

Effective for audits of financial statements  
for periods beginning on or after 15 December 2009

*Hong Kong Standard on Auditing 705*

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# Modifications to the Opinion in the Independent Auditor's Report

\* There are amendments attached to this HKSA resulting from the Hong Kong Companies Ordinance (Cap. 622) which became effective on 3 March 2014. The amendments apply to the first financial year of companies that begins on or after the commencement date of the new Companies Ordinance and all subsequent financial years (i.e. typically the first set of financial statements covered would be for a financial period ending on or after 2 March 2015. Generally, for companies incorporated prior to 3 March 2014 with a calendar year end, the first applicable financial period is for the year ending 31 December 2015).



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**HONG KONG STANDARD ON AUDITING 705**  
**MODIFICATIONS TO THE OPINION IN THE INDEPENDENT**  
**AUDITOR'S REPORT**

(Effective for audits of financial statements for periods beginning on or after 15 December 2009)

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Hong Kong Standard on Auditing (HKSA) 705, "Modifications to the Opinion in the Independent Auditor's Report" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

## Introduction

### Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with HKSA 700,<sup>1</sup> the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

### Types of Modified Opinions

2. This HKSA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon:
  - (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
  - (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements. (Ref: Para. A1)

### Effective Date

3. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2009.

### Objective

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

### Definitions

5. For purposes of the HKSA's, the following terms have the meanings attributed below:
  - (a) 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

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<sup>1</sup> HKSA 700, "Forming an Opinion and Reporting on Financial Statements."

- (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.
- (b) Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion.

## Requirements

### Circumstances When a Modification to the Auditor's Opinion Is Required

- 6. The auditor shall modify the opinion in the auditor's report when:
  - (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2-A7)
  - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8-A12)

### Determining the Type of Modification to the Auditor's Opinion

#### *Qualified Opinion*

- 7. The auditor shall express a qualified opinion when:
  - (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
  - (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

#### *Adverse Opinion*

- 8. The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

#### *Disclaimer of Opinion*

- 9. The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- 10. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

*Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement*

11. 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.
12. If management refuses to remove the limitation referred to in paragraph 11, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,<sup>2</sup> and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
13. 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 (Ref: Para. A13-A14)
    - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.
14. If the auditor withdraws as contemplated by paragraph 13(b)(i), before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: Para. A15)

*Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion*

15. 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. To include such an unmodified opinion in the same report<sup>3</sup> in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: Para. A16)

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<sup>2</sup> HKSA 260, "Communication with Those Charged with Governance," paragraph 13.

<sup>3</sup> HKSA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement," deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement.

## Form and Content of the Auditor's Report When the Opinion Is Modified

### *Basis for Modification Paragraph*

16. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by HKSA 700, include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: Para. A17)
17. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in the basis for modification paragraph. (Ref: Para. A18)
18. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.
19. If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:
  - (a) Discuss the non-disclosure with those charged with governance;
  - (b) Describe in the basis for modification paragraph the nature of the omitted information; and
  - (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: Para. A19)
20. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph the reasons for that inability.
21. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for modification paragraph the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A20)

### *Opinion Paragraph*

22. When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the opinion paragraph. (Ref: Para. A21, A23-A24)
23. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph:
  - (a) The financial statements present fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or

- (b) The financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “except for the possible effects of the matter(s) ...” for the modified opinion. (Ref: Para. A22)

- 24. When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph:
  - (a) The financial statements do not present fairly (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
  - (b) The financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.
- 25. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that:
  - (a) Because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly,
  - (b) The auditor does not express an opinion on the financial statements.

*Description of Auditor's Responsibility When the Auditor Expresses a Qualified or Adverse Opinion*

- 26. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor's responsibility to 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 modified audit opinion.

*Description of Auditor's Responsibility When the Auditor Disclaims an Opinion*

- 27. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: “Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Hong Kong Standards on Auditing. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.”<sup>3a</sup>

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<sup>3a</sup> In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to make a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor's duty under the Hong Kong Companies Ordinance.



