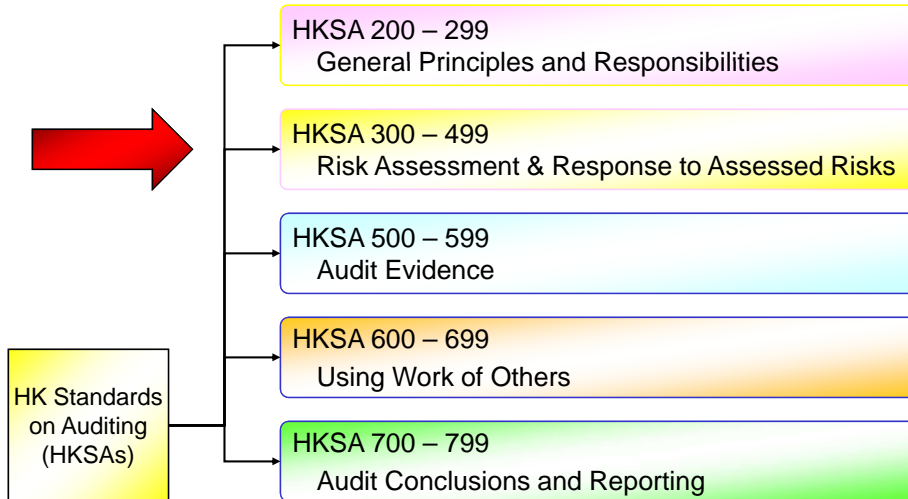


## Today's Agenda



Risk Assessment and Response to Assessed Risks

# Risk Assessment and Response



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# Risk Assessment and Response

**One of the Critical Requirements in our Audit**

HKSA 300 – 499  
Risk Assessment & Response to Assessed Risks

- HKSA 300 Planning an Audit of Financial Statements
- HKSA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement
- HKSA 320 Audit Materiality
- HKSA 330 The Auditor's Procedures in Response to Assessed Risks
- HKSA 402 Audit Considerations Relating to Entities Using Service Organizations

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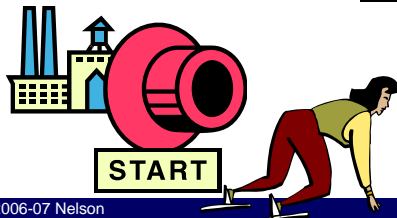
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# Preliminary Engagement Activities

## HKSA 300 Planning an Audit of Financial Statements

### Preliminary engagement activities

- The auditor should perform the following activities at the beginning of the current audit engagement: (HKSA 300.6)
  1. Perform procedures regarding the continuance of the client relationship and the specific audit engagement
  2. Evaluate compliance with ethical requirements, including independence
  3. Establish an understanding of the terms of the engagement



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# Overall Audit Strategy & Audit Plan

## HKSA 300 Planning an Audit of Financial Statements

### Preliminary engagement activities

### Planning Activities

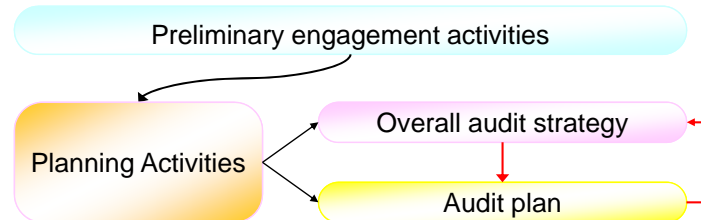
- Planning is not a discrete phase of an audit, but rather a continual and iterative process that
  - often begins shortly after (or in connection with) the completion of the previous audit and
  - continues until the completion of the current audit engagement.

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# Overall Audit Strategy & Audit Plan

## HKSA 300 Planning an Audit of Financial Statements



- The auditor **should** establish and document
  - Overall audit strategy for the audit and
  - Audit plan for the audit in order to reduce audit risk to an acceptably low level.
- Both the overall audit strategy and audit plan should be updated and changed as necessary during the course of the audit.

# Overall Audit Strategy

## HKSA 300 Planning an Audit of Financial Statements

- The establishment of the overall audit strategy involves:
  1. Determine the characteristics of the engagement that define the scope
    - e.g. HKFRS used, reporting under the Companies Ordinance, location of the components of the entity, industry specific reporting requirements
  2. Ascertain the reporting objectives
  3. Determine the focus of the engagement team's efforts

Overall audit strategy



# Audit Plan

## HKSA 300 Planning an Audit of Financial Statements

- The audit plan
  - is more detailed than the audit strategy and
  - includes:
    - A description of the nature, timing and extent of **planned risk assessment procedures** (HKSA 315)
    - A description of the nature, timing and extent of **planned further audit procedures at the assertion level** (HKSA 330)
    - Such **other audit procedures** required to be carried out for the engagement in order to comply with HKSA

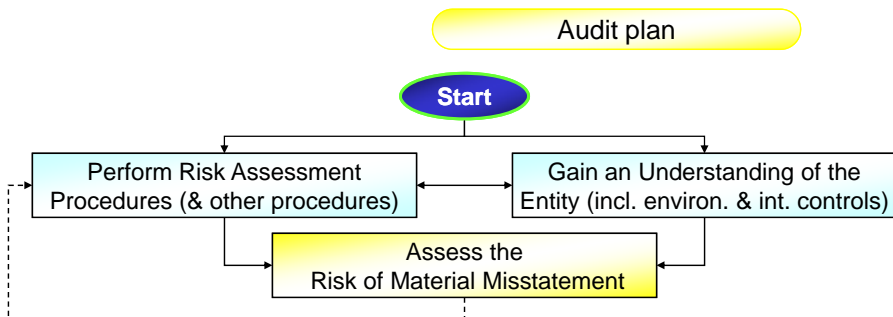
Audit plan

# Risk Assessment Procedures

## HKSA 300 Planning an Audit of Financial Statements

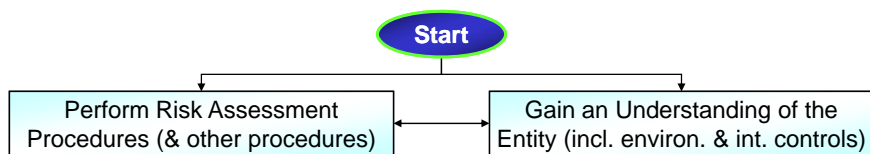
### HKSA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement

- Risk assessment procedures
  - Should be performed to obtain an understanding of the entity and its environment, including its internal control



# Risk Assessment Procedures

- Perform the following risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control:
  - a) Inquiries of management and others within the entity
  - b) Analytical procedures
  - c) Observation and inspection (HKSA 315.7)



