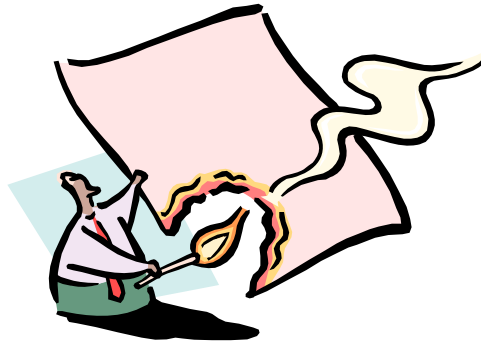


Audit Standards Update

15 April 2008



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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 (incl. 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)

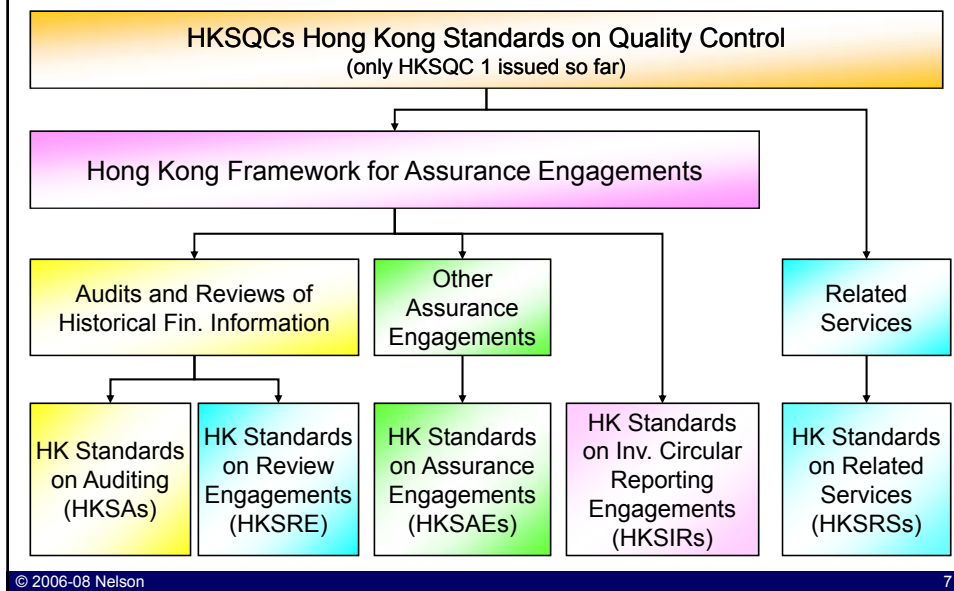


Overview

- 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

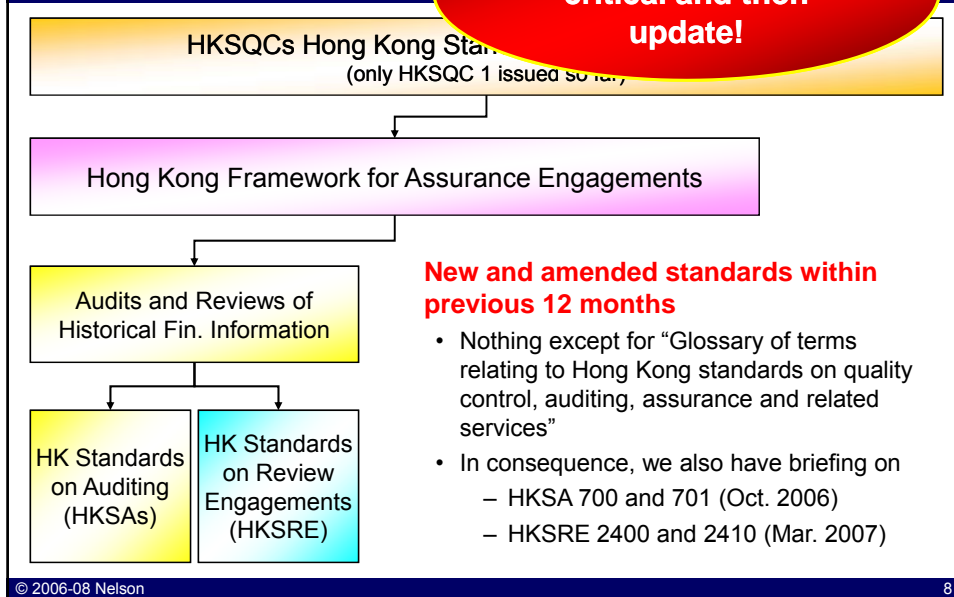


Overview



Overview

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



Today's Agenda



HKSQC 1 and Critical HKSA's

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*

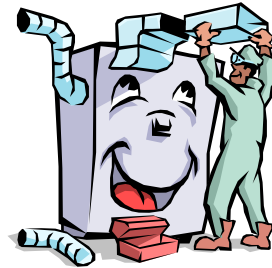
- to establish basic principles and essential procedures and to provide guidance
 - regarding a firm's responsibilities for its system of quality control
 - for audits and reviews of historical financial information, and
 - for other assurance and related services engagements.



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:

- Leadership responsibilities for quality within the firm
- Ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

• Quality Manual

• Promote internal culture
• CEO or Managing partner(s) assume ultimate responsibility

• Integrity of the client
• Competent to perform the job
• Comply with ethical requirement

• Sufficient and competent personnel committed to ethics
• Each job with appropriate staff

• 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:
 - Appropriate consultation takes place on difficult or contentious matters;
 - Sufficient resources are available to enable appropriate consultation to take place;
 - The nature and scope of such consultations are documented; and
 - 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:
 - 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

Documentation

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)



