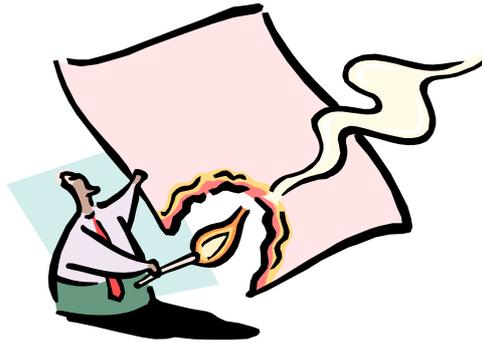


# Clarified Pronouncements on Auditing

18 November 2009



**Nelson Lam 林智遠**  
MBA MSc BBA ACA ACS CFA CPA(Aust)  
CPA(US) FCCA FCPA(Practising) MSCA

## Today's Agenda



Introduction

ISA/HKSA 210 and ISA/HKSA 265

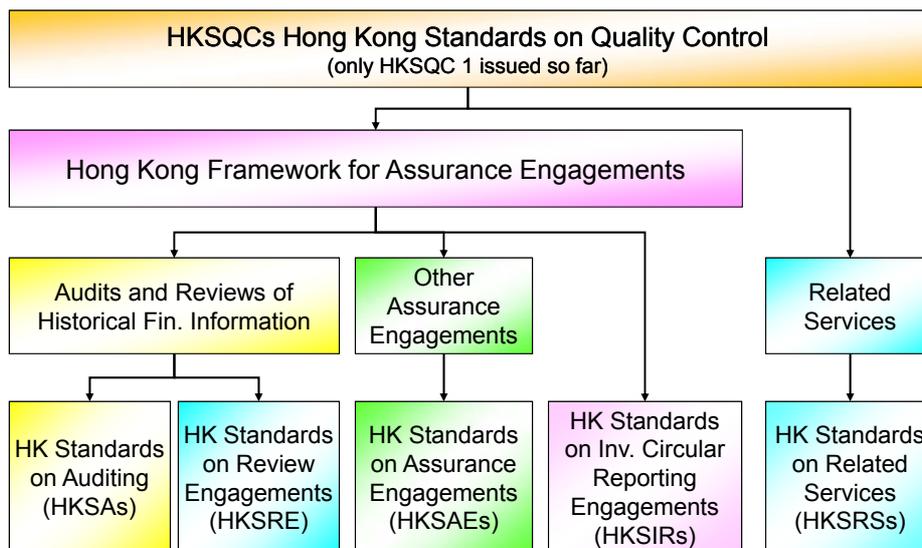
Other Revised and Redrafted  
ISAs/HKSAs

# Today's Agenda

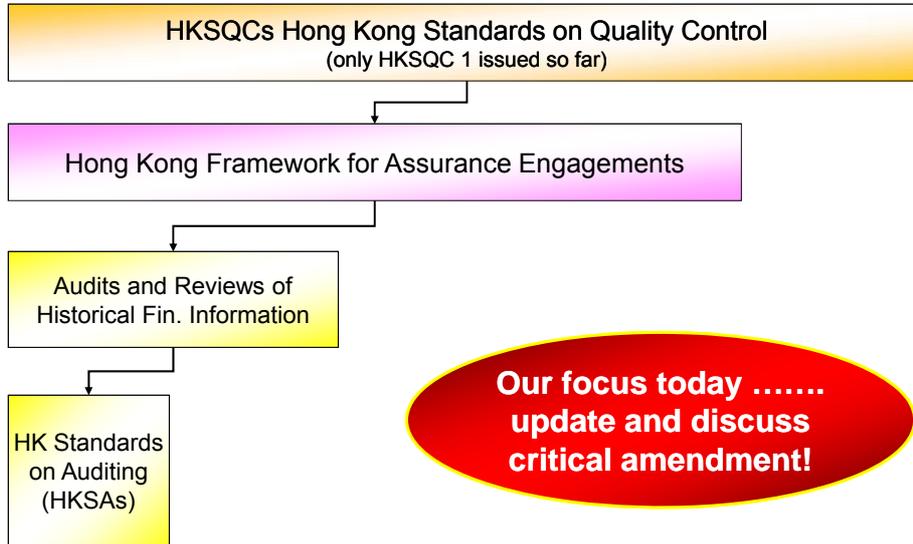


Introduction

# Overview



## Overview



## The IAASB Clarity Project



- In 2004, the IAASB of International Federation of Accountants also began a comprehensive programme to enhance the clarity of its ISAs (termed as the [IAASB Clarity Project](#))
  - The programme involved the application of new drafting conventions to all ISAs, either as part of
    - a substantive revision, or
    - through a limited redrafting,to reflect the new conventions and matters of clarity generally.
- The IAASB clarity project was completed in March 2009.

## The IAASB Clarity Project



- The final set of clarified standards comprises
  - 36 International Standards on Auditing (ISAs) and International Standard on Quality Control (ISQC) 1, including:
    - One new standard (ISA 265), addressing communication of deficiencies in internal control;
    - 16 standards containing new and revised requirements (these have been referred to as "revised and redrafted ISAs"); and
    - 20 standards that have been redrafted to apply the new conventions and reflect matters of general clarity only (these have been referred to as "redrafted ISAs and redrafted ISQC 1").
- Unless otherwise specified, the clarified pronouncements are effective for audits of financial statements for periods beginning on or after 15 December 2009.

