

Overview of Auditing

22 June 2010



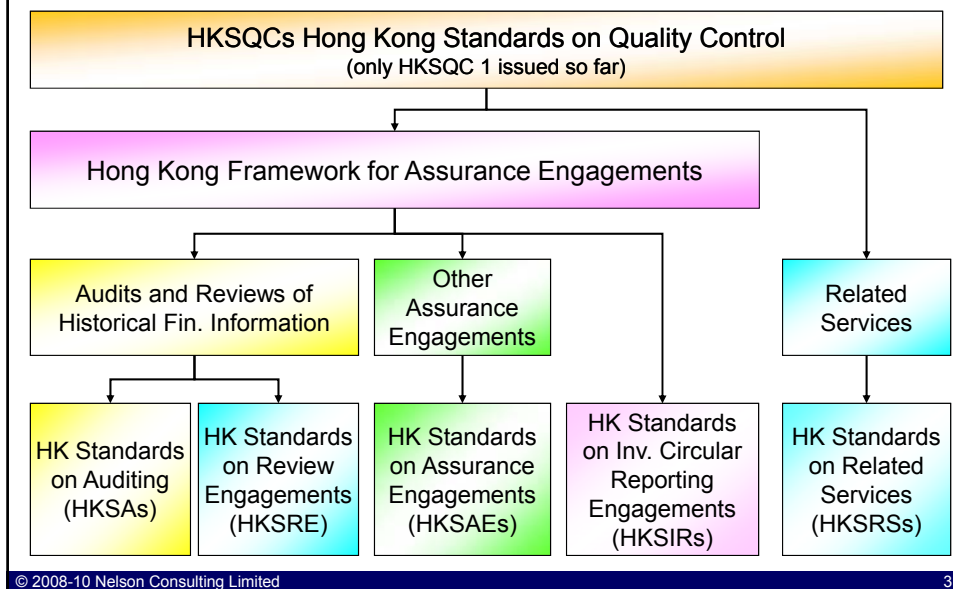
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Overview of Auditing



SCAA (香港華人會計師公會): www.scaacpa.org.hk
ARC (會計資源中心): www.arcentre.hk

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.



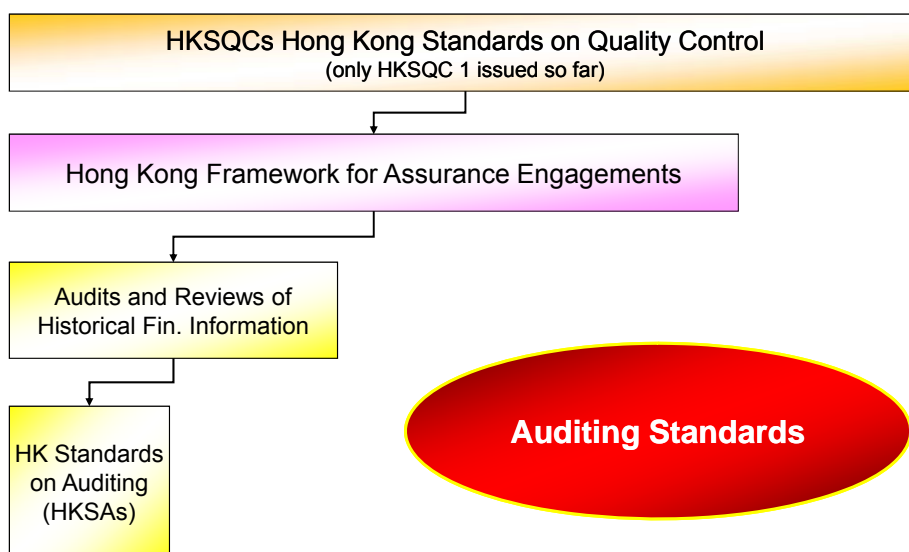
Main Changes from Clarity Project

- 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.

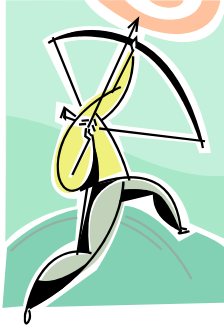
Main Changes from Clarity Project

- 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**

Overview



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 HKSAs.
 - 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 HKSAs, and
 - includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the HKSAs

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.