HKSQC 1 – Monitoring

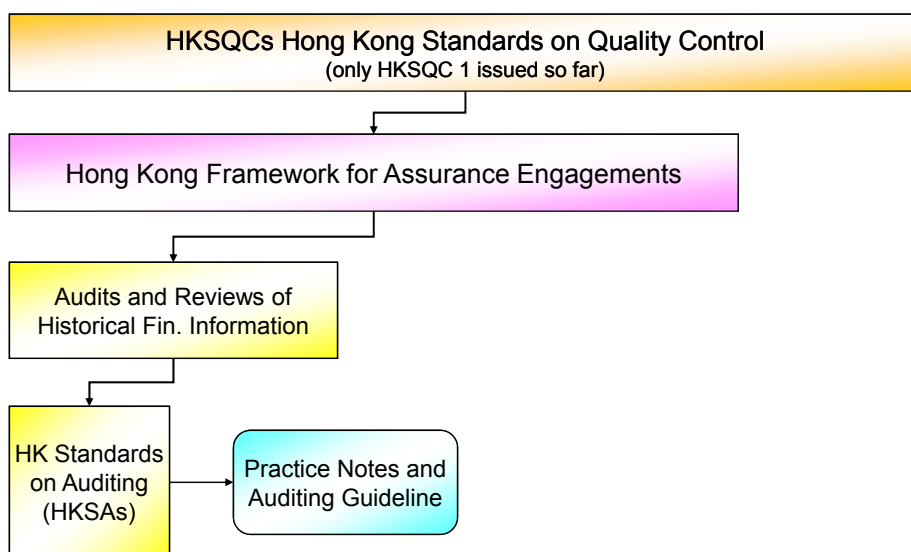
- Periodic inspection of a selection of completed engagement
 - Termed as Quality Assurance Review (QAR) in Practice Review Self-assessment Questionnaire
 - Ordinarily performed on a cyclical basis
 - Engagements selected for inspection include at least one engagement for each engagement partner over 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

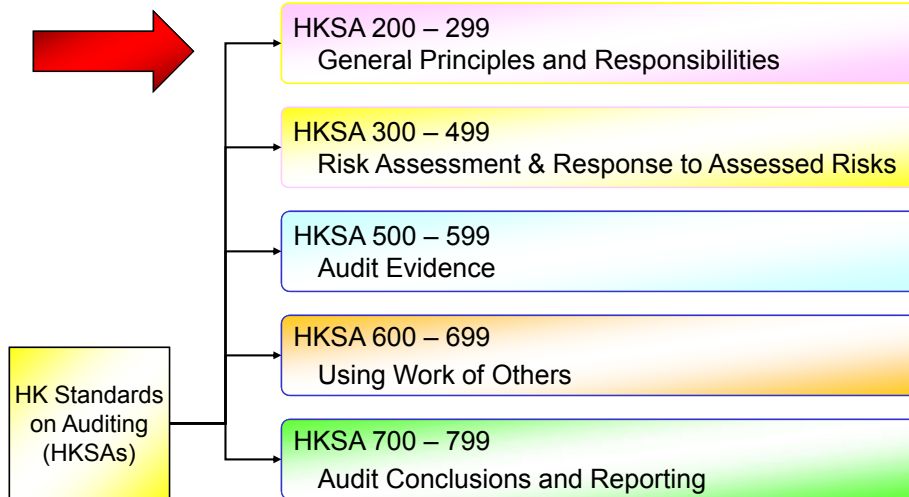
Quality Assurance Review (QAR)



HKSQC and HKSA's



HKSQL and HKSA



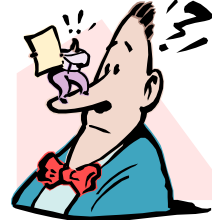
General Principles and Responsibilities

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)

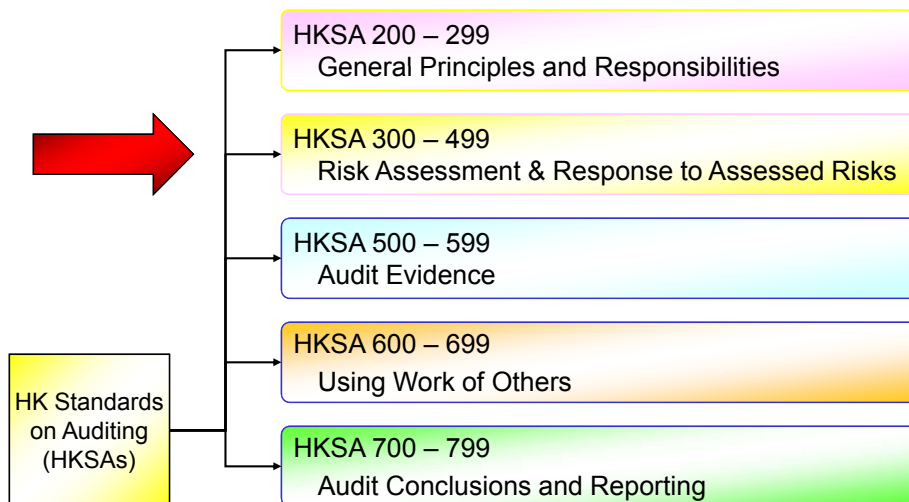


Today's Agenda



Risk Assessment and Response to Assessed Risks (incl. Assertions)