## The IAASB Clarity Project in HK

- HKICPA announced that:
  - the clarified HKSAs will use the equivalent ISA as the underlying standard and will conform with the equivalent ISAs.
  - Where necessary, local guidance will be included as in the extant HKSAs.
- HKICPA committed to issue the clarified HKSAs in batches
  - Part 1 covering 12 documents was issued in Jun. 2009
  - Part 2 covering 15 documents was issued in Jul. 2009
  - Part 3 covering 8 documents was issued in Sep. 2009
  - Part 4 covering 3 documents was issued in Oct. 2009



## The IAASB Clarity Project in HK

- The clarified HKSAs have the same effective date as the ISAs, i.e. for audits of financial statements for periods beginning on or after 15 December 2009.
- As most companies in Hong Kong have a 31 December year end, the first audit using the clarified standards would normally be for the period ending 31 December 2010.



## Main Changes from Clarity Project

- All ISAs/HKSAs contain certain improvements arising from IAASB's Clarity Project including improvements in language and clarity of purpose.
- Broadly, these include:
  - Identifying the overall objectives of the auditor when conducting an audit in accordance with ISAs, setting an objective in each ISA, and establishing an obligation on the auditor in relation to those objectives;
  - Clarifying the obligations imposed on auditors by the requirements of the ISAs and the language used to communicate such requirements; and
  - Eliminating ambiguity about the requirements an auditor needs to fulfill.

## Main Changes from Clarity Project

- The ISAs and HKSAs now have a new structure, in which information is presented in separate sections:
  - **Introduction**
    - Introductory material may include information regarding the purpose, scope, and subject matter of the ISA/HKSA, in addition to the responsibilities of the auditors and others in the context in which the ISA/HKSA is set.
  - **Objective**
    - Each ISA/HKSA now contains a clear statement of the objective of the auditor in the audit area addressed by that ISA/HKSA.
  - **Definitions**
  - **Requirements**
    - Each objective is supported by clearly stated requirements. Requirements are always expressed by the phrase "the auditor shall."
  - **Application and Other Explanatory Material**

## Today's Agenda



ISA/HKSA 210 and ISA/HKSA 265

## ISA/HKSA 210 (Clarified)

- ISA/HKSA 210 *Agreeing the Terms of Audit Engagements* was not subject to a revision project in its own right but, nevertheless, has been significantly revised as a result of conforming changes stemming from the revision of other ISAs.
- In particular the auditor is required to perform specific procedures in order to establish whether the preconditions for an audit are present.

**Preconditions** for an audit is defined as

- The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

## ISA/HKSA 210 (Clarified)

- In order to establish whether the preconditions for an audit are present, the auditor is required to:
  - a. Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
  - b. Obtain the agreement of management that it acknowledges and understands its responsibility in respect of certain areas.



## ISA/HKSA 210 (Clarified)

- The management's responsibility to be acknowledged:
  - i. For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
  - ii. For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
  - iii. To provide the auditor with:
    - a) Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - b) Additional information that the auditor may request from management for the purpose of the audit; and
    - c) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

## New ISA/HKSA – 265

- A new standard issued in the clarity project
  - ISA/HKSA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*
    - deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements



## New ISA/HKSA – 265

- Under ISA/HKSA 265, the objective of the auditor is
  - to communicate appropriately to those charged with governance and management deficiencies in internal control
  - that the auditor has identified during the audit and
  - that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

- Deficiency in internal control – This exists when:
  - i. A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or
  - ii. A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

## New ISA/HKSA – 265

- Significant deficiency in internal control :
  - A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.



## New ISA/HKSA – 265

### Example

- Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:
  - The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
  - The susceptibility to loss or fraud of the related asset or liability.
  - The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
  - The financial statement amounts exposed to the deficiencies.
  - The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
  - The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
  - The interaction of the deficiency with other deficiencies in internal control.

## New ISA/HKSA – 265

### Example

- Indicators of significant deficiencies in internal control include, for example:
  - Evidence of ineffective aspects of the control environment, such as:
    - Indications that significant transactions in which management is financially interested are not being appropriately scrutinized by those charged with governance.
    - Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
    - Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
  - Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
  - Restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud.
  - Evidence of management's inability to oversee the preparation of the financial statements.

## New ISA/HKSA – 265

- The auditor is required to
  - determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control.
  - determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.
  - communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.
  - communicate to management at an appropriate level of responsibility on a timely basis:
    - a. In writing, significant deficiencies in internal control
    - b. Other deficiencies in internal control identified are of sufficient importance to merit management's attention



## New ISA/HKSA – 265

- The auditor is required to
  - include in the written communication of significant deficiencies in internal control:
    - a. A description of the deficiencies and an explanation of their potential effects; and
    - b. Sufficient information to enable those charged with governance and management to understand the context of the communication.  
In particular, the auditor shall explain that:
      - i. The purpose of the audit was for the auditor to express an opinion on the financial statements;
      - ii. The audit included consideration of internal control relevant to the preparation 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 internal control; and
      - iii. The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.

# Today's Agenda



Other Revised and Redrafted  
ISAs/HKSAs

## 16 Revised & Redrafted ISA/HKSA

- 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
- 260 Communication with Those Charged with Governance
- 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
- 320 Materiality in Planning and Performing an Audit
- 402 Audit Considerations Relating to an Entity Using a Service Organization
- 450 Evaluation of Misstatements Identified during the Audit
- 505 External Confirmations
- 540 Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
- 550 Related Parties
- 580 Written Representations



## 16 Revised & Redrafted ISA/HKSA

- 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) ←
- 601 Using the Work of an Auditor's Expert ←
- 705 Modifications to the Opinion in the Independent Auditor's Report ←
- 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report ←
- 800 Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
- 805 Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
- 810 Engagements to Report on Summary Financial Statements

## ISA/HKSA 200



- ISA/HKSA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*
  - deals with the independent auditor's **overall responsibilities** when conducting an audit of financial statements in accordance with HKSA's.
    - sets out the overall objectives of the independent auditor,
    - explains the nature and scope of an audit designed to enable the independent auditor to meet those objectives
    - explains the scope, authority and structure of the HKSA's, and
    - includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the HKSA's

## ISA/HKSA 200

- ISA/HKSA 200 clearly sets out that:
  - In conducting an audit of financial statements, the **overall objectives** of the auditor are:
    - a. To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error,
      - thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
    - b. To report on the financial statements, and communicate as required by the HKSAs, in accordance with the auditor's findings.