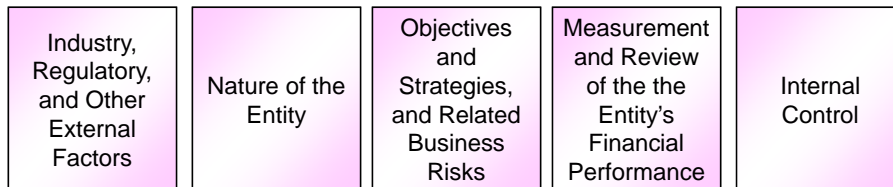
# Understanding the Entity

- Perform the following risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control:
  - a) Inquiries of management and others within the entity
  - b) Analytical procedures
  - c) Observation and inspection (HKSA 315.7)
- The understanding of the entity and its environment, including its internal control, should be
  - **sufficient** to identify and assess the **risks of material misstatement** of the financial statements whether due to fraud or error ..... (HKSA 315.2)

Gain an Understanding of the Entity (incl. environ. & int. controls)

## Understanding the Entity

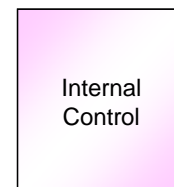
- The auditor's understanding of the entity and its environment consists of an understanding of the following aspects:



Gain an Understanding of the Entity (incl. environ. & int. controls)

## Internal Control

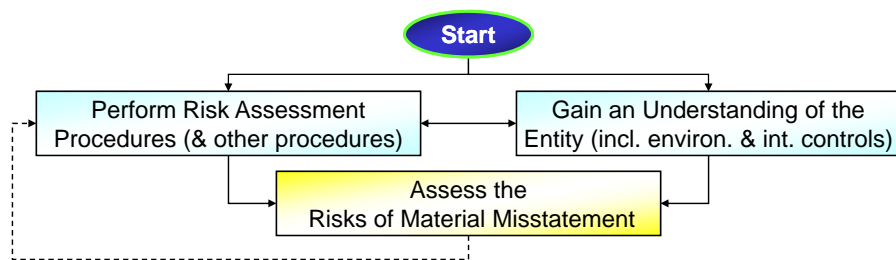
- The auditor should obtain an understanding of internal control relevant to the audit (HKSA 315.41)
- Internal control consists of the following components:
  - The control environment
  - The entity's risk assessment process
  - The information system, including the related business processes, relevant to financial reporting, and communication
  - Control activities
  - Monitoring of controls



Gain an Understanding of the Entity (incl. environ. & int. controls)

## Assessing the Risks

- The auditor should identify and assess the risks of material misstatement
  - at the financial statement level, and
  - at the assertion level for classes of transactions, account balances, and disclosures (HKSA 315.100)

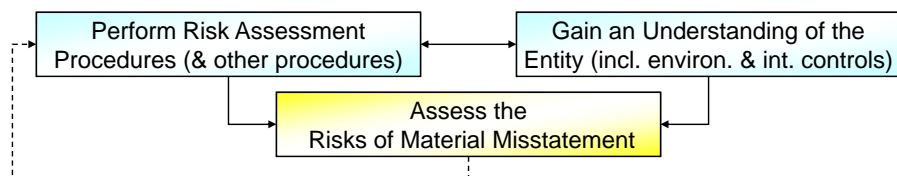


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## Assessing the Risks

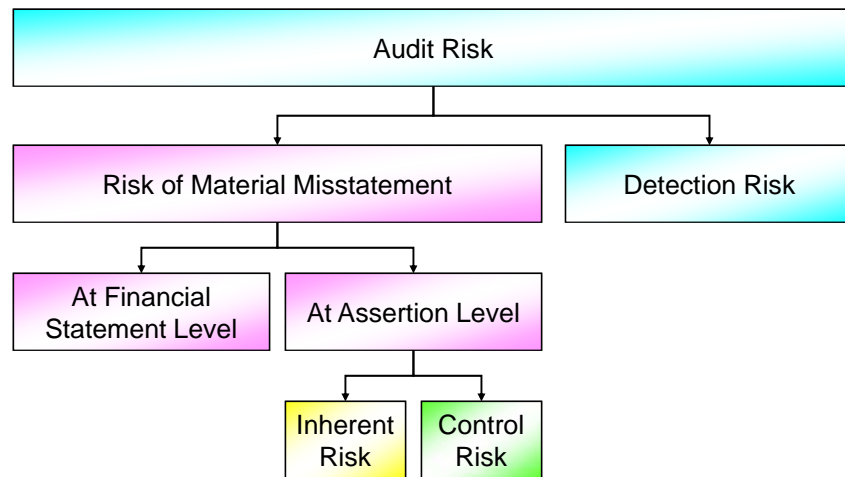
- For this purpose, the auditor:
  - Identifies risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
  - Relates the identified risks to what can go wrong at the assertion level;
  - Considers whether the risks are of a magnitude that could result in a material misstatement of the financial statements; and
  - Considers the likelihood that the risks could result in a material misstatement of the financial statements. (HKSA 315.100)



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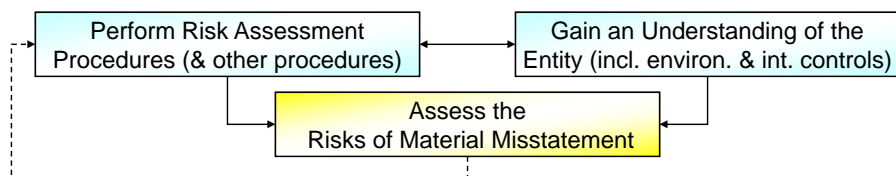
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## Assessing the Risks



## Assessing the Risks – Significant Risk

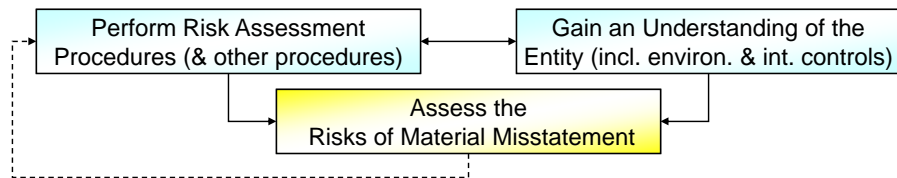
- The auditor should determine which of the risks identified are, in the auditor's judgment, risks that require special audit consideration (such risks are defined as "**significant risks**").
  - Significant risks often relate to significant **non-routine transactions** and **judgmental matters**.
    - **Non-routine transactions** are transactions that are **unusual**, either due to size or nature, and that therefore occur infrequently.
    - **Judgmental matters** may include the development of accounting estimates for which there is significant measurement uncertainty.