Risk Assessment and Response



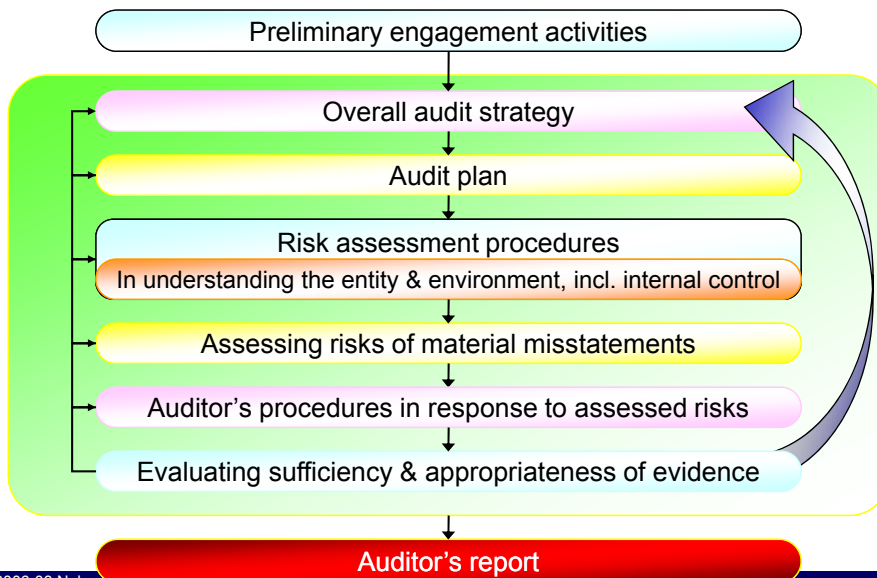
Risk Assessment and Response

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

Audit Process Overview

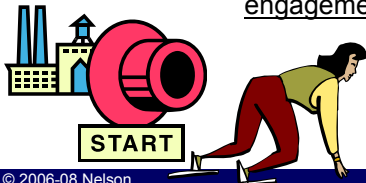


Preliminary Engagement Activities

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

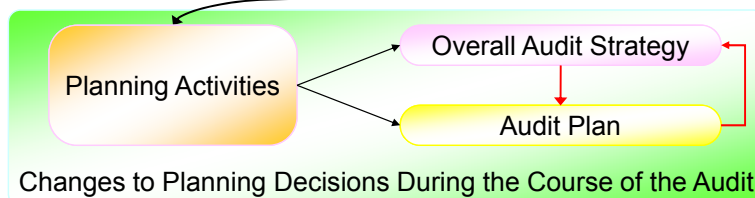


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Planning Activities

HKSA 300 Planning an Audit of Financial Statements

Preliminary Engagement Activities



- 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.

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Planning – Overall Audit Strategy

- HKSA 300 specifically requires that:
 - The auditor should establish the overall audit strategy for the audit (HKSA 300.8)
- The overall audit strategy
 - sets the scope, timing and direction of the audit, and
 - guides the development of the more detailed audit plan.

Overall Audit Strategy



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Planning – Overall Audit Strategy

- The establishment of the overall audit strategy involves:
 - a) Determining the characteristics of the engagement that define its scope
 - b) Ascertaining the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required
 - c) Considering the important factors that will determine the focus of the engagement team's efforts

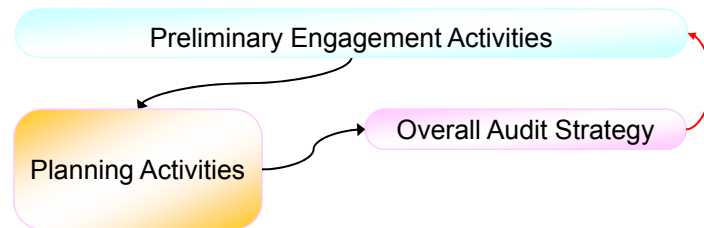
Overall Audit Strategy



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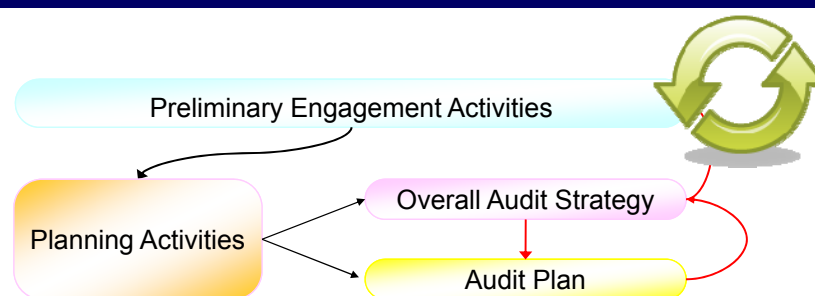
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Planning – Overall Audit Strategy



- In developing the overall audit strategy, the auditor also considers
 - the results of preliminary engagement activities and,
 - where practicable, experience gained on other engagements performed for the entity.

From Strategy to Audit Plan

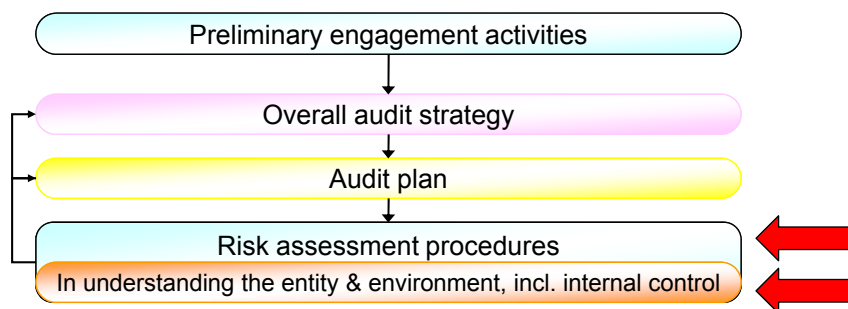


- Once the overall audit strategy has been established, the auditor is able to start the development of a more detailed audit plan to address the various matters identified in the overall audit strategy.
- Although the auditor ordinarily establishes the overall audit strategy before developing the detailed audit plan, the two planning activities
 - are not necessarily discrete or sequential processes
 - but are closely inter-related since changes in one may result in consequential changes to the other.

Planning – Audit Plan

- The auditor should develop **an audit plan** for the audit in order to reduce audit risk to an acceptably low level. (HKSA 300.13)
- 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** sufficient to assess the risks of material misstatements (as determined under HKSA 315) **Audit Plan**
 - A description of the nature, timing and extent of **planned further audit procedures at the assertion level** for each material class of transactions, account balance and disclosures (as determined under HKSA 330) **Risk Assessment Procedures**
Further Audit Procedures
 - Such **other audit procedures** required to be carried out for the engagement in order to comply with HKSA **Other Audit Procedures**

Audit Process Overview



1. Risk Assessment Procedures (and other sources)
2. Understanding the Entity and its Environment

Risk Assessment Procedures

- Audit procedures to obtain an understanding are referred to as “**risk assessment procedures**”
 - because some of the information obtained by performing such procedures may be used by the auditor as audit evidence to support assessments of the risks of material misstatement



Risk assessment procedures

In understanding the entity & environment, incl. internal control

- Obtaining an understanding of the entity and its environment, including its internal control, is
 - a continuous, dynamic process of gathering, updating and analyzing information throughout the audit.