### Communication with Those Charged with Governance

28. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification. (Ref: Para. A25)

### Conformity and Compliance with International Standards on Auditing

29. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 705 "Modifications to the Opinion in the Independent Auditor's Report" except for the different wording in the description of auditor's responsibility when the auditor disclaims an opinion in paragraph 27 due to the Hong Kong statutory requirement. With the exception of the foregoing difference, as explained in footnote 3a, compliance with the requirements of this HKSA ensures compliance with ISA 705.
30. Additional local guidance is provided in footnote 3a and Appendix.

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### Application and Other Explanatory Material

#### Types of Modified Opinions (Ref: Para. 2)

- A1. The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

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

#### Nature of Material Misstatements (Ref: Para. 6(a))

- A2. HKSA 700 requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.<sup>4</sup> This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with HKSA 450.<sup>5</sup>

<sup>4</sup> HKSA 700, paragraph 11.

<sup>5</sup> HKSA 450, "Evaluation of Misstatements Identified during the Audit," paragraph 11.

- A3. HKSA 450 defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:
- (a) The appropriateness of the selected accounting policies;
  - (b) The application of the selected accounting policies; or
  - (c) The appropriateness or adequacy of disclosures in the financial statements.

*Appropriateness of the Selected Accounting Policies*

- A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:
- (a) The selected accounting policies are not consistent with the applicable financial reporting framework; or
  - (b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.
- A5. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

*Application of the Selected Accounting Policies*

- A6. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:
- (a) When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or
  - (b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

*Appropriateness or Adequacy of Disclosures in the Financial Statements*

- A7. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:
- (a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;
  - (b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or
  - (c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

**Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence** (Ref: Para. 6(b))

- A8. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:
- (a) Circumstances beyond the control of the entity;
  - (b) Circumstances relating to the nature or timing of the auditor's work; or
  - (c) Limitations imposed by management.
- A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.
- A10. Examples of circumstances beyond the control of the entity include when:
- The entity's accounting records have been destroyed.
  - The accounting records of a significant component have been seized indefinitely by governmental authorities.
- A11. Examples of circumstances relating to the nature or timing of the auditor's work include when:
- The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
  - The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
  - The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.
- A12. Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:
- Management prevents the auditor from observing the counting of the physical inventory.
  - Management prevents the auditor from requesting external confirmation of specific account balances.

**Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement** (Ref: Para. 13(b)-14)

- A13. The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to withdrawing.

- A14. In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor that is appointed to audit the financial statements of public sector entities. It may also be the case in jurisdictions where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report.<sup>6</sup>
- A15. When the auditor concludes that withdrawal from the audit is necessary because of a scope limitation, there may be a professional, legal or regulatory requirement for the auditor to communicate matters relating to the withdrawal from the engagement to regulators or the entity's owners.

**Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: Para. 15)**

- A16. The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:
- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.<sup>7</sup>
  - The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position (see HKSA 510.<sup>8</sup>). In this case, the auditor has not expressed a disclaimer of opinion on the financial statements as a whole.

**Form and Content of the Auditor's Report When the Opinion Is Modified**

*Basis for Modification Paragraph (Ref: Para. 16-17, 19, 21)*

- A17. Consistency in the auditor's report helps to promote users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.
- A18. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph in the auditor's report is the quantification of the effects on income tax, income before taxes, net income and equity if inventory is overstated.
- A19. Disclosing the omitted information in the basis for modification paragraph would not be practicable if:
- (a) The disclosures have not been prepared by management or the disclosures are otherwise not readily available to the auditor; or
  - (b) In the auditor's judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

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<sup>6</sup> HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report," paragraph A5.

<sup>7</sup> See paragraph A32 of HKSA 700 for a description of this circumstance.

<sup>8</sup> HKSA 510, "Initial Audit Engagements—Opening Balances," paragraph 10.

- A20. An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

*Opinion Paragraph* (Ref: Para. 22-23)

- A21. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.
- A22. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the opinion paragraph as these are not sufficiently clear or forceful.