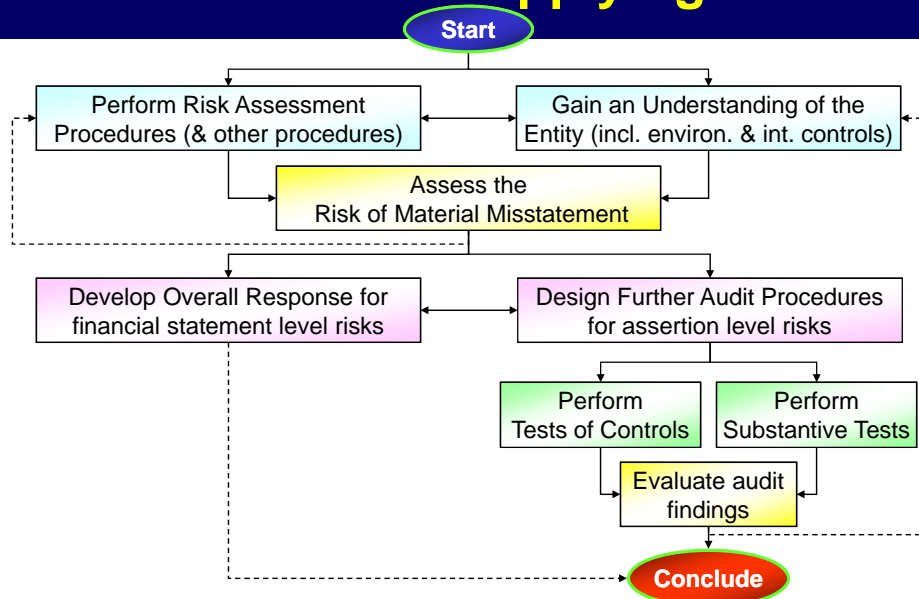
## Assessing the Risks – Another Risk

### Risks for which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

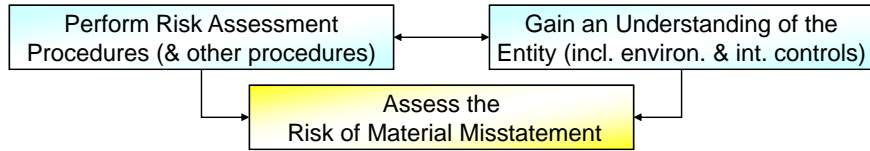
- The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities,
  - over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures.



## Risk Assessment Applying to Audit

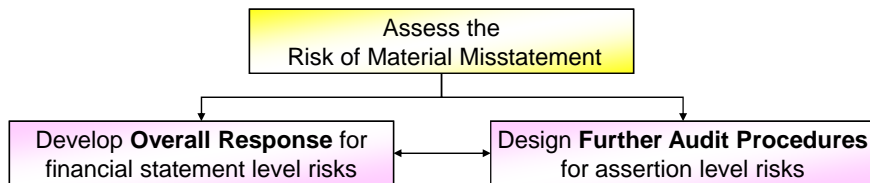


# Risk Assessment



- Obtain an understanding of the entity and its environment, including its internal control,
  - **sufficient** to identify and assess the **risks of material misstatement** of the financial statements whether due to fraud or error .....(HKSA 315.2)
- To identify and assess the risks of material misstatement
  - at the **financial statement level** and
  - at the **assertion level** for classes of transactions, a/c bal. and disclosures

# Risk Assessment → Response



- at the **financial statement level**
- at the **assertion level** for classes of transactions, a/c bal. and disclosures

**Linkage of Risk with Audit Response**

# Overall Response

- The auditor should determine overall response to address the risks of material misstatement at the financial statement level. (HKSA 330.4)
  - The assessment of the risks of material misstatement at the financial statement level is affected by the auditor's understanding of the control environment.

Develop **Overall Response** for financial statement level risks

Risk of material misstatement at the overall financial statement level

- refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions
- often relate to the entity's control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level (HKSA200.18)

# Risk Assessment → Response

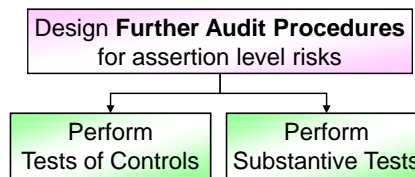
Example

Description of the issues identified	Risk resulted	Significant risk (Y/N)	Overall Response
1. The entity is an owner-managed private entity and thus lacking formal internal control system.	The financial statements might have been prepared inaccurately.	No	<ul style="list-style-type: none"> <li>• The audit team is reminded to maintain professional scepticism in performing the engagement.</li> <li>• More experienced audit staff is assigned to the engagement.</li> </ul>
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.	No	<ul style="list-style-type: none"> <li>• Audit staff with experience and knowledge in computer data and source information transfer is assigned to the audit team.</li> </ul>



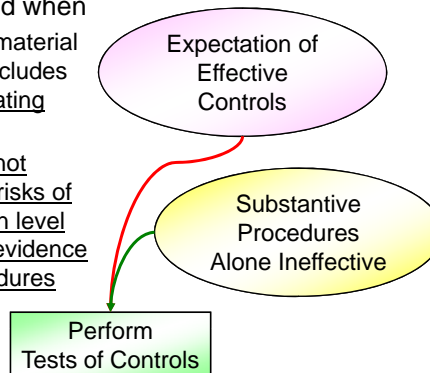
# Further Audit Procedures

- 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)
- Nature of further audit procedures refers to:
  - Their purpose (tests of controls or substantive procedures)
  - Their type (inspection, observation, inquiry, confirmation, recalculation, reperformance or analytical procedures)
- Timing refers to:
  - when audit procedures are performed or
  - the period or date to which the audit evidence applies
- Extent include the quantity of a specific audit procedures to be performed.



# Further Audit Procedures

- Tests of controls should be performed when
  - The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that controls are operating effectively (HKSA 330.23)
  - 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 (HKSA 330.25)



## Further Audit Procedures

- Design and perform substantive procedures for each material class of transactions, account balance, and disclosure
  - irrespective of the assessed risk of material misstatement (HKSA 330.49)
- 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)

Design **Further Audit Procedures**  
for assertion level risks

Perform  
Substantive Tests

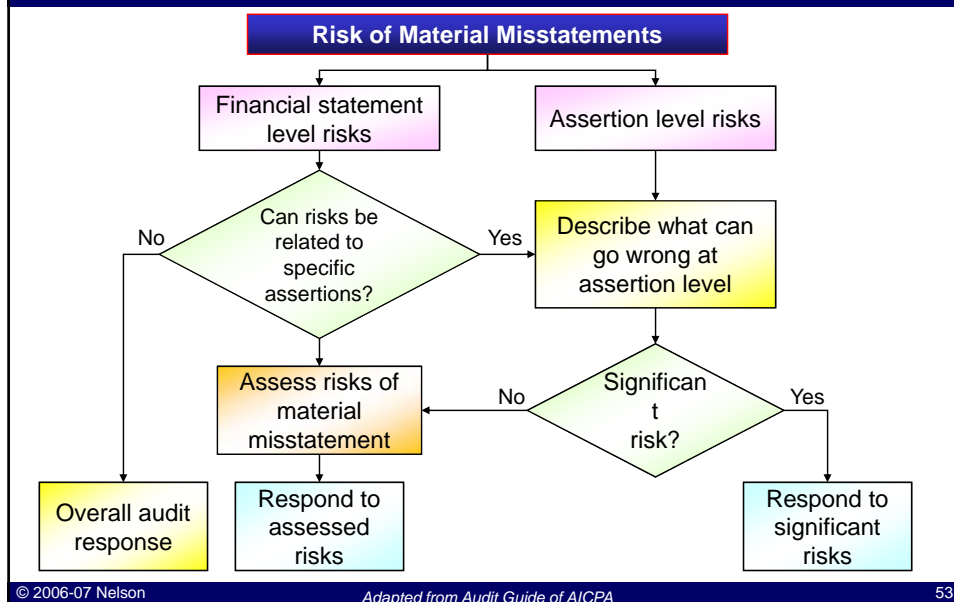
## Further Audit Procedures

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

Design **Further Audit Procedures**  
for assertion level risks

Perform  
Substantive Tests

## Further Audit Procedures



## Further Audit Procedures

- Timing
  - 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)
- Adequacy of Presentation and Disclosure
  - 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.