Risk Assessment Procedures

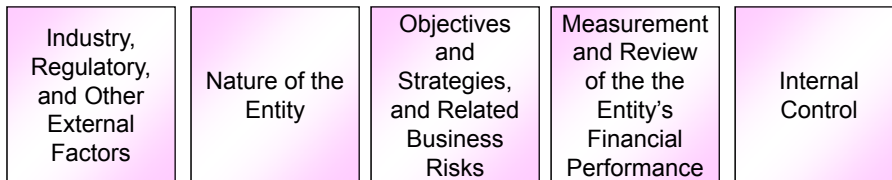
- HKSA 315 specifically requires that:
 - The auditor should perform the following risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control:
 - a) **Inquiries** of management and others within the entity;
 - b) **Analytical procedures**; and
 - c) **Observation** and **inspection**. (HKSA 315.7)



Understanding of the Entity

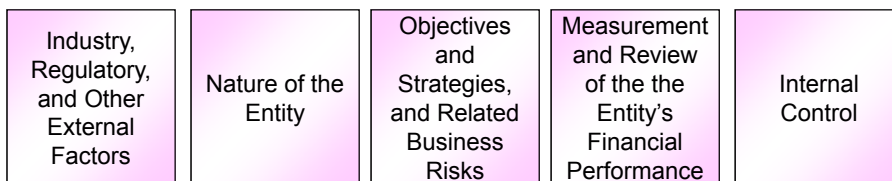
- Risk assessment procedures are used to obtain an understanding of the entity

Risk assessment procedures
In understanding the entity & environment, incl. internal control



Understanding of the Entity

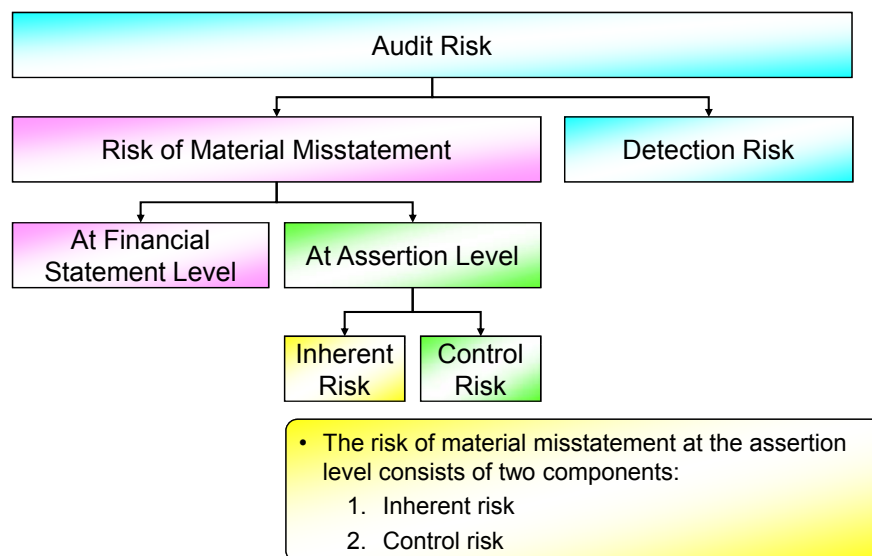
- The auditor's understanding of the entity and its environment consists of an understanding of the following aspects:
 1. Industry, regulatory, and other external factors, including the applicable financial reporting framework.
 2. Nature of the entity, including the entity's selection and application of accounting policies.
 3. Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements.
 4. Measurement and review of the entity's financial performance.
 5. Internal control.



Assessing the Risks

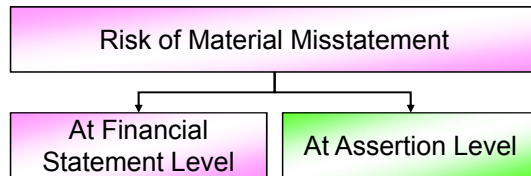


Assessing the Risks



- The risk of material misstatement at the assertion level consists of two components:
 1. Inherent risk
 2. Control risk

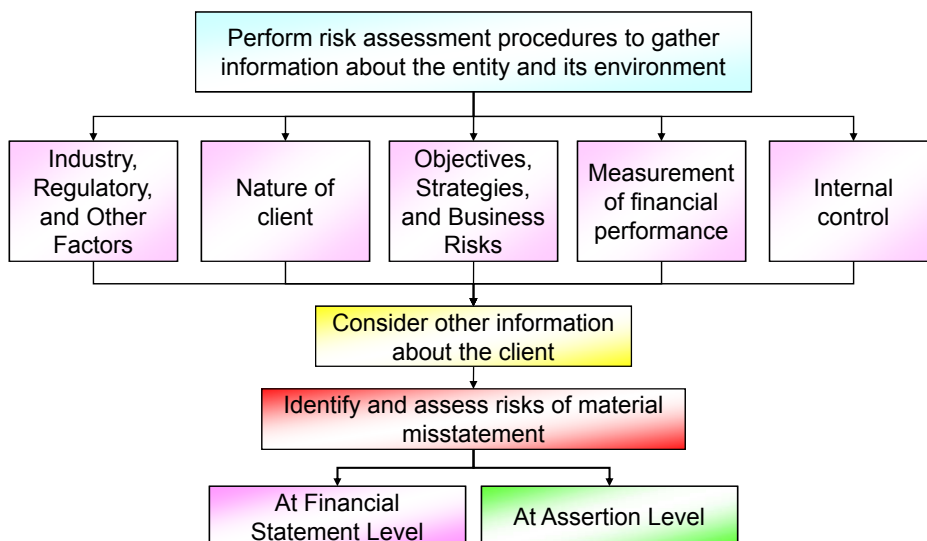
Assessing the Risks



HKSA 315 requires that

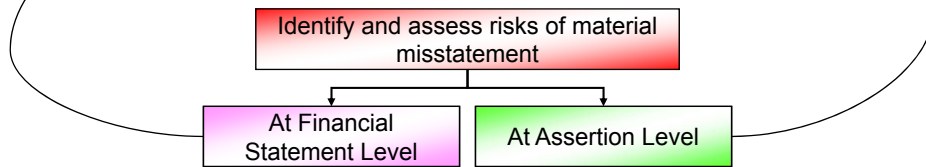
- The auditor should identify and assess the risks of material misstatement
 - at the financial statement level, and
 - at the assertion level for classes of transactions, account balances, and disclosures (HKSA 315.100)