*Illustrative Auditors' Reports*

- A23. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.
- A24. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive.

**Communication with Those Charged with Governance** (Ref: Para. 28)

- A25. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables:
- (a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);
  - (b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and
  - (c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

## Appendix

(Ref: Para. A23-24)

### Illustrations of Auditors' Reports with Modifications to the Opinion

- Illustration 1: An auditor's report containing a qualified opinion due to a material misstatement of the financial statements.
- Illustration 2: An auditor's report containing an adverse opinion due to a material misstatement of the financial statements.
- Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence.
- Illustration 4: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements.
- Illustration 5: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements.

**Illustration 1:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.<sup>1</sup>**
- **Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>1a</sup>

**[Report on the Financial Statements]<sup>2</sup>**

We have audited the financial statements of ABC Limited (the "Company") set out on pages ..... to ....., which comprise the [balance sheet][statement of financial position]<sup>2a</sup> as at 31 December 20X1, and the [income statement][statement of comprehensive income]<sup>2a</sup>, statement of changes in equity and [cash flow statement][statement of cash flows]<sup>2a</sup> for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>3</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

<sup>1</sup> HKSA 210, "Agreeing the Terms of Audit Engagements."

<sup>1a</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>2</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>2a</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>3</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>4</sup> Not used.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>4a</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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 of financial statements that give a true and fair view 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.<sup>6</sup> 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 qualified audit opinion.

### *Basis for Qualified Opinion*

The Company's inventories are carried in the [balance sheet][statement of financial position]<sup>2a</sup> at xxx. The directors have not stated the inventories at the lower of cost and net realizable value but have stated them solely at cost, which constitutes a departure from Hong Kong Financial Reporting Standards. The Company's records indicate that had the directors stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

### *Qualified Opinion*

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

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<sup>4a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>5</sup> Not used.

<sup>6</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."



**[Report on Other Legal and Regulatory Requirements]**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]<sup>2</sup>

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

**Illustration 2:**

**Circumstances include the following:**

- **Audit of consolidated general purpose financial statements prepared by the directors of the parent in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.**
- **In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance. Assume compliance with Hong Kong Companies Ordinance on non-consolidation of a subsidiary.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>6a</sup>

**[Report on the Consolidated Financial Statements]<sup>7</sup>**

We have audited the consolidated financial statements of ABC Limited (the "Company") and its subsidiaries (together "the Group") set out on pages ..... to ....., which comprise the consolidated and company [balance sheets][statements of financial position]<sup>7a</sup> as at 31 December 20X1, and the consolidated [income statement][statement of comprehensive income]<sup>7a</sup>, the consolidated statement of changes in equity and the consolidated [cash flow statement][statement of cash flows]<sup>7a</sup> for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>8</sup> Responsibility for the Consolidated Financial Statements*

The directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

<sup>6a</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>7</sup> The sub-title "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>7a</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>8</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>9</sup> Not used.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit<sup>9a</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view 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.<sup>11</sup> 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 consolidated financial statements.

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

### *Basis for Adverse Opinion*

As explained in Note X, the Company has not consolidated the financial statements of subsidiary DEF Limited it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under Hong Kong Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the Company. Had DEF been consolidated, many elements in the financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

### *Adverse Opinion*

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 20X1, and of the Group's [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the consolidated financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.<sup>11a</sup>

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<sup>9a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>10</sup> Not used.

<sup>11</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

<sup>11a</sup> Assume the consolidated financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance in all other respects.

**[Report on Other Legal and Regulatory Requirements]**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]<sup>7</sup>

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

**Illustration 3:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>11b</sup>

**Report on the Financial Statements**

We have audited the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the [balance sheet][statement of financial position]<sup>12a</sup> as at 31 December 20X1, and the [income statement][statement of comprehensive income]<sup>12a</sup>, statement of changes in equity and [cash flow statement][statement of cash flows]<sup>12a</sup> for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>13</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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<sup>11b</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>12</sup> Not used.