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## ISA/HKSA 200

- ISA/HKSA 200 (clarified) also introduces new guidance in relation to
  - professional skepticism,
  - professional judgment,
  - the implications of the inherent limitations of an audit, and
  - other matters relevant to the application of the ISA/HKSA.
- All clarified ISAs/HKSAs follow the new clarity structure and have been drafted in light of the obligations and conventions set out in ISA/HKSA 200 (clarified).

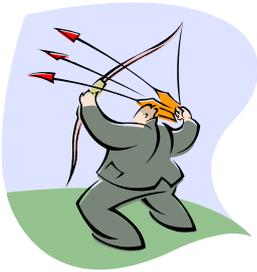


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## ISA/HKSA 200

- In accordance with ISA/HKSA 200, the auditor in auditing financial statements is required to:
  - a. Comply with the relevant ethical requirements.
  - b. Plan and perform an audit with professional skepticism.
  - c. Exercise professional judgment in planning and performing an audit of financial statements.
  - d. Obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.
  - e. Comply with all HKSAs relevant to the audit.



## ISA/HKSA 200

- To conduct an audit of financial statements in accordance with HKSAs,
  - HKSA 200 requires an auditor to comply with all HKSAs relevant to the audit.
- An HKSA is relevant to the audit when:
  - the HKSA is in effect and
  - the circumstances addressed by the HKSA exist.
- The auditor is required to comply with each requirement of an HKSA unless in the circumstances of the audit:
  - a. The entire HKSA is not relevant; or
  - b. The requirement is not relevant because it is conditional and the condition does not exist.



## ISA/HKSA 200

- ISA/HKSA 200 also introduces the concept of **premise**, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted
  - That those charged with governance have acknowledged and understand that they have the responsibilities that are fundamental to the conduct of an audit in accordance with ISA/HKSAs, including
    - preparation of financial statements in accordance with the applicable financial reporting framework;
    - Internal control to enable the preparation of financial statements that are free from material misstatement
    - To provide the auditor with access to all information, additional information and unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.



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## ISA/HKSA 260

- ISA/HKSA 260 *Communication with Those Charged with Governance*
  - deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements.



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## ISA/HKSA 260

- Under ISA/HKSA 260, the objectives of the auditor are:
  - a. To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
  - b. To obtain from those charged with governance information relevant to the audit;
  - c. To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
  - d. To promote effective two-way communication between the auditor and those charged with governance.

Significant Findings

Communication process

## ISA/HKSA 260

- For **significant findings**, communication includes:
  - a. The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosure.  
When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
  - b. Significant difficulties, if any, encountered during the audit;
  - c. Unless all of those charged with governance are involved in managing the entity:
    - i. Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
    - ii. Written representations the auditor is requesting; and
  - d. Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

## ISA/HKSA 260

- For the communication process,
  - The auditor shall communicate **in writing** with those charged with governance regarding
    - **significant findings** from the audit if, in the auditor's professional judgment, oral communication would not be adequate.
      - Written communications need not include all matters that arose during the course of the audit.
    - **auditor independence** as required by ISA/HKSA 260
  - The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit.
  - If it has not, the auditor shall evaluate the effect, if any, on
    - the auditor's assessment of the risks of material misstatement and
    - the auditor's ability to obtain sufficient appropriate audit evidence, and shall take appropriate action.



## ISA/HKSA 260

### Example

- If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take such actions as:
  - Modifying the auditor's opinion on the basis of a scope limitation.
  - Obtaining legal advice about the consequences of different courses of action.
  - Communicating with third parties (for example, a regulator), or a higher authority in the governance structure that is outside the entity, such as the owners of a business (for example, shareholders in a general meeting), or the responsible government minister or parliament in the public sector.
  - Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.

## ISA/HKSA 320 and 450

- In the clarity project of ISA, the consideration of materiality is divided into:
  - a. Materiality in planning and performing an audit of financial statements in ISA 320 "*Materiality in Planning and Performing an Audit*"; and
  - b. Materiality in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements on the financial statements in ISA 450 "*Evaluation of Misstatements Identified during the Audit*".
- HKSA 320 and HKSA 450 issued in Hong Kong follow the same clarity result.



## ISA/HKSA 320 and 450

- The auditor applies the concept of materiality and audit risk throughout the audit and in:
  - a. Planning and performing the audit; and
  - b. Evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.



## ISA/HKSA 320

- ISA/HKSA 320 sets out that:
  - The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit.
- The revised ISA/HKSA 320 specifically requires an auditor to determine at least 2 types of materiality in planning an audit, namely:
  - a. Materiality for the financial statements as a whole; and
  - b. Performance materiality.

Materiality for the financial statements as a whole

Performance materiality

## ISA/HKSA 320

### Audit Process

Planning

Preliminary engagement activities

Planning activities

Risk assessment

Understanding the entity and its environment

Identify and assess risks of material misstatements

Risk response

Design and implement auditor's responses to assessed risks

Reviewing and reporting

Overall reviewing

Drawing conclusions and reporting

An audit is a cumulative and iterative process

## ISA/HKSA 320

- **Materiality for the financial statements as a whole** must be determined when the auditor establishes the overall audit strategy.
- The auditor's assessment of materiality helps the auditor determine
  - what items to examine and
  - whether to use sampling and analytical procedures.