Assessing the Risks



Assessing the Risks

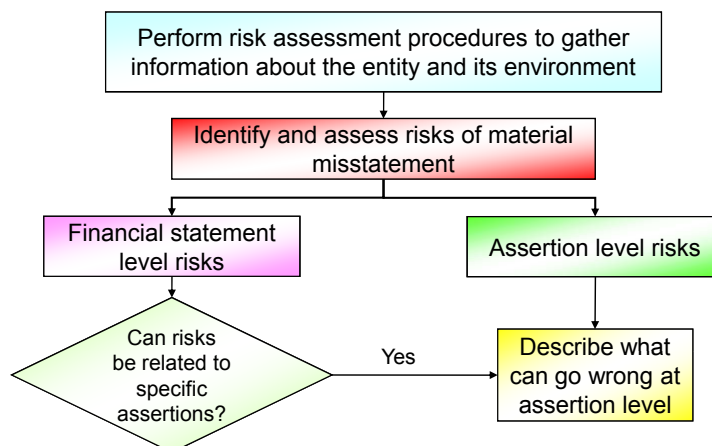
- The auditor uses information gathered by performing risk assessment procedures as audit evidence to support the risk assessment, and
 - in turn, uses the risk assessment to determine the nature, timing, and extent of further audit procedures to be performed.
- The auditor determines
 - whether the identified risks of material misstatement relate to specific classes of transactions, account balances, and disclosures and related assertions, or
 - whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions



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Assessing the Risks



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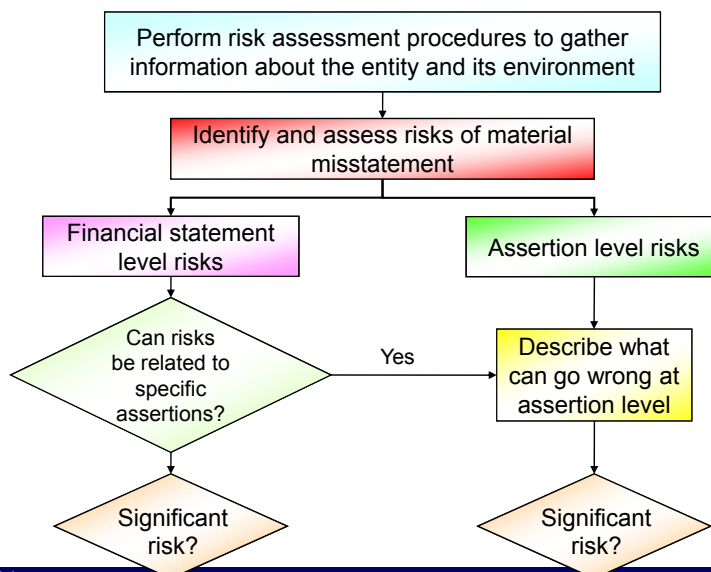
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Determine Significant Risks

- As part of the risk assessment, 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**”. (HKSA 315.108)
- The determination of significant risks, which arise on most audits, is a matter for the auditor’s professional judgment.
 - In exercising this judgment, the auditor excludes the effect of identified controls related to the risk to determine whether
 - the nature of the risk,
 - the likely magnitude of the potential misstatement including the possibility that the risk may give rise to multiple misstatements, and
 - the likelihood of the risk occurring
 are such that they require special audit consideration.



Determine Significant Risks



Determine Significant Risks

- Significant risks are often derived from **business risks** that may result in a material misstatement. In considering the nature of the risks, the auditor considers a number of matters, including the following:
 - Whether the risk is a risk of fraud.
 - Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention.
 - The complexity of transactions.
 - Whether the risk involves significant transactions with related parties.
- 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.



Determine Significant Risks

Example

- Risks of material misstatement may be greater for risks relating to **significant non-routine transactions** arising from matters such as:
 - Greater management intervention to specify the accounting treatment.
 - Greater manual intervention for data collection and processing.
 - Complex calculations or accounting principles.
 - The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.
- Risks of material misstatement may be greater for risks relating to **significant judgmental matters** that require the development of accounting estimates, arising from matters such as the following:
 - Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
 - Required judgment may be subjective, complex or require assumptions about the effects of future events, for example, judgment about fair value.

Determine Other Risks

Risks for which Substantive Procedures Alone do not Provide Sufficient Appropriate Audit Evidence

- As part of the risk assessment, 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. (HKSA 315.115)

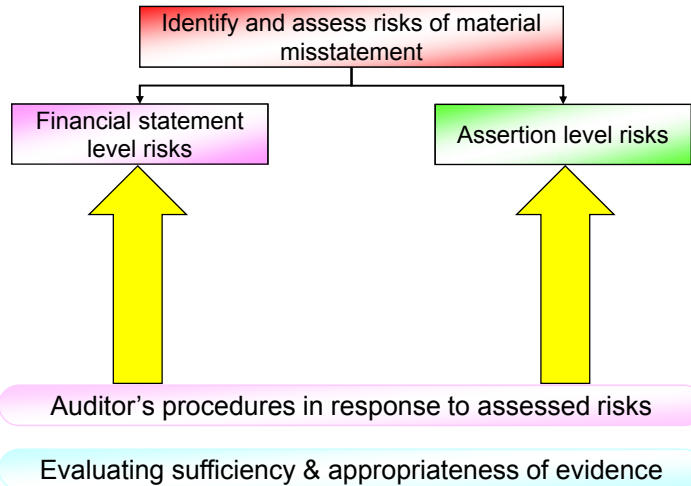
Any examples?