<sup>12a</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>13</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>14</sup> Not used.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>14a</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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 of financial statements that give a true and fair view 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.<sup>16</sup> 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 qualified audit opinion.

### *Basis for Qualified Opinion*

ABC Limited's investment in DEF Limited, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the [balance sheet][statement of financial position]<sup>20a</sup> as at 31 December 20X1, and ABC's share of DEF's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year because we were denied access to the financial information, management, and the auditors of DEF. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

### *Qualified Opinion*

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

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<sup>14a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>15</sup> Not used.

<sup>16</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

**Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance** <sup>16a</sup>

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

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<sup>16a</sup> For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

**Illustration 4:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>16b</sup>

**Report on the Financial Statements**

We were engaged to audit the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the [balance sheet][statement of financial position]<sup>17a</sup> as at 31 December 20X1, and the [income statement][statement of comprehensive income]<sup>17a</sup>, statement of changes in equity and [cash flow statement][statement of cash flows]<sup>17a</sup> for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>18</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

<sup>16b</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>17</sup> Not used.

<sup>17a</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>18</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>19</sup> Not used.



*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>19a</sup>. Except for the inability to obtain sufficient appropriate audit evidence as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. 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.<sup>19b</sup> Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

*Basis for Disclaimer of Opinion*

The Company's investment in its joint venture DEF (Country X) Limited is carried at xxx on the Company's [balance sheet][statement of financial position]<sup>17a</sup>, which represents over 90% of the Company's net assets as at 31 December 20X1. We were not allowed access to the management and the auditors of DEF, including DEF's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Company's proportional share of DEF's assets that it controls jointly, its proportional share of DEF's liabilities for which it is jointly responsible, its proportional share of DEF's income and expenses for the year, and the elements making up the statement of changes in equity and [cash flow statement][statement of cash flows].<sup>17a</sup>

*Disclaimer of Opinion*

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

**Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance**<sup>19c</sup>

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a joint venture:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

<sup>19a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>19b</sup> In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to make a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor's duty under the Hong Kong Companies Ordinance.

<sup>19c</sup> For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

**Illustration 5:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>19d</sup>

**Report on the Financial Statements**

We were engaged to audit the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the [balance sheet][statement of financial position]<sup>20a</sup> as at 31 December 20X1, and the [income statement][statement of comprehensive income]<sup>20a</sup>, statement of changes in equity and [cash flow statement][statement of cash flows]<sup>20a</sup> for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>21</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>22a</sup>. Except for the inability to obtain sufficient appropriate audit evidence as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and

<sup>19d</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>20</sup> Not used.

<sup>20a</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>21</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>22</sup> Not used.

<sup>22a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.<sup>22b</sup> Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

*Basis for Disclaimer of Opinion*

We were not appointed as auditors of the Company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31 December 20X0 and 20X1 which are stated in the [balance sheet][statement of financial position]<sup>20a</sup> at xxx and xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our audit report, the directors were still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the [balance sheet][statement of financial position]<sup>20a</sup> at a total amount of xxx as at 31 December 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the [income statement][statement of comprehensive income]<sup>20a</sup>, statement of changes in equity and [cash flow statement][statement of cash flows].<sup>20a</sup>

*Disclaimer of Opinion*

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

**Report on matters under sections 141 (4) and 141 (6) of the Hong Kong Companies Ordinance**<sup>22c</sup>

In respect alone of the inability to obtain sufficient appropriate audit evidence about the inventories and accounts receivable:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

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<sup>22b</sup> In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to make a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor's duty under the Hong Kong Companies Ordinance.

<sup>22c</sup> For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

**AMENDMENTS RESULTING FROM  
THE HONG KONG COMPANIES ORDINANCE (CAP. 622)**

Note: The following sets out the amended text required for this Standard resulting from Hong Kong Companies Ordinance (Cap. 622) which became effective on 3 March 2014. The amended text apply to the first financial year of companies that begins on or after the commencement date of the new Companies Ordinance and all subsequent financial years (i.e. typically the first set of financial statements covered would be for a financial period ending on or after 2 March 2015. Generally, for companies incorporated prior to 3 March 2014 with a calendar year end, the first applicable financial period is for the year ending 31 December 2015).