ISA/HKSA 200

- ISA/HKSA 200 also clearly sets out that:
 - In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements,
 - the ISAs/HKSAs require that the auditor
 - disclaim an opinion or
 - withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation.



ISA/HKSA 200

- ISA/HKSA 200 points out the difference between
 - Fair presentation framework
 - and
 - Compliance framework



Compliance framework refers to

- a financial reporting framework that requires compliance with the requirements of the framework,
 - but does not contain the acknowledgements in (i) or (ii) set out in the "fair presentation framework".

Fair presentation framework refers to

- a financial reporting framework that requires compliance with the requirements of the framework and:
 - Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
 - Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

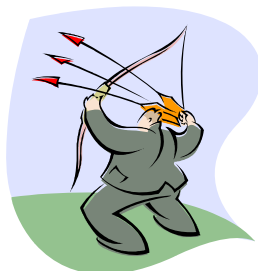
ISA/HKSA 200

- 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).



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 ISAs/HKSAs relevant to the audit.



ISA/HKSA 200

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



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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 ISAs/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 300

ISA/HKSA 300 Planning an Audit of Financial Statements

1. Involvement of Key Engagement Team Members
2. Preliminary engagement activities
3. Planning activities
4. Documentation
5. Additional considerations in initial audit engagement

ISA/HKSA 300 – Involve Members

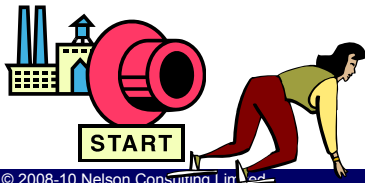
- The engagement partner and other key members of the engagement team shall be involved in planning the audit,
 - including planning and participating in the discussion among engagement team members.



ISA/HKSA 300 – Pre. Eng. Activities

Preliminary engagement activities

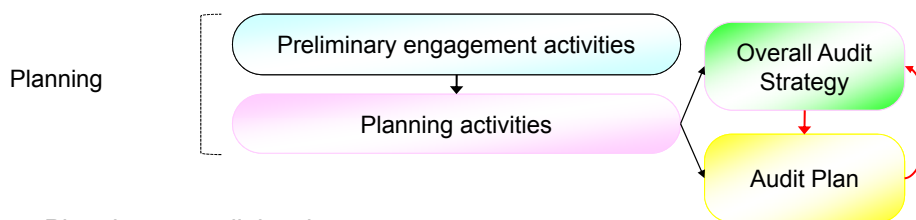
- The auditor shall undertake the following activities at the beginning of the current audit engagement:
 - a. Performing procedures required by ISA/HKSA 220 regarding the continuance of the client relationship and the specific audit engagement;
 - b. Evaluating compliance with relevant ethical requirements, including independence, in accordance with ISA/HKSA 220; and
 - c. Establishing an understanding of the terms of the engagement, as required by ISA/HKSA 210.



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ISA/HKSA 300 – Planning Activities



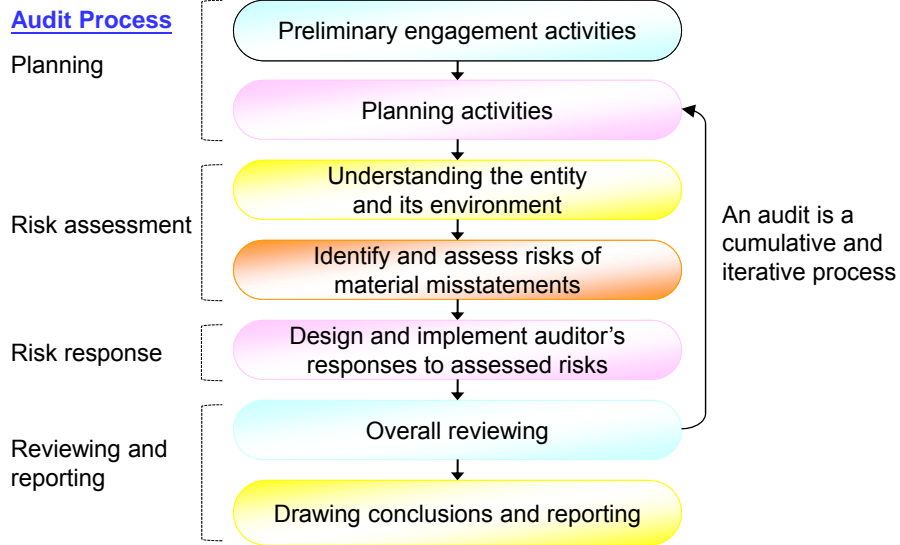
- Planning an audit involves
 - establishing the overall audit strategy for the engagement and
 - developing an audit plan.