Design **Further Audit Procedures** for assertion level risks

Perform Substantive Tests

# Risk Assessment → Response

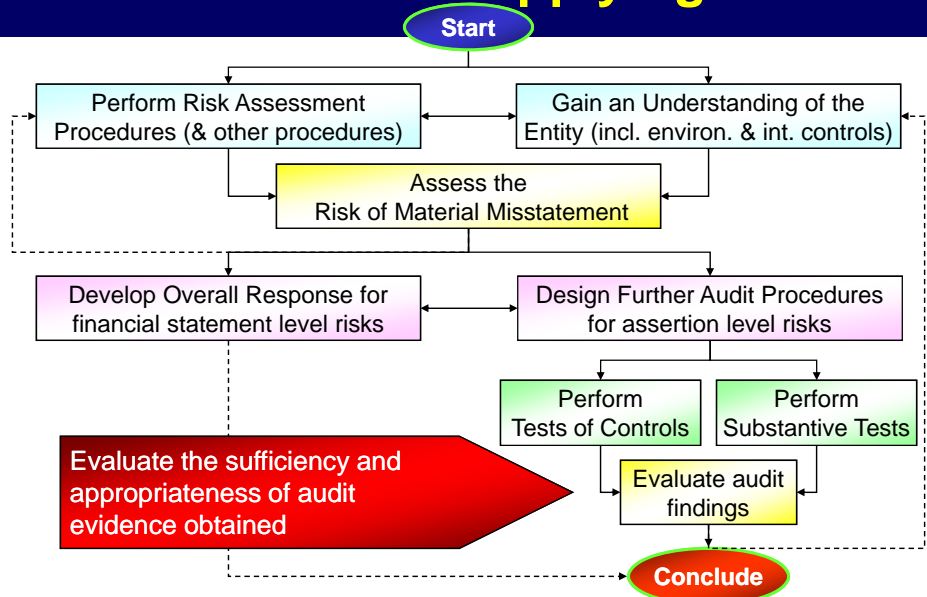
Example

Issues and Risks identified	Relevant Assertions	Significant risk (Y/N)	Audit Response (Further Audit Procedures)
1. (Example) Property acquired in Shanghai during the year	Rights and Obligations	Yes (non routine)	<ul style="list-style-type: none"> <li>Land search performed in Shanghai</li> <li>Physical inspection and count on property, plant and equipment to be performed</li> </ul>
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"> <li>Consider the appropriateness of accounting policy on property adopted</li> <li>Check cost of acquisition to the sale and purchase agreement and match with the payment</li> <li>Verify the calculation of depreciation independently</li> <li>Review the entity's impairment review</li> </ul>

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# Risk Assessment Applying to Audit



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Adapted from Audit Guide of AICPA

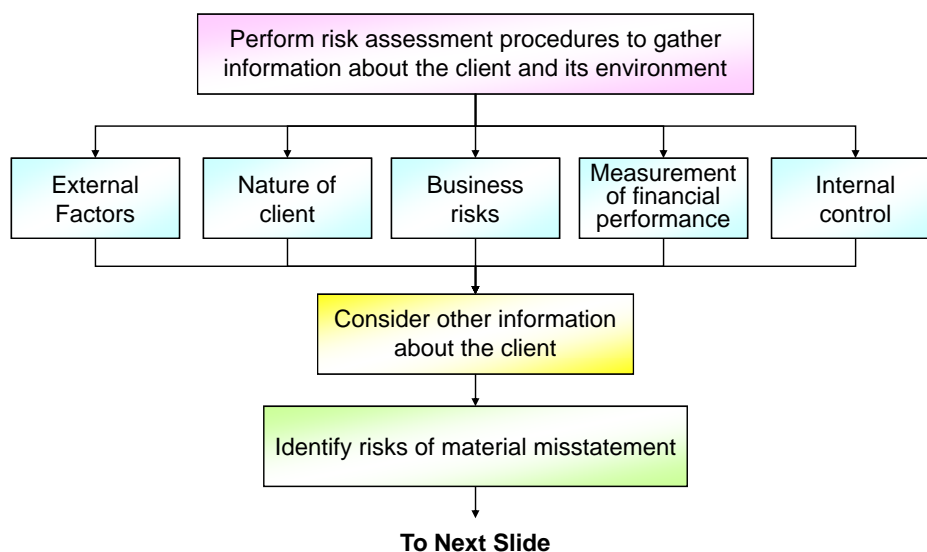
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# Summary of Risk Assessment

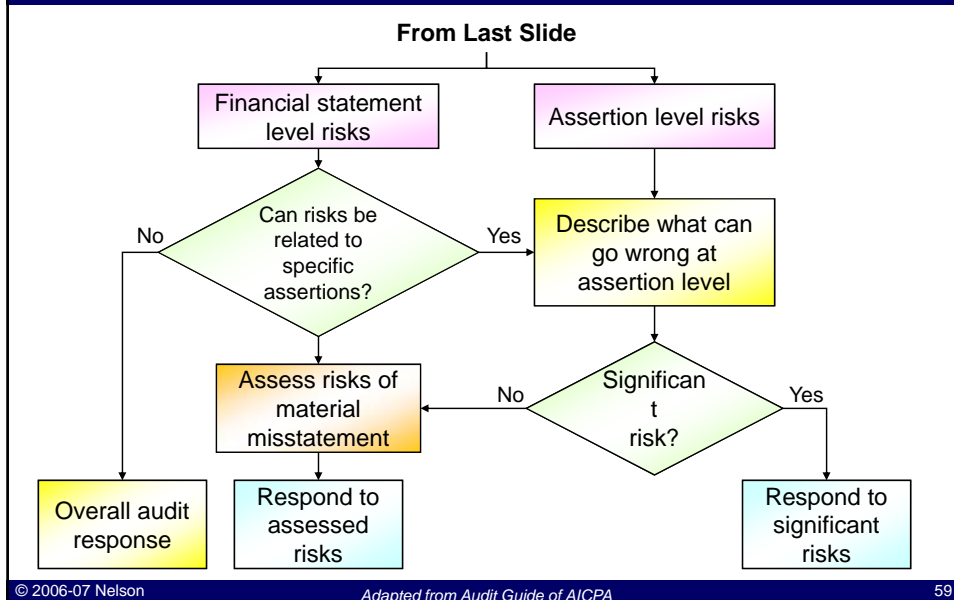
- Risk assessment approach revised in HKSA's
  - Planning is not a discrete phase of an audit, but rather a continual and iterative process
  - Understanding of the entity and its environment, including its internal controls is an essential aspect
  - “Overall response” and “further audit procedures” to link with the assessed risks