**Footnote 3a in paragraph 27:**

<sup>3a</sup> In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to prepare a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor's duty under the Hong Kong Companies Ordinance.

**Appendix:**

...

**Illustration 1:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.<sup>1</sup>**
- **Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>1a</sup>

**[Report on the Financial Statements]<sup>2</sup>**

<sup>1</sup> HKSA 210, "Agreeing the Terms of Audit Engagements."

<sup>1a</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>2</sup> The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

We have audited the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and]<sup>2a</sup> the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>3</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>4a</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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 of financial statements that give a true and fair view 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.<sup>6</sup> 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 qualified audit opinion.

*Basis for Qualified Opinion*

The Company's inventories are carried in the statement of financial position at xxx. The directors have not stated the inventories at the lower of cost and net realizable value but have stated them solely at cost, which constitutes a departure from Hong Kong Financial Reporting Standards. The Company's records indicate that had the directors stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value.

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<sup>2a</sup> HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>3</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>4</sup> Not used.

<sup>4a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>5</sup> Not used.

<sup>6</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

**[Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]<sup>2</sup>

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

**Illustration 2:**

**Circumstances include the following:**

- **Audit of consolidated general purpose financial statements prepared by the directors of the parent in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the group audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.**
- **In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance. Assume compliance with Hong Kong Companies Ordinance on non-consolidation of a subsidiary.**

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>6a</sup>

**[Report on the Consolidated Financial Statements]<sup>7</sup>**

We have audited the consolidated financial statements of ABC Limited ("the Company") and its subsidiaries set out on pages ..... to ....., which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and]<sup>7a</sup> the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors<sup>8</sup> Responsibility for the Consolidated Financial Statements*

The directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

<sup>6a</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>7</sup> The sub-title "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>7a</sup> HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>8</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>9</sup> Not used.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit<sup>9a</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view 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.<sup>11</sup> 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 consolidated financial statements.

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

*Basis for Adverse Opinion*

As explained in Note X, the Company has not consolidated the financial statements of subsidiary DEF Limited it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under Hong Kong Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the Company. Had DEF been consolidated, many elements in the financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

*Adverse Opinion*

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view of the financial position of the Company and its subsidiaries as at 31 December 20X1, and of their financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.<sup>11a</sup>

**[Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]<sup>7</sup>

<sup>9a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>10</sup> Not used

<sup>11</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

<sup>11a</sup> Assume the consolidated financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance in all other respects.



MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

**Illustration 3:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.**
- **The information in the directors' report is not consistent with the financial statements.**

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>11b</sup>

**Report on the Financial Statements**

We have audited the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and]<sup>12a</sup> the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>13</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

<sup>11b</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>12</sup> Not used.

<sup>12a</sup> HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>13</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>14</sup> Not used.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>14a</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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 of financial statements that give a true and fair view 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.<sup>16</sup> 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 qualified audit opinion.

*Basis for Qualified Opinion*

ABC Limited's investment in DEF Limited, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the statement of financial position as at 31 December 20X1, and ABC's share of DEF's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year because we were denied access to the financial information, management, and the auditors of DEF. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

*Qualified Opinion*

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

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<sup>14a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>15</sup> Not used.

<sup>16</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

**Report on [Directors' Report under section 406(2) and]<sup>16a</sup> Other Matters under sections 407(2)<sup>16b</sup> and 407(3)<sup>16b</sup> of the Hong Kong Companies Ordinance<sup>16c</sup>**

**[Directors' and Auditor's Respective Responsibility for the Directors' Report]<sup>16a</sup>**

In addition to the respective responsibilities of the directors and auditor stated in above section "Report on the Financial Statements", the directors are also responsible for the preparation of the directors' report as set out on pages ... to ... in accordance with the Hong Kong Companies Ordinance.