- Ordinarily, such risks relate to significant classes of transactions such as an entity's revenue, purchases, and cash receipts or cash payments.

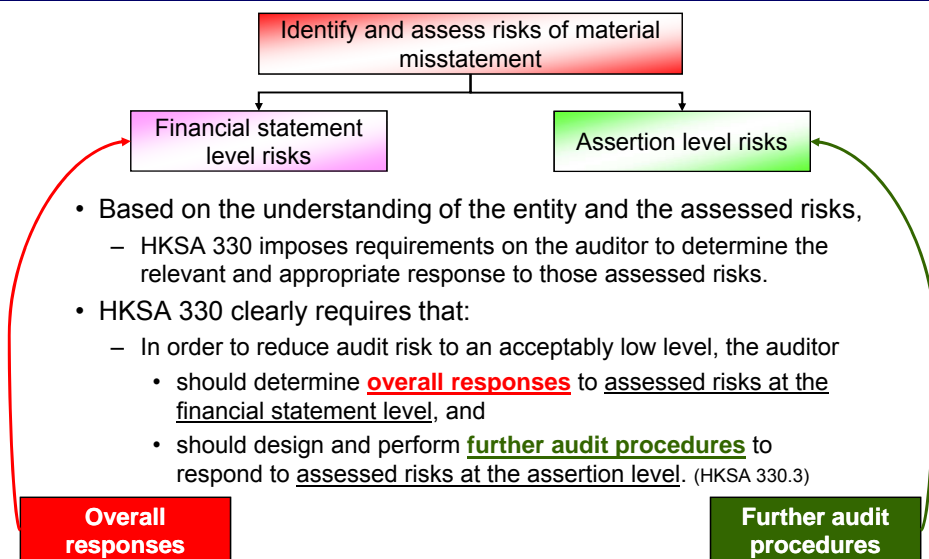
Audit Process Overview



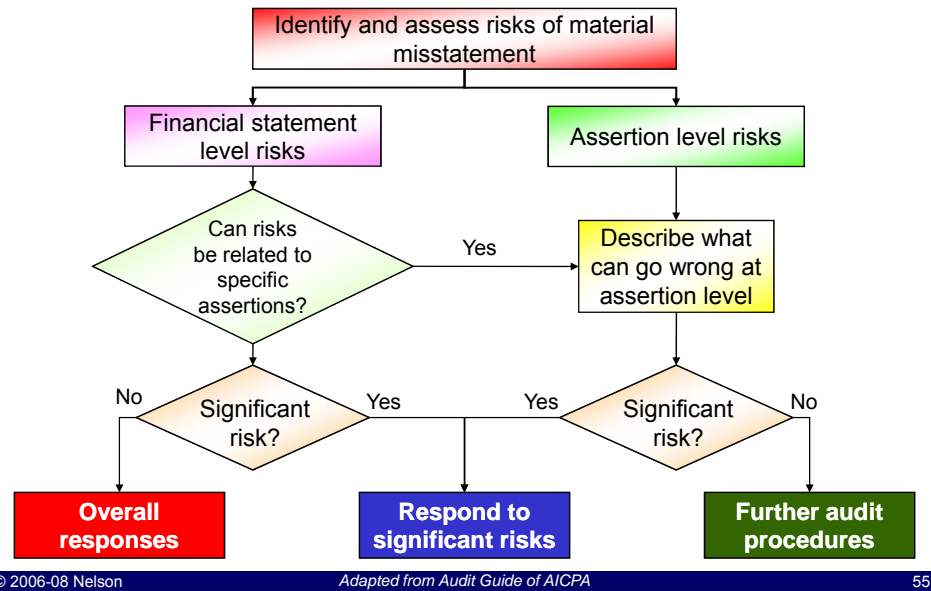
Responses to Assessed Risks



Responses to Assessed Risks



Responses to Assessed Risks



Overall Responses

Example

- 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 Linked to Risks

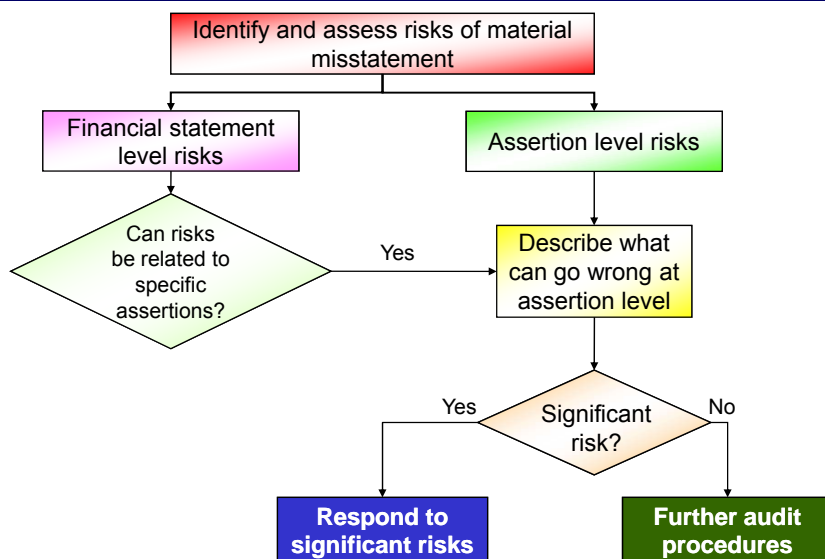
Example

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.

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Risks at Assertion Level



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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

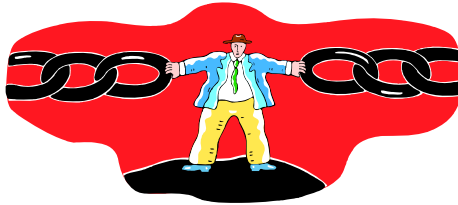
Account Balances

Presentation and Disclosure



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.