# Summary of Risk Assessment



# Summary of Risk Assessment

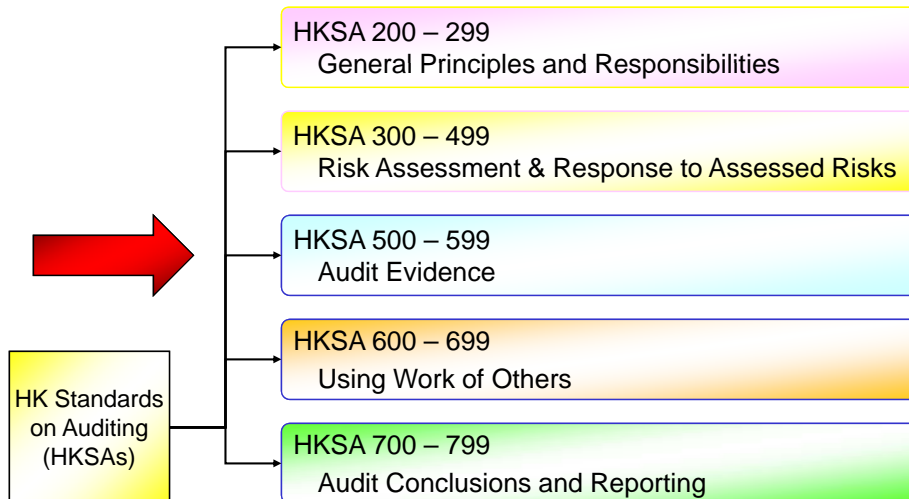


# Today's Agenda



Audit Evidence – Assertions

# Risk Assessment and Response



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# Audit Evidence

- HKSA 500.2 requires the auditor to obtain sufficient appropriate evidence to enable him to draw reasonable conclusions on which to base the audit opinion.
  - **Sufficiency**
    - relates to the quantity of the audit evidence
  - **Appropriateness**
    - refers to the quality of audit evidence in terms of its relevance and reliability to support for or detect a misstatement
- HKSA 500.16 requires the auditor to use assertions for classes of transactions, account balances, and presentation and disclosures
  - in sufficient detail to form a basis for the assessment of risks of material misstatement and the design and performance of further audit procedures.

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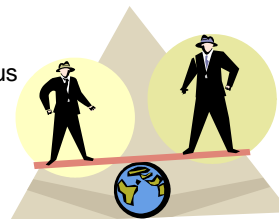
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# Audit Evidence and Assertions

- Type of assertions
  - 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

# Audit Evidence

- Audit procedures
  - Always performs risk assessment procedures in accordance with HKSA 315
  - Performs tests of control to obtain audit evidence to support a control risk assessment
  - Because of the inherent limitations to internal control, always performs substantive procedures for material items
  - May use different types of audit procedures
    - inspection, observation, inquiry, confirmation, recalculation, reperformance or analytical procedures
  - Before using audit evidence obtained from previous audits, perform audit procedures to establish its continuing relevance
  - Consider the use of computer assisted audit techniques

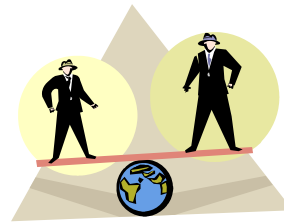




## Audit Evidence – Audit of Estimates

HKSA 540 Audit of Accounting Estimates

HKSA 545 Auditing Fair Value Measurements and Disclosures



## HKSA 540 Accounting Estimates

- Auditors should design and perform further audit procedures to obtain sufficient appropriate audit evidence as to whether the entity's accounting estimates are reasonable in the circumstances and, when required, appropriately disclosed.
- The evidence for detecting a material misstatement in an accounting estimate will often be more difficult to obtain and less persuasive than those for other items in the financial statements
- Adopt one or a combination of the following approaches to audit an accounting estimate
  1. Review and test the process used by management to develop the estimate
  2. Use an independent estimate for comparison with that prepared by management
  3. Review subsequent events

## HKSA 545 Fair Value Measurement

- HKSA 545.3 requires the auditor to obtain sufficient appropriate audit evidence that fair value measurements and disclosures are in accordance with the entity's applicable financial reporting framework.
- The requirements include:
  - Understanding the entity's process for determining fair value measurements and disclosures and relevant control activities, and assessing risk
  - Evaluating the appropriateness of fair value measurements and disclosures
  - Using the work of an expert
  - Audit procedures responsive to the risk of material misstatement of the entity's fair value measurements and disclosures

More .....

## HKSA 545 Fair Value Measurement

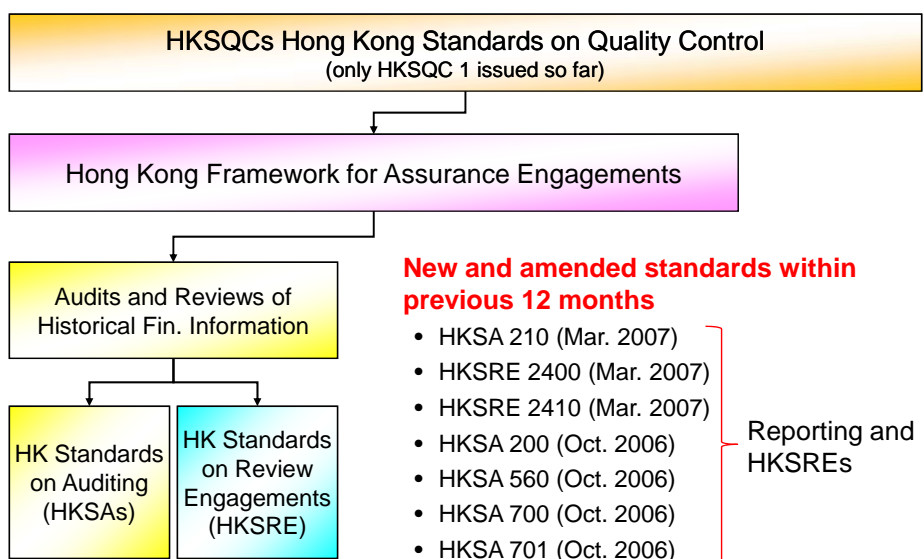
- HKSA 545.343 requires the auditor to design and perform further audit procedures in response to assessed risks of material misstatement of assertions relating to the entity's fair value measurements and disclosures
  - To evaluate whether the significant assumptions used by management in measuring fair values, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements
  - To perform audit procedures on the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions
  - May make an independent estimate of fair value
  - To consider the effect of subsequent events on the fair value measurements and disclosures in the financial statements.