It is our responsibility to read the information in the directors' report for the year ended 31 December 20X1 as set out on pages ... to ... to identify and report inconsistencies with the financial statements. However, we have not audited or reviewed the directors' report and accordingly do not express an audit opinion or a review conclusion or any assurance conclusion on the directors' report as a whole.]

**Matters on which we are required to report by exception**

In accordance with the Hong Kong Companies Ordinance, we have the following matters to report. In our opinion:

- [the information given in [insert relevant paragraph/ section] in the directors' report for the year ended 31 December 20X1 is not consistent with the financial statements for the year ended 31 December 20X1. [State the details of the inconsistencies<sup>16a</sup>.]]
- in respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate as described in the Basis for Qualified Opinion paragraph above:
  - we were unable to determine whether adequate accounting records had been kept; and
  - we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

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<sup>16a</sup> Section 406(2) of the Hong Kong Companies Ordinance (CO) requires the auditor to opine on the directors' report:

- (2) If a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor-
- (a) must state that opinion in the auditor's report; and
  - (b) may bring that opinion to the members' attention at a general meeting.

<sup>16b</sup> Section 407 of the CO requires the auditor to opine on other matters:

- (1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
- (a) whether adequate accounting records have been kept by the company; and
  - (b) whether the financial statements are in agreement with the accounting records.
- (2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
- (a) adequate accounting records have not been kept by the company; or
  - (b) the financial statements are not in agreement with the accounting records in any material respect.
- (3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.
- (4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

<sup>16c</sup> For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

**Illustration 4:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.**
- **The information in the directors' report is not consistent with the financial statements.**

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>16d</sup>

**Report on the Financial Statements**

We were engaged to audit the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and]<sup>17a</sup> the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>18</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

<sup>16d</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>17</sup> Not used.

<sup>17a</sup> HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>18</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>19</sup> Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit<sup>19a</sup>. Except for the inability to obtain sufficient appropriate audit evidence as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.<sup>19b</sup> Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

The Company's investment in its joint venture DEF (Country X) Limited is carried at xxx on the Company's statement of financial position, which represents over 90% of the Company's net assets as at 31 December 20X1. We were not allowed access to the management and the auditors of DEF, including DEF's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Company's proportional share of DEF's assets that it controls jointly, its proportional share of DEF's liabilities for which it is jointly responsible, its proportional share of DEF's income and expenses for the year, and the elements making up the statement of changes in equity and statement of cash flows.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. In all other respects, in our opinion the financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

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<sup>19a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>19b</sup> In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to prepare a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor's duty under the Hong Kong Companies Ordinance.

**Report on [Directors' Report under section 406(2) and]<sup>19c</sup> Other Matters under sections 407(2)<sup>19d</sup> and 407(3)<sup>19d</sup> of the Hong Kong Companies Ordinance<sup>19e</sup>**

[Directors' and Auditor's Respective Responsibility for the Directors' Report<sup>19c</sup>

In addition to the respective responsibilities of the directors and auditor stated in above section "Report on the Financial Statements", the directors are also responsible for the preparation of the directors' report as set out on pages ... to ... in accordance with the Hong Kong Companies Ordinance.

It is our responsibility to read the information in the directors' report for the year ended 31 December 20X1 as set out on pages ... to ... to identify and report inconsistencies with the financial statements. However, we have not audited or reviewed the directors' report and accordingly do not express an audit opinion or a review conclusion or any assurance conclusion on the directors' report as a whole.]

**Matters on which we are required to report by exception**

In accordance with the Hong Kong Companies Ordinance, we have the following matters to report. In our opinion:

- [the information given in [insert relevant paragraph/ section] in the directors' report for the year ended 31 December 20X1 is not consistent with the financial statements for the year ended 31 December 20X1. [State the details of the inconsistencies<sup>19c</sup>.]]
- in respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a joint venture as described in the Basis for Disclaimer of Opinion paragraph above:
  - we were unable to determine whether adequate accounting records had been kept; and
  - we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

XYZ & Co.