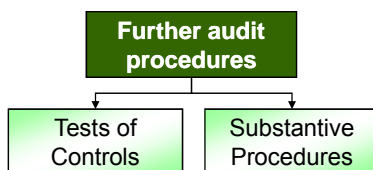
Nature

Timing

Extent

Further audit procedures

FAP under HKSA 330



- FAPs (from the nature perspective) are divided into:
 - Test of controls
 - Substance procedures
- HKSA 330 imposes certain requirements on performing these two kinds of procedures

Nature

Timing

Extent

Further audit procedures

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

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

- 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)

Timing



Test in current audit

Controls Changed

Controls Not Changed

Test once every third audit

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

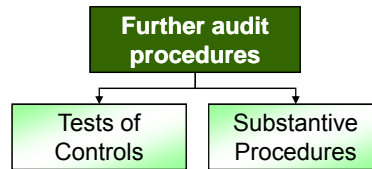


Respond to significant risks

- Audit evidence from prior year deemed not sufficient
- Test should be performed in the current period

FAP – Substantive Procedures

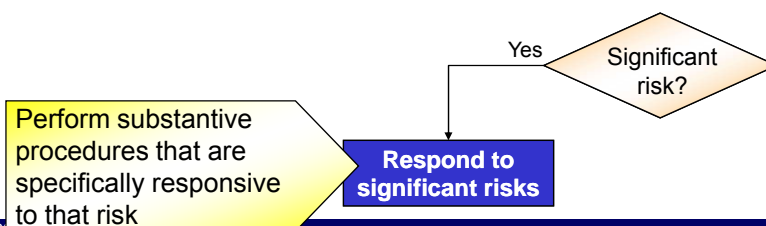
- Substantive procedures are performed in order to detect material misstatements at the assertion level, and include
 - tests of details of classes of transactions, account balances, and disclosures
 - substantive analytical procedures



FAP – Substantive Procedures

- 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 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

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



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.

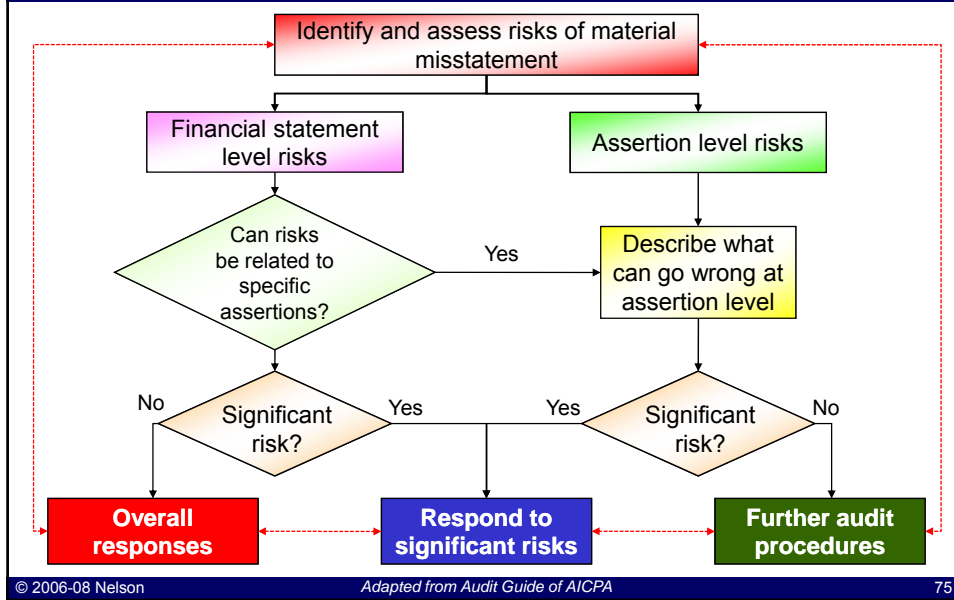


Evaluate Sufficiency and Appropriateness

- 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



Today's Agenda



Update (Reporting and HKSREs)

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
(HKSAAs)

HK Standards
on Review
Engagements
(HKSRE)

New and amended standards within previous 12 months

- Nothing except for "Glossary of terms relating to Hong Kong standards on quality control, auditing, assurance and related services"
- In consequence, we also have briefing on
 - HKSA 700 and 701 (Oct. 2006)
 - HKSRE 2400 and 2410 (Mar. 2007)

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 (Oct. 2006)
- HKSRE 2400 and 2410 (Mar. 2007)

HKSA 700 and 701

HKSA 700 and 701

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.



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)



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.

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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.
(HKSA 700.39 – 41)

New

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

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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

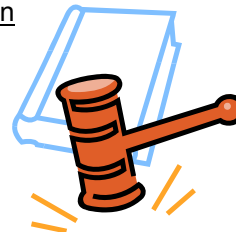
- The auditor's report should be in writing. (HKSA 700.58)
- A written report encompasses both
 - reports issued in hard copy format and
 - those using an electronic medium.



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



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

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)

Emphasis of matter

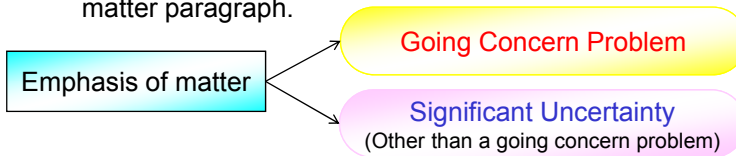
Going Concern Problem

Significant Uncertainty
(Other than a going concern problem)

Refer to
HKSA 570

HKSA 701 – Emphasis of Matter

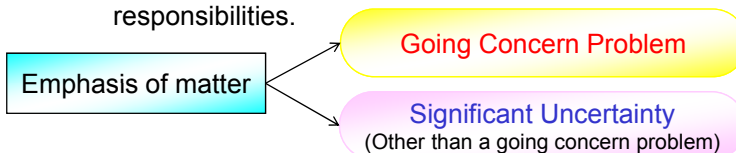
- The addition of a paragraph emphasizing a going concern problem or significant uncertainty is ordinarily adequate to meet the auditor's reporting responsibilities regarding such matters.
- However, in extreme cases, such as situations involving multiple uncertainties that are significant to the financial 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



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
 - b) There is a disagreement with management regarding
 - the acceptability of the accounting policies selected,
 - the method of their application, or
 - the adequacy of financial statement disclosures.