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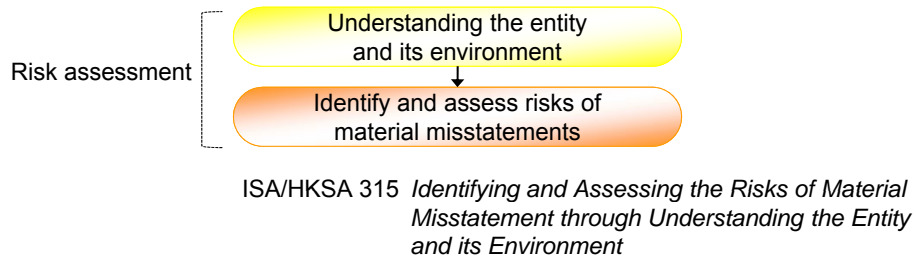
Audit Process Overview

Audit Process

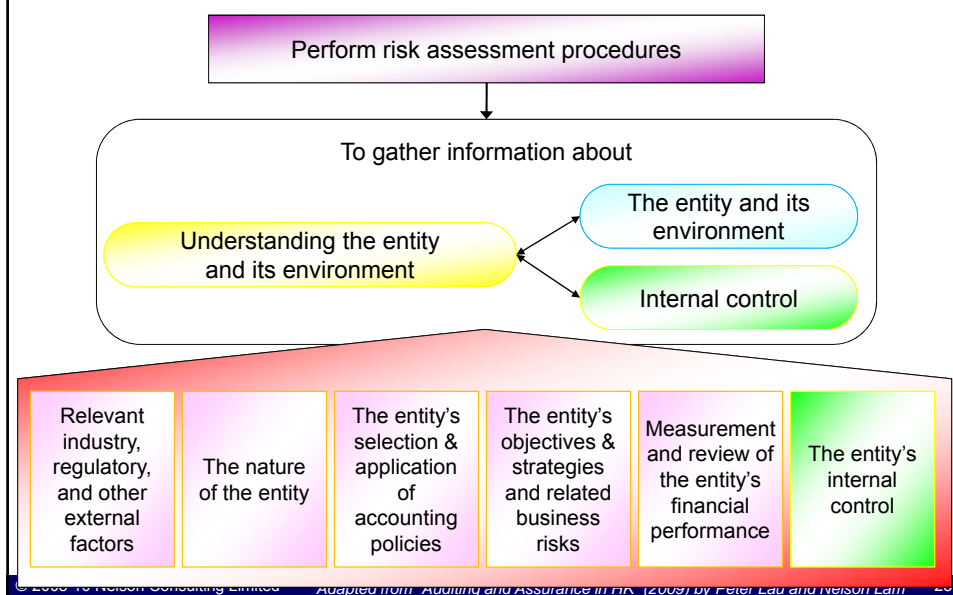


Audit Process Overview

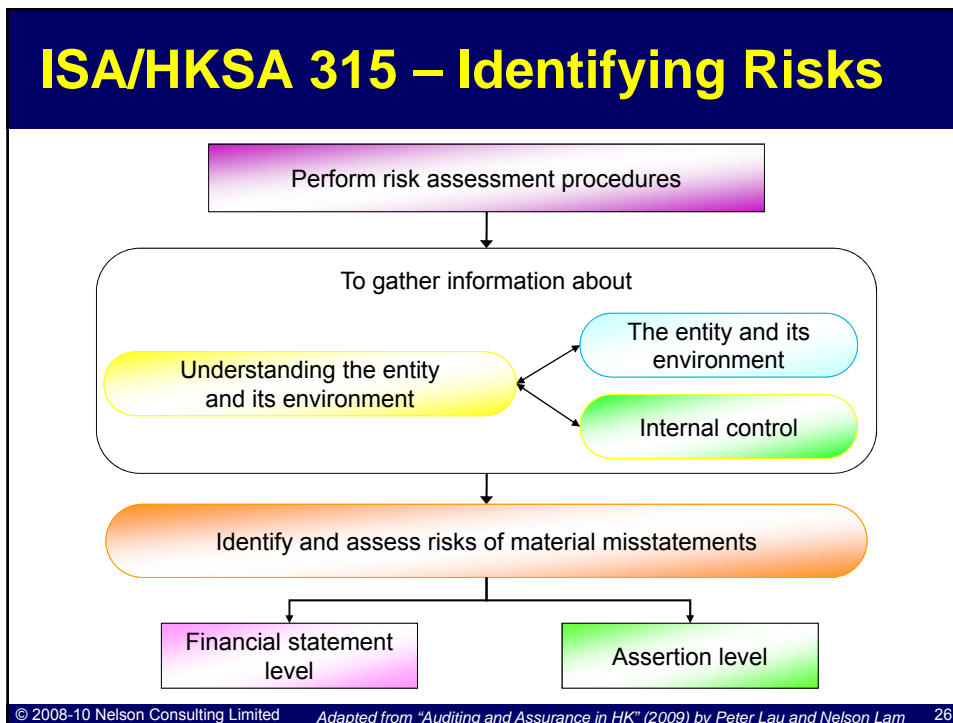
Audit Process



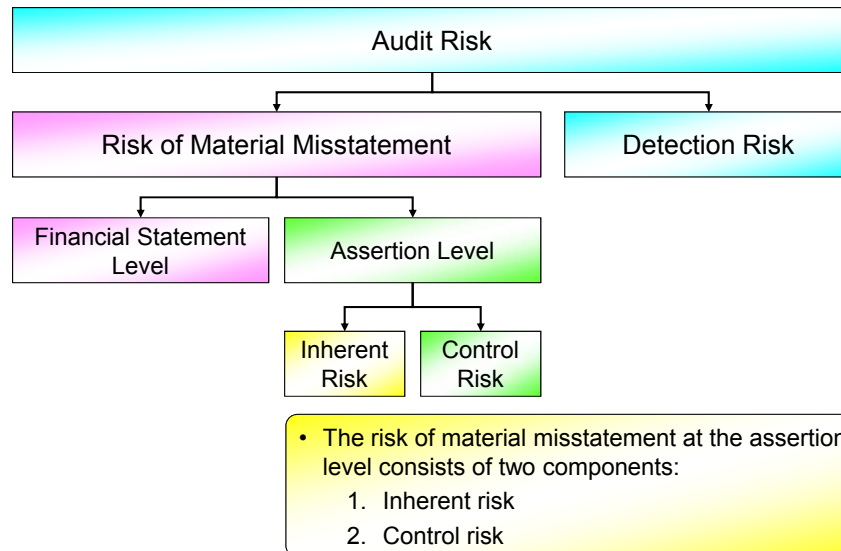
ISA/HKSA 315 – Overview



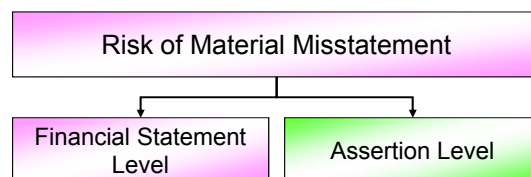
ISA/HKSA 315 – Identifying Risks



ISA/HKSA 315 – Identifying Risks



ISA/HKSA 315 – Identifying Risks



HKSA 315 requires that

- The auditor shall identify and assess the risks of material misstatement at:
 - a) the financial statement level; and
 - b) the assertion level for classes of transactions, account balances, and disclosures
 to provide a basis for designing and performing further audit procedures. (ISA 315.25)

ISA/HKSA 315 – Assertions

- 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 (ISA 315.A111)