# Today's Agenda



Update (Reporting and HKSREs)

## Update



## Update – Reporting and HKSREs

### HKSAs for Audit Conclusion and Reporting

HKSA 700 The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements

HKSA 701 Modifications to the Independent Auditor's Report

### HKSREs (Hong Kong Standards on Review Engagements)

HKSRE 2400 Engagements to Review Financial Statements

HKSRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity



## HKSA 700 and 701

### HKSAs for Audit Conclusion and Reporting

HKSA 700 The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements

HKSA 701 Modifications to the Independent Auditor's Report

- Issued in Oct. 2006 and to replace SAS 600
- Effective for auditor's reports dated on or after 31 Dec. 2006
- HKSA 700 gave rise to conforming amendments to the following HKSAs
  - HKSA 200: effective for audits of financial statements for periods beginning on or after 15 Dec. 2005 and where auditor's reports are dated on or after 31 Dec. 2006
  - HKSA 560: effective for auditor's reports dated on or after 31 Dec. 2006
  - HKSA 210: effective date not yet fixed as implementation of these amendments in the equivalent ISA 210 has been deferred by the IAASB, and attached as Appendix 3 to HKSA 210 for reference only

## HKSA 700 and 701

- HKSA 700
  - addresses circumstances when the auditor is able to express an unqualified opinion and no modification to the auditor's report is necessary.
- HKSA 701
  - establishes standards and provides guidance on the modifications to this report for
    - an emphasis of matter,
    - a qualified opinion,
    - a disclaimer of opinion, or
    - an adverse opinion

- In the past, SAS 600 addressed both modified and unmodified report

### HKSA 700.4 requires:

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

## HKSA 700

### HKSA 700.11 requires:

- The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements.
- The elements of the auditor's report required by HKSA 700 include:
  - a) Title;
  - b) Addressee;
  - c) Introductory paragraph;
  - d) Management's responsibility for the financial statements;
  - e) Auditor's responsibility;
  - f) Auditor's opinion;
  - g) Other reporting responsibilities;
  - h) Auditor's signature;
  - i) Date of the auditor's report; and
  - j) Auditor's address.

## HKSA 700 – Title and Addressee

### a) Title

- The auditor's report should have a title that clearly indicates that it is the report of an independent auditor (HKSA 700.18)

SAS 600 required "an appropriate title is used to distinguish clearly the auditors' report from other information relating to the reporting entity with which it may be published."

### b) Addressee

- The auditor's report should be addressed as required by the circumstances of the engagement. (HKSA 700.20)

SAS 600 required "the auditors' report on the financial statements of a company is addressed to its members (normally the shareholders) because the audit is undertaken on their behalf."

## HKSA 700 – Introductory Paragraph

### c) Introductory paragraph

- The introductory paragraph in the auditor's report should identify the entity whose financial statements have been audited and should state that the financial statements have been audited.
- The introductory paragraph should also:
  - a) Identify the title of each of the financial statements that comprise the complete set of financial statements;
  - b) Refer to the summary of significant accounting policies and other explanatory notes; and
  - c) Specify the date and period covered by the financial statements. (HKSA 700.22)

Include the title of:

- Balance sheet
- Income statement
- Cash flow statement
- Statement of changes in equity

SAS 600 only required the followings:

- "identifying the financial statements that have been audited"
  - Suggested the wordings "We have audited the financial statements on pages ..... to ..... ."
- "refers to accounting principles, comprising the accounting standards and accounting policies"

# HKSA 700 – Introductory Paragraph

Example

## Sample Report (Extract Only)

Independent Auditor's Report  
To The Shareholders of ABC Limited  
(incorporated in Hong Kong with limited liability)

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



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# HKSA 700 – Responsibility

## d) Management's Responsibility for the Financial Statements

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

- a) Designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;
- b) Selecting and applying appropriate accounting policies; and
- c) Making accounting estimates that are reasonable in the circumstances. (HKSA 700.28)



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# HKSA 700 – Responsibility

Example

## Sample Report (Extract Only)

### Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes

- designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;
- selecting and applying appropriate accounting policies; and
- making accounting estimates that are reasonable in the circumstances.

# HKSA 700 – Responsibility

## e) Auditor's Responsibility

- The auditor's report should state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. (HKSA 700.32)
- The auditor's report should state that the audit was conducted in accordance HKSAs. The auditor's report should also explain that those standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. (HKSA 700.34)

Renamed and restructured

- previously, part of the requirements were included in "Basis of opinion"



# HKSA 700 – Responsibility

## e) Auditor's Responsibility

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

New

New

New

# HKSA 700 – Responsibility

## e) Auditor's Responsibility

- The auditor's report should describe an audit by stating that:
  - c) An audit also includes evaluating
    - the appropriateness of the accounting policies used,
    - the reasonableness of accounting estimates made by management,
    - as well as the overall presentation of the financial statements. (HKSA 700.37)
- The auditor's report should state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion. (HKSA 700.38)

The category of "basis of opinion" was deleted and some requirements are included in "auditor's responsibility" now

# HKSA 700 – Responsibility

Example

## Sample Report (Extract Only)

### Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with HKSAs issued by the HKICPA. Those standards require that we

- comply with ethical requirements and
- plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

# HKSA 700 – Responsibility

Example

## Sample Report (Extract Only)

### Auditor's responsibility

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

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

# HKSA 700 – Auditor’s Opinion

## f) Auditor’s Opinion

- An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
- When expressing an unqualified opinion,
  - the opinion paragraph of the auditor’s report should state the auditor’s opinion that the financial statements give a true and fair view or present fairly, in all material respects, in accordance with the applicable financial reporting framework  
(unless the auditor is required by law or regulation to use different wording for the opinion, in which case the prescribed wording should be used).
- When HKFRSs are not used as the financial reporting framework,
  - the reference to the financial reporting framework in the wording of the opinion should identify the jurisdiction or country of origin of the financial reporting framework.



e.g. “... in accordance with accounting principles generally accepted in Country X ...”

# HKSA 700 – Other Issues

## g) Other Reporting Responsibilities

- When the auditor addresses other reporting responsibilities within the auditor’s report on the financial statements, these other reporting responsibilities should be addressed in a separate section in the auditor’s report that follows the opinion paragraph.  
(HKSA 700.48)



## h) Auditor’s Signature

- The auditor’s report should be signed. (HKSA 700.50)

## i) Date of the Auditor’s Report

- The auditor should date the report on the financial statements no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements.
- Sufficient appropriate audit evidence should include evidence that the entity’s complete set of financial statements has been prepared and that those with the recognized authority have asserted that they have taken responsibility for them. (HKSA 700.52)

SAS 600 required the date as of the completion date of the audit.

## HKSA 700 – Other Issues

### i) Auditor's Address

- The report should name the location in the country or jurisdiction where the auditor practices. (HKSA 700.57)



### Auditor's Report

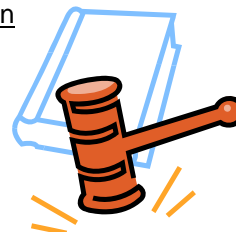
- The auditor's report should be in writing. (HKSA 700.58)
- A written report encompasses both
  - reports issued in hard copy format and
  - those using an electronic medium.