Materiality for the financial statements as a whole

## ISA/HKSA 320

- In addition to materiality for the financial statements as a whole,
  - an auditor must also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures
    - when, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.



For particular classes of transactions, a/c balances or disclosures

Materiality for the financial statements as a whole

## ISA/HKSA 320

- Performance materiality:
  - means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.
  - if applicable, also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

Performance materiality

## ISA/HKSA 320

- The auditor is required to determine performance materiality for purposes of:
  - a. Assessing the risks of material misstatement and
  - b. Determining the nature, timing and extent of further audit procedures.

Performance materiality

## ISA/HKSA 320

- The auditor shall revise **materiality** for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures)
  - in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.
- If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate,
  - the auditor shall determine
    - whether it is necessary to revise performance materiality, and
    - whether the nature, timing and extent of the further audit procedures remain appropriate.

Materiality for the financial statements as a whole

Performance materiality

## ISA/HKSA 320

- The auditor shall include in the audit documentation the following amounts and the factors considered in their determination:
  - a. Materiality for the financial statements as a whole;
  - b. If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures;
  - c. Performance materiality; and
  - d. Any revision of (a)-(c) as the audit progressed.

Materiality for the financial statements as a whole

Performance materiality

## ISA/HKSA 402

- ISA/HKSA 402 *Audit Considerations Relating to an Entity Using a Service Organization*
  - deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations.



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## ISA/HKSA 402

- ISA/HKSA 402 expands on how the user auditor applies ISA/HKSA 315 and 330
  - in obtaining an understanding of the user entity, including internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement and
  - in designing and performing further audit procedures responsive to those risks.



- **Service organization** is defined as:
  - A third-party organization (or segment of a third-party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.

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## ISA/HKSA 402

### Example

- A user entity may use a service organization such as
  - one that processes transactions and maintains related accountability, or records transactions and processes related data.
- Service organizations that provide such services include, for example,
  - bank trust departments that invest and service assets for employee benefit plans or for others;
  - mortgage bankers that service mortgages for others; and
  - application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions.

## ISA/HKSA 402

### Example

- Examples of service organization services that are relevant to the audit include:
  - Maintenance of the user entity's accounting records.
  - Management of assets.
  - Initiating, recording or processing transactions as agent of the user entity.
- Smaller entities may use
  - external bookkeeping services ranging from the processing of certain transactions (for example, payment of payroll taxes) and maintenance of their accounting records to the preparation of their financial statements.
    - The use of such a service organization for the preparation of its financial statements does not relieve management of the smaller entity and, where appropriate, those charged with governance of their responsibilities for the financial statements.

## ISA/HKSA 402

- ISA/HKSA 402 requires
  - when obtaining an understanding of the user entity in accordance with ISA/HKSA 315,
    - the user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operations
  - when obtaining an understanding of internal control relevant to the audit in accordance with ISA/HKSA 315,
    - the user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organization, including those that are applied to the transactions processed by the service organization.



## ISA/HKSA 402

- If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:
  - a. Obtaining a type 1 or type 2 report, if available;
  - b. Contacting the service organization, through the user entity, to obtain specific information;
  - c. Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization; or
  - d. Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization. (Ref: Para. A)

## ISA/HKSA 402

- **Report on the description and design of controls at a service organization (Type 1 Report):**
  - A report that comprises:
    - i. A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date; and
    - ii. A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organization's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

## ISA/HKSA 402

- **Report on the description, design, and operating effectiveness of controls at a service organization (Type 2 Report)**
  - A report that comprises:
    - i. A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and
    - ii. A report by the service auditor with the objective of conveying reasonable assurance that includes:
      - a. The service auditor's opinion on the description of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
      - b. A description of the service auditor's tests of the controls and the results thereof.

## ISA/HKSA 402

- In determining the sufficiency and appropriateness of the audit evidence provided by a type 1 or type 2 report, the user auditor shall be satisfied as to:
  - a. The service auditor's professional competence and independence from the service organization; and
  - b. The adequacy of the standards under which the type 1 or type 2 report was issued.

## ISA/HKSA 402

- In responding to assessed risks in accordance with ISA/HKSA 330, the user auditor shall:
  - a. Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity; and, if not,
  - b. Perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the user auditor's behalf.

## ISA/HKSA 402

- When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively,
  - the user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:
    - a. Obtaining a type 2 report, if available;
    - b. Performing appropriate tests of controls at the service organization; or
    - c. Using another auditor to perform tests of controls at the service organization on behalf of the user auditor.

## ISA/HKSA 402

- The user auditor shall inquire of management of the user entity
  - whether the service organization has reported to the user entity, or
  - whether the user entity is otherwise aware of, any fraud, non-compliance with laws and regulations or uncorrected misstatements affecting the financial statements of the user entity.
- The user auditor shall evaluate how such matters affect the nature, timing and extent of the user auditor's further audit procedures, including the effect on the user auditor's conclusions and user auditor's report.

## ISA/HKSA 402

- If the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements
  - The user auditor **shall modify the opinion** in the user auditor's report in accordance with ISA/HKSA 705.
- The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so.
- If reference to the work of a service auditor is relevant to an understanding of a modification to the user auditor's opinion,
  - the user auditor's report shall indicate that such reference does not diminish the user auditor's responsibility for that opinion.