Limitation of Scope

Disagreement

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
Circumstances		
Limitation of scope	Qualified (except for limitation) Opinion	Disclaimer Opinion
Disagreement with management	Qualified (except for disagreement) Opinion	Adverse Opinion

Modified Opinion

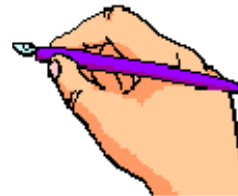
HKSA 701 – Modified Opinion

- 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



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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

2. Limitation imposed by circumstances

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

Modified Opinion

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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



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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)

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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)

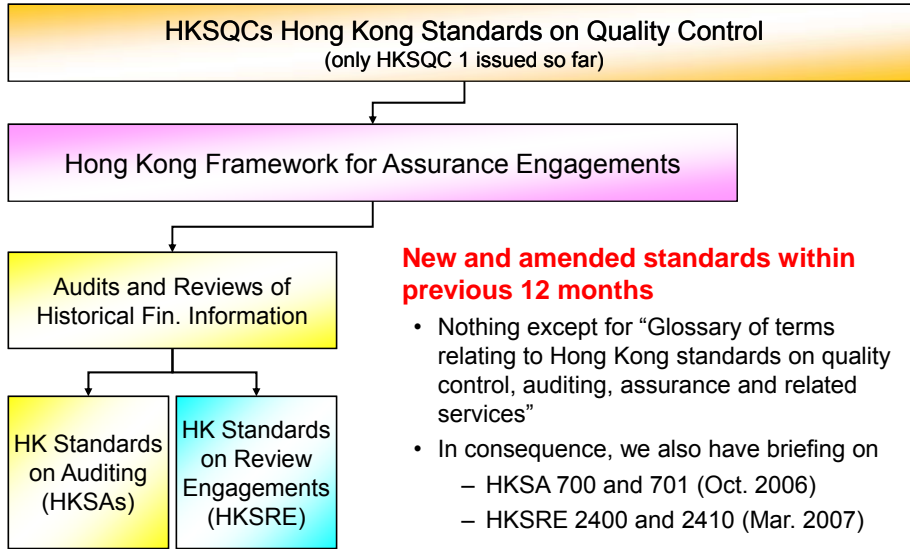
Basis for adverse opinion para. (new para. for all the substantive reasons and a quantification of the effect)

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.

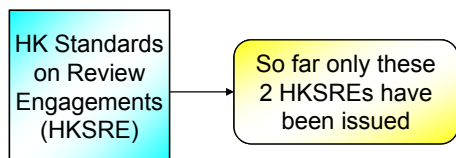
Update



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

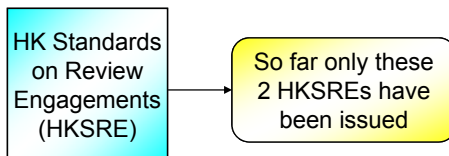


HKSRE 2400 and 2410

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.



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 HKSAAs, 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)

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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)

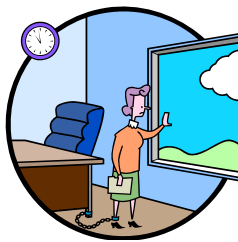


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HKSRE 2410

- 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.”

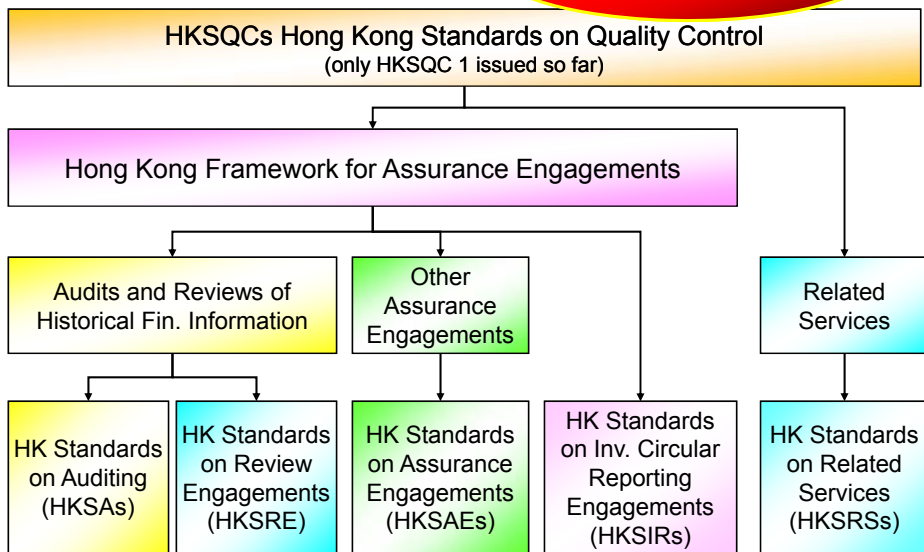


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Overview

Future



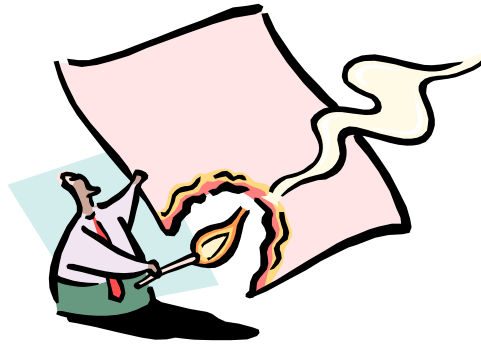
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Audit Standards Update

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Audit Standards Update

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