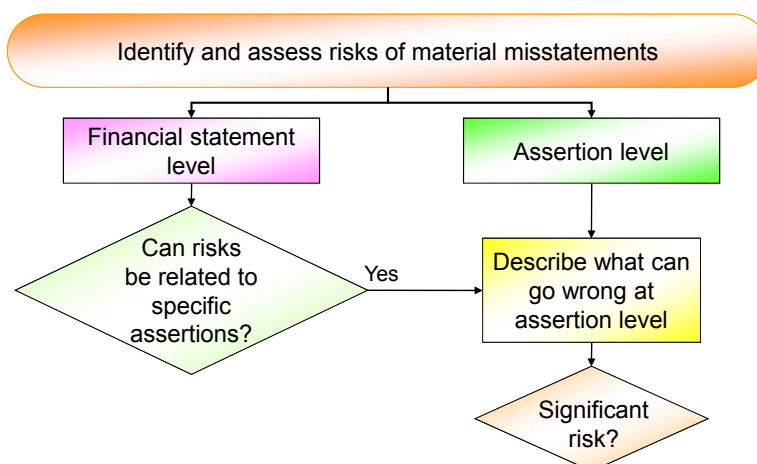
Class of Transactions

Account Balances

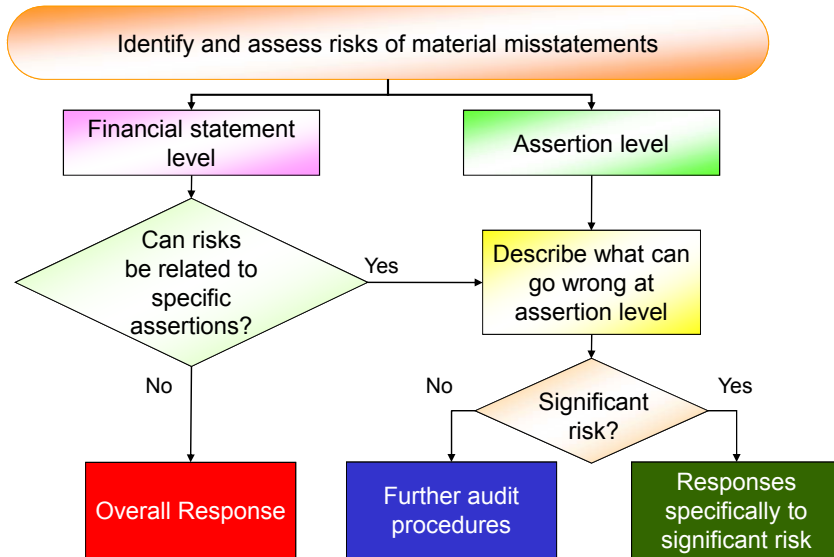
Presentation and Disclosure



ISA/HKSA 315 – Significant Risk



Responses to Assessed Risks

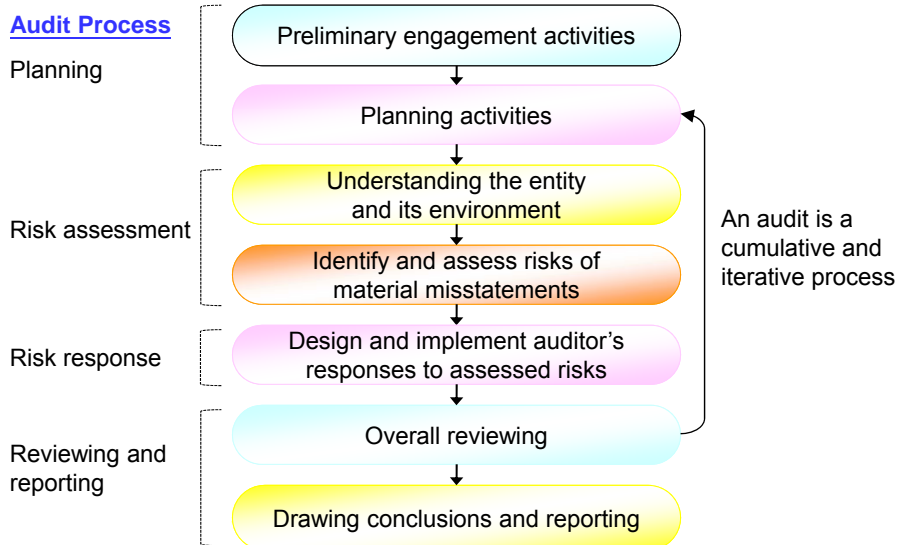


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Adapted from "Auditing and Assurance in HK" (2009) by Peter Lau and Nelson Lam

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Audit Process Overview



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