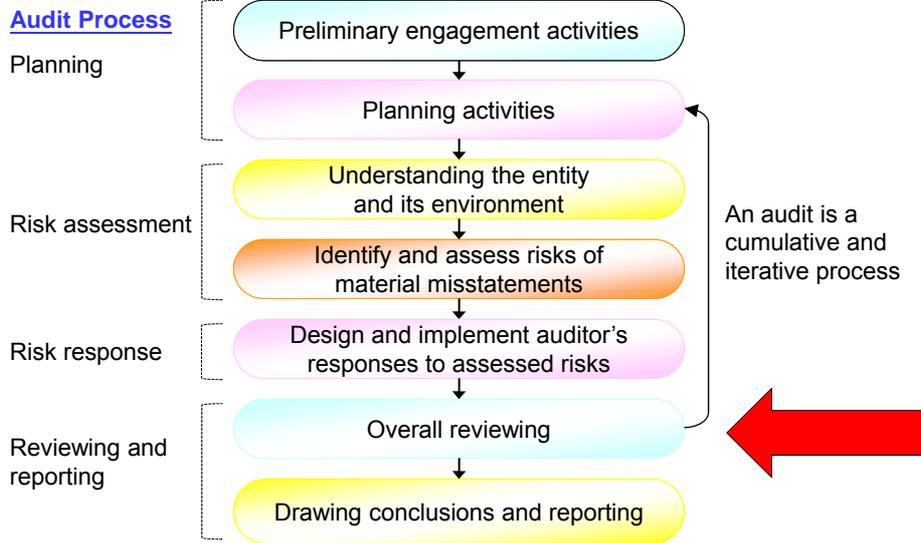
## ISA/HKSA 450

- ISA/HKSA 450 *Evaluation of Misstatements Identified during the Audit*
  - deals with the auditor's responsibility to evaluate the effect
    - of identified misstatements on the audit and
    - of uncorrected misstatements, if any, on the financial statements.
- ISA/HKSA 450 is a new standard that has been derived from the revision of ISA/HKSA 320 on audit materiality.



# ISA/HKSA 450

## Audit Process



# ISA/HKSA 450

- ISA/HKSA 450 sets out that the objective of the auditor is to evaluate:
  - a. The effect of identified misstatements on the audit; and
  - b. The effect of uncorrected misstatements, if any, on the financial statements.
- ISA/HKSA 450 specifically requires the auditor to accumulate misstatements identified during the audit, other than those that are **clearly trivial**.
  - The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements.



## ISA/HKSA 450

- “Clearly trivial” is not another expression for “not material.”
  - Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality determined in accordance with HKSA 320, and will be matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances.
  - When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.



## ISA/HKSA 450 – Consideration

- The auditor is required to determine whether the overall audit strategy and audit plan need to be revised if:
  - a. The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or
  - b. The aggregate of misstatements accumulated during the audit approaches materiality determined, including
    - materiality for the financial statements as a whole and
    - performance materiality,in accordance with ISA/HKSA 320 as discussed above.

## ISA/HKSA 450 – Communication

- When misstatements are accumulated during the audit, the auditor is required to:
  - a. Communicate all such accumulated misstatements with the appropriate level of management, unless prohibited by law or regulation; and
  - b. Request management to correct those misstatements.
- If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor is required to:
  - a. Obtain an understanding of management's reasons for not making the corrections and
  - b. Take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

## ISA/HKSA 450 – Evaluation

- Before evaluating the effect of uncorrected misstatements,
  - the auditor must reassess materiality determined to confirm whether it remains appropriate in the context of the entity's actual financial results.
- Then, the auditor must determine whether **uncorrected misstatements** are material, individually or in aggregate.
- **Uncorrected misstatements are defined**
  - to be misstatements that the auditor has accumulated during the audit and that have not been corrected.



## ISA/HKSA 450 – Evaluation

- In making this determination, the auditor shall consider:
  - a. The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
  - b. The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole



## ISA/HKSA 450 – Evaluation

### Example

- Circumstances that may affect the evaluation include the extent to which the misstatement:
  - Affects compliance with regulatory requirements;
  - Affects compliance with debt covenants or other contractual requirements;
  - Masks a change in earnings or other trends, especially in the context of general economic and industry conditions;
  - Affects ratios used to evaluate the entity's financial position, results of operations or cash flows;
  - Affects segment information presented in the financial statements;
  - Has the effect of increasing management compensation;
  - Affects other information that will be communicated in documents containing the audited financial statements that may reasonably be expected to influence the economic decisions of the users of the financial statements
    - For example, information to be included in a "Management Discussion and Analysis" or an "Operating and Financial Review"

## ISA/HKSA 450 – Evaluation

- Unless prohibited by law or regulation, the auditor must communicate with those charged with governance
  - uncorrected misstatements and
  - the effect that they, individually or in aggregate, may have on the opinion in the auditor's report.
- The auditor's communication must include:
  - a. To identify material uncorrected misstatements individually and to request that uncorrected misstatements be corrected; and
  - b. To communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

## ISA/HKSA 450

- The auditor must request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.
- A summary of such items must be included in or attached to the written representation.

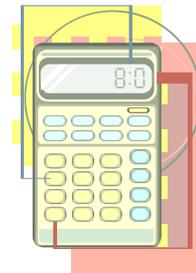


## ISA/HKSA 450

- In evaluating the identified misstatement, the auditor must include in the audit documentation:
  - a. The amount below which misstatements would be regarded as clearly trivial;
  - b. All misstatements accumulated during the audit and whether they have been corrected; and
  - c. The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

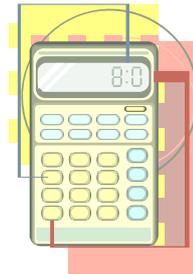
## ISA/HKSA 540

- ISA/HKSA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
  - deals with the auditor's responsibility relating to accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements



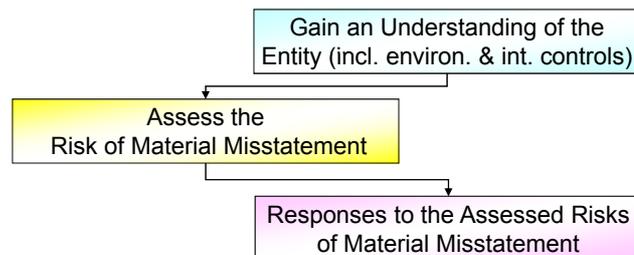
## ISA/HKSA 540

- Pursuant to the increasing use of estimated amount in accounting standards, the revision of ISA 540 was undertaken to improve the rigor of the auditing of estimates.
- The principles and techniques for auditing estimates also apply to auditing fair values, and, indeed, it can be difficult to distinguish an estimate from a fair value.
- Following initial exposure, a decision was therefore made by IAASB to merge ISA 545, *Auditing Fair Value Measurements and Disclosures*, into ISA 540



## ISA/HKSA 540

- The objective of the auditor is to obtain sufficient appropriate audit evidence about whether:
  - a. accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and
  - b. related disclosures in the financial statements are adequate,in the context of the applicable financial reporting framework.



## ISA/HKSA 540

- The auditor shall obtain an understanding of:
  - The requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosure
  - How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements.
  - How management makes the accounting estimates, and an understanding of the data on which they are based, including:
    - i. The method or model used in making the accounting estimate;
    - ii. Relevant controls;
    - iii. Whether management has used an expert;
    - iv. The assumptions underlying the accounting estimates;
    - v. Whether there is a change from the prior period in the methods for making the accounting estimates, and if so, why; and
    - vi. Whether and, if so, how management has assessed the effect of estimation uncertainty.

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

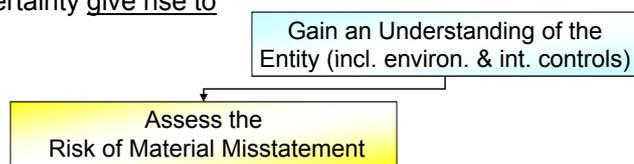
## ISA/HKSA 540

- The auditor shall review
  - the outcome of accounting estimates included in the prior period financial statements, or,
  - where applicable, their subsequent re-estimation for the purpose of the current period.
    - The nature and extent of the auditor's review takes account of
      - the nature of the accounting estimates, and
      - whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.
    - However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at the time.

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

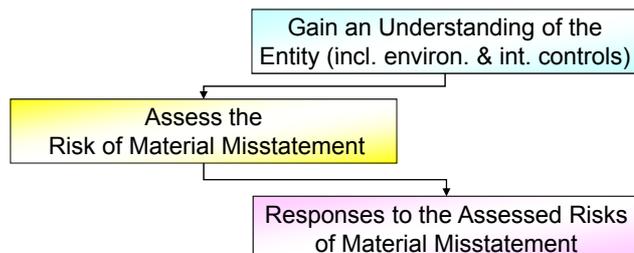
## ISA/HKSA 540

- In identifying and assessing the risks of material misstatement, as required by ISA/HKSA 315,
  - the auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimate.
- The auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.



## ISA/HKSA 540

- In responding to the assessed risks of material misstatement, the auditor shall undertake one or more of the described responses, taking account of the nature of the accounting estimate.



## ISA/HKSA 540

- The responses include:
  - a) Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate.
  - b) Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether:
    - i) The method of measurement used is appropriate in the circumstances; and
    - ii) The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework.
  - c) Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures.
  - d) Develop a point estimate or a range to evaluate management's point estimate.

Responses to the Assessed Risks  
of Material Misstatement

## ISA/HKSA 540

- In determining the matters identified or in responding to the assessed risks of material misstatement,
  - the auditor shall consider whether specialized skills or knowledge in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence.



Responses to the Assessed Risks  
of Material Misstatement

## ISA/HKSA 540

- For accounting estimates that give rise to **significant risks**, in addition to other substantive procedures performed to meet the requirements of ISA/HKSA 330, the auditor shall evaluate the following:
  - a. How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
  - b. Whether the significant assumptions used by management are reasonable.
  - c. Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.

Responses to the Assessed Risks  
of Material Misstatement

## ISA/HKSA 540

- The auditor shall review the judgments and decisions made by management in the making of accounting estimates to identify whether there are **indicators of possible management bias**.
  - Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates.
- Such indicators may affect the auditor's conclusion as to whether the auditor's risk assessment and related responses remain appropriate, and the auditor may need to consider the implications for the rest of the audit.
- Further, they may affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement, as discussed in ISA/HKSA 700



## ISA/HKSA 540

### Example

- Examples of indicators of possible management bias with respect to accounting estimates include:
  - Changes in an accounting estimate, or the method for making it, where management has made a subjective assessment that there has been a change in circumstances.
  - Use of an entity's own assumptions for fair value accounting estimates when they are inconsistent with observable marketplace assumptions.
  - Selection or construction of significant assumptions that yield a point estimate favorable for management objectives.
  - Selection of a point estimate that may indicate a pattern of optimism or pessimism.

## ISA/HKSA 550

- ISA/HKSA 550 *Related Parties*
  - deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements



## ISA/HKSA 550

- The objectives of the auditor are:
  - a. Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:
    - i. To recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and
    - ii. To conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:
      - a. Achieve fair presentation (for fair presentation frameworks); or
      - b. Are not misleading (for compliance frameworks); and
  - b. In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework

## ISA/HKSA 550

- The revised ISA/HKSA places greater emphasis on a risk based approach to the consideration of related parties.
- It also seeks to improve auditor performance with the difficult task of identifying related party relationships and transactions not disclosed to them by management.
- Certain new requirements are thus introduced.