## HKSA 700 – Other Issues

### **Auditor's Report for Audits Conducted in Accordance with Both HKSAs and Auditing Standards of a Specific Jurisdiction or Country**

- The auditor's report should refer to the audit having been conducted in accordance with the HKSAs
  - only when the auditor has complied fully with all of the HKSAs relevant to the audit. (HKSA 700.62)
- When the auditor's report refers to both HKSAs and auditing standards of a specific jurisdiction or country,
  - the auditor's report should identify the jurisdiction or country of origin of the auditing standards. (HKSA 700.64)



## HKSA 700 – Other Issues

### Auditor's Report for Audits Conducted in Accordance with Both HKSAs and Auditing Standards of a Specific Jurisdiction or Country

- When the auditor prepares the auditor's report using the layout or wording specified by the law, regulation or auditing standards of the specific jurisdiction or country, the auditor's report should refer to the audit being conducted in accordance with both HKSAs and the auditing standards of the specific jurisdiction or country only if the auditor's report includes, at a minimum, each of the following elements:
  - a. A title;
  - b. An addressee;
  - c. An introductory paragraph;
  - d. A description of management's responsibility;
  - e. A description of the auditor's responsibility;
  - f. An opinion paragraph;
  - g. The auditor's signature;
  - h. The date of the auditor's report; and
  - i. The auditor's address. (HKSA 700.65)

## HKSA 700 – Other Issues

### Unaudited Supplementary Information Presented with Audited Financial Statements

- The auditor should be satisfied that any supplementary information presented together with the financial statements that is not covered by the auditor's opinion is clearly differentiated from the audited financial statements. (HKSA 700.67)
- If the auditor concludes that the entity's presentation of any unaudited supplementary information does not differentiate it sufficiently from the audited financial statements,
  - the auditor should explain in the auditor's report that that information has not been audited. (HKSA 700.70)



# HKSA 701

## Modifications to the Independent Auditor's Report



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# HKSA 701

## HKSA 701

- Is to establish standards and provide guidance on
  - the circumstances when the independent auditor's report should be modified and
  - the form and the content of the modifications to the auditor's report in those circumstances.
- Describes how the auditor's report wording is modified in the following situations:
  - Matters that do not affect the auditor's opinion
    - a) Emphasis of matter
  - Matters that do affect the auditor's opinion
    - a) Qualified opinion,
    - b) Disclaimer of opinion, or
    - c) Adverse opinion.

Emphasis of matter

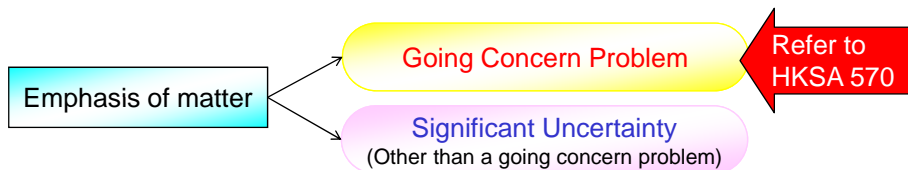
Modified Opinion

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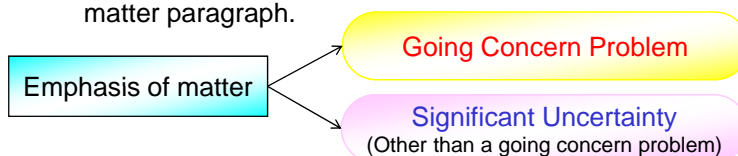
## HKSA 701 – Emphasis of Matter

- The auditor should modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem. (HKSA 700.6)
- The auditor should consider modifying the auditor's report by adding a paragraph if there is a significant uncertainty (other than a going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements. (HKSA 701.7)



## HKSA 701 – Emphasis of Matter

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



## HKSA 701 – Emphasis of Matter

- Emphasis of matter paragraph, can also be used to report on matters other than those affecting the financial statements.
  - Such paragraph may preferably be added
    - after the paragraph containing the auditor's opinion
    - but before the section on any other reporting responsibilities.

Matters other than those affecting the financial statements

Emphasis of matter

Going Concern Problem

Significant Uncertainty

(Other than a going concern problem)

## HKSA 701 – Emphasis of Matter

### Example

- If an amendment to other information in a document containing audited financial statements is necessary and the entity refuses to make the amendment,
  - the auditor would consider including in the auditor's report an emphasis of matter paragraph describing the material inconsistency

Matters other than those affecting the financial statements

Emphasis of matter





## HKSA 701 – Modified Opinion

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

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

Limitation of Scope

b) There is a disagreement with management regarding

Disagreement

- the acceptability of the accounting policies selected,
- the method of their application, or
- the adequacy of financial statement disclosures.

Modified Opinion

## HKSA 701 – Modified Opinion

A qualified opinion expressed

- when the auditor concludes that an unqualified opinion cannot be expressed
- but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. (HKSA 701.12)

Modified Opinion

A disclaimer of opinion expressed

- when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. (HKSA 701.13)

An adverse opinion expressed

- when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements. (HKSA 701.14)

## HKSA 701 – Modified Opinion

- When the auditor concludes that an unqualified opinion cannot be expressed :

Effect	Not So Material and Pervasive	So Material and Pervasive
<b>Circumstances</b>		
Limitation of scope	Qualified (except for limitation) Opinion	Disclaimer Opinion
Disagreement with management	Qualified (except for disagreement) Opinion	Adverse Opinion

Modified Opinion

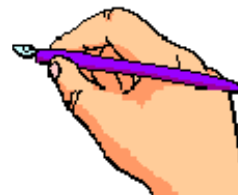
## HKSA 701 – Modified Opinion

- Whenever the auditor expresses an opinion that is other than unqualified,
  - a clear description of all the substantive reasons should be included in the report and,
  - unless impracticable, a quantification of the possible effect(s) on the financial statements. (HKSA 701.15)

Reasons

Quantification

Modified Opinion



# HKSA 701 – Modified Opinion

## 1. Limitation imposed by the entity

- a. When the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists,
  - the auditor would ordinarily not accept such a limited engagement as an audit engagement, unless required by statute.
- b. When the limitation infringes on the auditor's statutory duties
  - a statutory auditor would not accept such an audit engagement

Limitation of Scope

Modified Opinion

## 2. Limitation imposed by circumstances

- Timing of appointment
- Inadequate accounting records
- Unable to carry out desired audit procedures

# HKSA 701 – Modified Opinion

- When there is a limitation on the scope of the auditor's work that requires expression of a qualified opinion or a disclaimer of opinion,
  - the auditor's report should
    - describe the limitation and
    - indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed. (HKSA 701.18)

Limitation of Scope

Modified Opinion



# HKSA 701 – Modified Opinion

Example

## Sample Disclaimer Report (Extract Only)

Introductory para. (modified as below)

We were engaged to audit the accompanying financial statements .....

Management responsibility para. (no modification)

Auditor's responsibility para. (modified as below)

Our responsibility is to express an opinion on these financial statements based on our audit. Except for the limitation in the scope of our work as explained below, we conducted our audit ..... are free from material misstatement.