<sup>19c</sup> Section 406(2) of the Hong Kong Companies Ordinance (CO) requires the auditor to opine on the directors' report:

- (2) If a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor-
- (a) must state that opinion in the auditor's report; and
  - (b) may bring that opinion to the members' attention at a general meeting.

<sup>19d</sup> Section 407 of the CO requires the auditor to opine on other matters:

- (1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
- (a) whether adequate accounting records have been kept by the company; and
  - (b) whether the financial statements are in agreement with the accounting records.
- (2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
- (a) adequate accounting records have not been kept by the company; or
  - (b) the financial statements are not in agreement with the accounting records in any material respect.
- (3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.
- (4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

<sup>19e</sup> For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".



MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report

**Illustration 5:**

**Circumstances include the following:**

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**
- **In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.**
- **The information in the directors' report is not consistent with the financial statements.**

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)<sup>19f</sup>

**Report on the Financial Statements**

We were engaged to audit the financial statements of ABC Limited ("the Company") set out on pages ..... to ....., which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and]<sup>20a</sup> the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

*Directors'<sup>21</sup> Responsibility for the Financial Statements*

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

<sup>19f</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>20</sup> Not used.

<sup>20a</sup> HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>21</sup> Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>22</sup> Not used.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit<sup>22a</sup>. Except for the inability to obtain sufficient appropriate audit evidence as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.<sup>22b</sup> Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31 December 20X0 and 20X1 which are stated in the statement of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our audit report, the directors were still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the statement of financial position at a total amount of xxx as at 31 December 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up [the statement of profit or loss and] <sup>20a</sup> the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows.

### Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. In all other respects, in our opinion the financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

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<sup>22a</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

<sup>22b</sup> In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to prepare a report to the members of the company on the company's annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor's report should state the auditor's responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor's duty under the Hong Kong Companies Ordinance.

**Report on [Directors' Report under section 406(2) and]<sup>22c</sup> Other Matters under sections 407(2)<sup>22d</sup> and 407(3)<sup>22d</sup> of the Hong Kong Companies Ordinance<sup>22e</sup>**

[Directors' and Auditor's Respective Responsibility for the Directors' Report<sup>22c</sup>

In addition to the respective responsibilities of the directors and auditor stated in above section "Report on the Financial Statements", the directors are also responsible for the preparation of the directors' report as set out on pages ... to ... in accordance with the Hong Kong Companies Ordinance.

It is our responsibility to read the information in the directors' report for the year ended 31 December 20X1 as set out on pages ... to ... to identify and report inconsistencies with the financial statements. However, we have not audited or reviewed the directors' report and accordingly do not express an audit opinion or a review conclusion or any assurance conclusion on the directors' report as a whole.]

**Matters on which we are required to report by exception**

In accordance with the Hong Kong Companies Ordinance, we have the following matters to report. In our opinion:

- [the information given in [insert relevant paragraph/ section] in the directors' report for the year ended 31 December 20X1 is not consistent with the financial statements for the year ended 31 December 20X1. [State the details of the inconsistencies<sup>22c</sup>.]]
- in respect alone of the inability to obtain sufficient appropriate audit evidence about the inventories and accounts receivable as described in the Basis for Disclaimer of Opinion paragraph above:
  - we were unable to determine whether adequate accounting records had been kept; and
  - we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

<sup>22c</sup> Section 406(2) of the Hong Kong Companies Ordinance (CO) requires the auditor to opine on the directors' report:

- (2) If a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor-
- (a) must state that opinion in the auditor's report; and
  - (b) may bring that opinion to the members' attention at a general meeting.

<sup>22d</sup> Section 407 of the CO requires the auditor to opine on other matters:

- (1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
- (a) whether adequate accounting records have been kept by the company; and
  - (b) whether the financial statements are in agreement with the accounting records.
- (2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
- (a) adequate accounting records have not been kept by the company; or
  - (b) the financial statements are not in agreement with the accounting records in any material respect.
- (3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.
- (4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

<sup>22e</sup> For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Auditor's address]

Date of the auditor's report