## ISA/HKSA 550

- The engagement team discussion that HKSA 315 and HKSA 240 require shall include
  - specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.
- The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:
  - a. Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
  - b. Authorize and approve significant transactions and arrangements with related parties; and
  - c. Authorize and approve significant transactions and arrangements outside the normal course of business.

## ISA/HKSA 550

- In meeting the ISA/HKSA 315 requirement to identify and assess the risks of material misstatement,
  - the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks.
- In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business
  - as giving rise to significant risks.



## ISA/HKSA 550

- If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor,
  - the auditor shall perform specific procedures, including
    - Promptly communicate the relevant information to the other members of the engagement team;
    - Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation;
    - Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;
    - Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and
    - If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.

## ISA/HKSA 550

- For identified significant related party transactions outside the entity's normal course of business, the auditor shall:
  - a. Inspect the underlying contracts or agreements, if any, and evaluate whether:
    - i. The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
    - ii. The terms of the transactions are consistent with management's explanations; and
    - iii. The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
  - b. Obtain audit evidence that the transactions have been appropriately authorized and approved.

## ISA/HKSA 580

- ISA/HKSA 580 *Written Representations*
  - deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance in an audit of financial statements



## ISA/HKSA 580

- The objectives of the auditor are:
  - a. To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
  - b. To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other ISAs/HKSAs; and
  - c. To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

## ISA/HKSA 580

- The revised standard introduces a number of significant changes.
- To address the original concern that auditors may be over relying on written representations it is made clearer that, although written representations provide necessary audit evidence,
  - they support other audit evidence obtained and do not on their own provide sufficient appropriate audit evidence about any of the matters with which they deal.



## ISA/HKSA 580

- Changes include:
  - Requiring auditors to obtain written representations about management's responsibilities, including:
    - that management has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement;
    - that management has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement; and
    - all transactions have been recorded and are reflected in the financial statements.
  - If management does not provide the written representations acknowledging its responsibilities
    - the auditor is required to disclaim an opinion on the financial statements.

## ISA/HKSA 600

- ISA/HKSA 600 *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)*
  - No matter it is an audit of group financial statements or not, the auditor's duties are the same.
  - ISA/HKSA 600 only deals with the special considerations that apply to group audits, in particular to those involve other auditors to audit the components, i.e. component auditors.



## ISA/HKSA 600

- ISA/HKSA 600 specifies that the objectives of the auditor are:
  - a. To determine whether to act as the auditor of the group financial statements (i.e. the acceptance and continuance for group audits); and
  - b. If acting as the auditor of the group financial statements:
    - i. To communicate clearly with **component auditors** about the scope and timing of their work on financial information related to components and their findings; and
    - ii. To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

# ISA/HKSA 600



# ISA/HKSA 600

- The group engagement team is also required to determine the following:
  - a. **Overall materiality** for the group financial statements as a whole.
  - b. **Materiality for particular area**.
  - c. **Component materiality** for those components where component auditors will perform an audit or a review for purposes of the group audit
    - Component materiality is the materiality for a component determined by the group engagement team.
  - d. **Clearly trivial level** – the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.

## ISA/HKSA 600

- In addition to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment, the group engagement team is required to:
  - a. Enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage; and
  - b. Obtain an understanding of the consolidation process, including the instructions issued by group management to components.

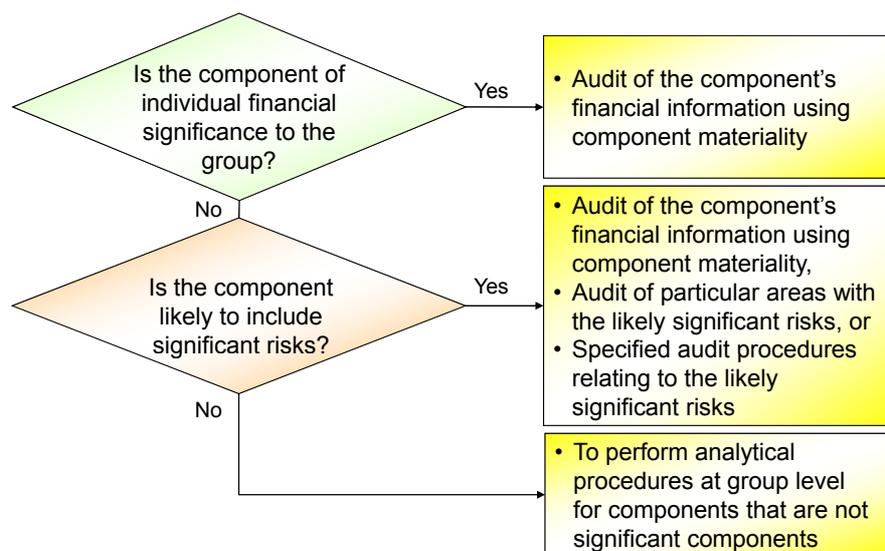
## ISA/HKSA 600

- Group-wide controls are not exactly the same as internal controls and are applicable over group financial reporting.
  - Group-wide controls are controls designed, implemented and maintained by group management over group financial reporting.
- The group engagement team's understanding of the consolidation process also includes the matters relating to:
  - a. Applicable financial reporting framework, and
  - b. Consolidation adjustments and reclassifications.
- To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components.

## ISA/HKSA 600

- When a component is a **significant component**,
  - the group engagement team is required to request a component auditor to perform work on the financial information of a component.
- Significant component is defined to be a component identified by the group engagement team:
  - a. That is of individual financial significance to the group, or
  - b. That, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements.

## ISA/HKSA 600



## ISA/HKSA 600

- In accordance with ISA/HKSA 600,
  - the group engagement team is also required to determine the nature, timing and extent of its involvement in the work of the **component auditors**.
- If significant risks of material misstatement of the group financial statements have been identified in a component on which a component auditor performs the work,
  - the group engagement team is required to evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial statements.
- Based on its understanding of the component auditor,
  - the group engagement team is required to determine whether it is necessary to be involved in the further audit procedures.