However, because of the matter described in the basis for disclaimer of opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer opinion para. (new para. for all the substantive reasons and a quantification of the possible effect)

Opinion para. (modified with a disclaimer opinion)

# HKSA 701 – Modified Opinion

- The auditor may disagree with management about matters, such as
  - the acceptability of accounting policies selected,
  - the method of their application, or
  - the adequacy of disclosures in the financial statements.
- If such disagreements are material to the financial statements, the auditor should express
  - a qualified opinion or
  - an adverse opinion. (HKSA 701.20)

Disagreement

So material and pervasive

Modified Opinion

# HKSA 701 – Modified Opinion

Example

## Sample Adverse Report (Extract Only)

Introductory para. (no modification)

Management responsibility para. (no modification)

Auditor's responsibility para. (no modification)

Basis for adverse opinion para. (new para. for all the substantive reasons and a quantification of the effect)

Opinion para. (modified with an adverse opinion as below)

Adverse opinion

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

# Update

HKSQCs Hong Kong Standards on Quality Control  
(only HKSQC 1 issued so far)

Hong Kong Framework for Assurance Engagements

Audits and Reviews of  
Historical Fin. Information

HK Standards  
on Auditing  
(HKSA)

HK Standards  
on Review  
Engagements  
(HKSRE)

### New and amended standards within previous 12 months

- HKSA 210 (Mar. 2007)
- HKSRE 2400 (Mar. 2007)
- HKSRE 2410 (Mar. 2007)
- HKSA 200 (Oct. 2006)
- HKSA 560 (Oct. 2006)
- HKSA 700 (Oct. 2006)
- HKSA 701 (Oct. 2006)

Reporting and  
HKSREs

# Update

## HKSREs (Hong Kong Standards on Review Engagements)

HKSRE 2400 Engagements to Review Financial Statements

HKSRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

HK Standards on Review Engagements (HKSRE)

- HKSRE 2400 (Mar. 2007)
- HKSRE 2410 (Mar. 2007)

So far only these 2 HKSREs have been issued

# HKSRE 2400 and 2410

## HKSREs (Hong Kong Standards on Review Engagements)

HKSRE 2400 Engagements to Review Financial Statements

HKSRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

- HKSRE 2410 issued in March 2007 gave rise to conforming amendments to HKSRE 2400.
  - Effective for reviews of financial statements for periods beginning on or after 15 December 2006 unless HKSRE 2410 is early adopted.
  - Early adoption of HKSRE 2410 is permissible.

HK Standards on Review Engagements (HKSRE)

So far only the above 2 HKSREs have been issued

## HKSRE 2400 and 2410

- HKSRE 2400 is to establish standards and provide guidance
  - on the practitioner's professional responsibilities when a practitioner, who is not the auditor of an entity, undertakes an engagement to review financial statements is undertaken and
  - on the form and content of the report that the practitioner issues in connection with such a review.
  - A practitioner, who is the auditor of the entity, engaged to perform a review of interim financial information performs such a review in accordance with HKSRE 2410.
- In turn, HKSRE 2410 is to establish standards and provide guidance
  - on the auditor's professional responsibilities when the auditor undertakes an engagement to review interim financial information of an audit client, and
  - on the form and content of the report.

Except for this change, no substantial changes is resulted (as compared with the one issue in June 2005)

Brief introduction

## HKSRE 2410

- Extended the requirements on the review of interim financial information performed by the independent auditor of the entity
- Correlated the interim review with the auditor's responsibility on annual audit
- HKSRE 2410 specifically requires the auditor in the review engagement the followings:
  - To comply with the ethical requirements relevant to the audit of the annual financial statements of the entity (HKSRE 2410.4)
  - To have an understanding of the entity and its environment, including its internal control, as it relates to the preparation of both annual and interim financial information, sufficient to plan and conduct the (review) engagement (HKSRE 2410.12)
  - To obtain, if the auditor has not yet performed an audit of the annual financial statements in accordance with HKSA's, the above understanding as it relates to the preparation of both annual and interim financial information (not only sufficient to plan and conduct the review engagement) (HKSRE 2410.17)

## HKSRE 2410

- HKSRE 2410 imposes additional requirements (as not stated in HKSRE 2400) and requires the auditor:
  - To inquire whether management has changed its assessment of the entity’s ability to continue as a going concern.
    - If in doubt, additional inquiry and consideration required. (HKSRE 2410.27)
  - To obtain written management representation with additional and specific contents. (HKSRE 2410.34)
  - To read other information that accompanies the interim financial information to consider any inconsistency. (HKSRE 2410.36)

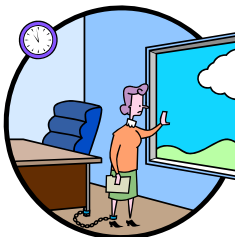


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## HKSRE 2410

- HKSRE 2410 requires a longer form of review report with some modified wordings, including:
  - “A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.”
  - “A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit.”
  - “Accordingly, we do not express an audit opinion.”



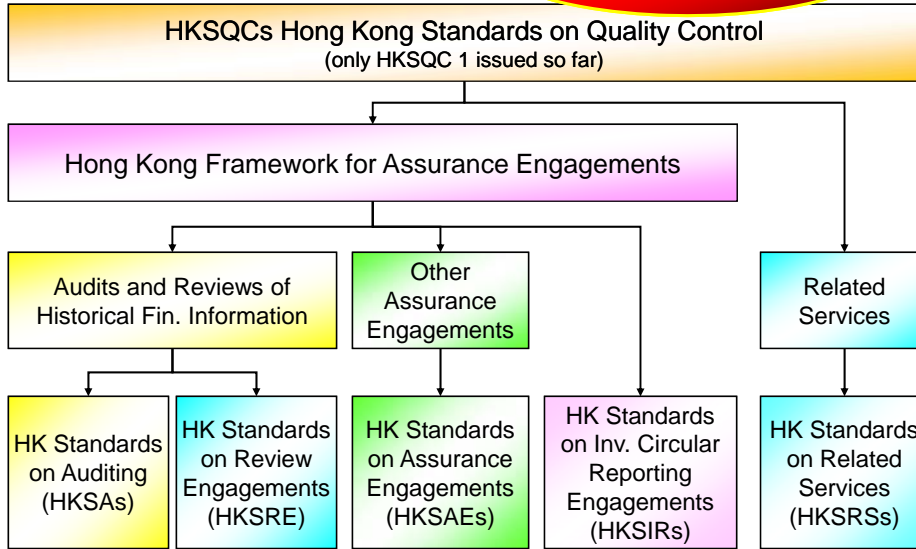
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# Overview

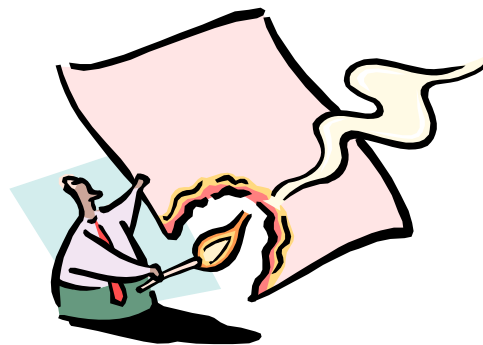
Future .....



# Audit Standards Update

20 July 2007

Full version of the slides can be found in  
[www.NelsonCPA.com.hk](http://www.NelsonCPA.com.hk)



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