## ISA/HKSA 600

- Based on the understanding of the consolidation process, the group engagement team is required to design and perform further audit procedures on the **consolidation process** to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process.
  - This must include evaluating whether all components have been included in the group financial statements.
- The group engagement team is required to evaluate:
  - a. the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications, and
  - b. whether any fraud risk factors or indicators of possible management bias exist.

## ISA/HKSA 600

- The group engagement team is required to include in the audit documentation the following matters:
  - a. An analysis of components, indicating those that are significant, and the type of work performed on the financial information of the components.
  - b. The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon.
  - c. Written communications between the group engagement team and the component auditors about the group engagement team's requirements.

## ISA/HKSA 620

- ISA/HKSA 620 *Using the Work of an Auditor's Expert*
  - deals with the auditor's responsibilities relating to the work of an individual or organization in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.



## ISA/HKSA 620

- The objectives of the auditor are:
  - a. To determine whether to use the work of an auditor's expert; and
  - b. If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes.

- **Auditor's expert** is defined as:

- An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence.
- An auditor's expert may be either
  - an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or
  - an auditor's external expert.

## ISA/HKSA 620

- The scope of the revised standard is restricted to consideration of the auditor's use of the work of an expert, employed or engaged by the auditor, possessing expertise in a field other than accounting or auditing.
- Conforming amendments have been made to paragraph of ISA/HKSA 500, *Audit Evidence*, so that it addresses use of management's experts.
- Considerations where a member of the engagement team with expertise in a specialized area of accounting or auditing is used are addressed in ISA/HKSA 220.20, *Quality Control for an Audit of Financial Statements*.



## ISA/HKSA 705 and 706

- Modified opinion was originally under ISA/HKSA 701
- The clarity project separates the requirements of ISA/HKSA 701 into
  - ISA/HKSA 705 *Modifications to the Opinion in the Independent Auditor's Report*
  - ISA/HKSA 706 *Emphasis of Matter and Other Matter Paragraphs in the Independent Auditor's Report*



## ISA/HKSA 705

- ISA/HKSA 705 *Modifications to the Opinion in the Independent Auditor's Report*
  - deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with ISA/HKSA 700, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.



## ISA/HKSA 705

- ISA/HKSA 705 sets out the objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:
  - The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
  - The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Disagreement

Limitation



## ISA/HKSA 705

- ISA/HKSA 705 also specifically includes:

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statement	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient appropriate audit evidence	Qualified Opinion	Disclaimer Opinion

## ISA/HKSA 705

- ISA/HKSA 705 clearly defined the meaning of **pervasive**:
  - A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.
  - Pervasive effects on the financial statements are those that, in the auditor's judgment:
    - i. Are not confined to specific elements, accounts or items of the financial statements;
    - ii. If so confined, represent or could represent a substantial proportion of the financial statements; or
    - iii. In relation to disclosures, are fundamental to users' understanding of the financial statements.

## ISA/HKSA 705

- ISA/HKSA 705 newly requires:
  - If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements,
    - the auditor shall request that management remove the limitation.
  - If management refuses to remove the limitation,
    - the auditor shall
      - communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and
      - determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence

## ISA/HKSA 705

- ISA/HKSA 705 newly requires:
  - If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:
    - a. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive,
      - the auditor shall qualify the opinion; or
    - b. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
      - i. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
      - ii. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

## ISA/HKSA 705

- ISA/HKSA 705 newly requires:
  - When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole,
    - the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. (so-called "piecemeal opinion")
      - To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

## ISA/HKSA 706

- ISA/HKSA 706, *Emphasis of Matter and Other Matter Paragraphs in the Independent Auditor's Report*
  - Deal with additional communication in the auditor's report when the auditor considers it necessary to:
    - a. Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
    - b. Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.



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## ISA/HKSA 706

- ISA/HKSA 706 specifies:
  - **Emphasis of Matter paragraph**
    - A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
  - **Other Matter paragraph**
    - A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.



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## ISA/HKSA 706

- ISA/HKSA 706 provides for the auditor to use an Emphasis of Matter only if the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.
- It also requires that an Emphasis of Matter paragraph only refer to information presented or disclosed in the financial statements.
  - This reinforces the fact that an Emphasis of Matter may not be used as an alternative to a modified opinion, but leaves the question of whether to include one at all to the judgment of the auditor.



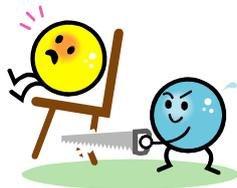
## ISA/HKSA 706

- When the auditor includes an **Emphasis of Matter paragraph** in the auditor's report, the auditor shall:
  - a. Include it immediately after the Opinion paragraph in the auditor's report;
  - b. Use the heading "Emphasis of Matter," or other appropriate heading;
  - c. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
  - d. Indicate that the auditor's opinion is not modified in respect of the matter emphasized.



## ISA/HKSA 706

- If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation,
  - the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter," or other appropriate heading.
  - The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section..



## Revised & Redrafted ISA/HKSA

- 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)
- 601 Using the Work of an Auditor's Expert
- 705 Modifications to the Opinion in the Independent Auditor's Report
- 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- 800 Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks ←
- 805 Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement ←
- 810 Engagements to Report on Summary Financial Statements ←

# Clarified Pronouncements on Auditing

18 November 2009



**Nelson Lam 林智遠**  
nelson@nelsoncpa.com.hk  
www.NelsonCPA.com.hk  
www.Facebook.com/NelsonCPA

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www.Facebook.com/NelsonCPA

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