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Mr. Steve Ong
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Hong Kong Institute of Certified Public Accountants
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Wanchai, Hong Kong

Dear Steve,

IAASB Exposure Draft ("Exposure Draft") on Proposed International Standard on Assurance Engagements (ISAE) – 3000 (Revised) "Assurance Engagements other than Audits or Reviews of Historical Financial Information" and the consequential amendments to:

- **"International Framework for Assurance Engagements" ("Framework Statement");**
- **ISAE 3402 – "Assurance Reports on Controls at a Service Organization";**
- **ISAE 3410 – "Assurance Engagements on Greenhouse Gas Statements"**

We have completed our review of the Exposure Draft which sets out substantial revisions to ISAE 3000 to make the statement a principle-based standard that is intended to apply to a broad range of underlying subject matters. The Exposure Draft has also substantially revised the Framework Statement to take into account changes introduced in the revised ISAE 3000.

Our comments, which are primarily on the Framework Statement and ISAE 3000, are set out below.

(a) "Overall structure of the IAASB's standards"

Page 107 of the Exposure Draft includes a diagram of the proposed overall structure of the standards and practice statements that the IAASB intends to adopt. A copy of the diagram is attached at **Appendix A** for easy reference. We believe that it is possible that the proposed structure for assurance engagements may not be easily scalable as there are only two major categories of assurance engagements; namely, "Audits and reviews of historical financial information engagements" and "Other assurance engagements".

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A possible alternative approach would be to categorize or group assurance engagements under the different “levels of assurance or comfort” provided to the intended users. This may be preferable for the following reasons:-

- (i) the level of assurance provided would be the determining factor of the type of opinion or conclusion given in the practitioner’s report;
- (ii) the type of opinion or conclusion provided determines or is intricately linked to the scope, nature and extent of work required to be undertaken by the practitioner. The scope, nature and extent of work should be similar for like engagements, and if this approach is adopted it should reduce the need to duplicate detailed guidance; and
- (iii) the structure would be more easily scalable to the numerous different types of subject matter on which individual standards would be developed to provide specific guidance that is unique to the subject matter. We believe that the categorization of “Other assurance engagements” is too wide and will lead to a mixture of engagements in that category and this will cause confusion.

The intent of the proposed ISAE 3000 is for it to be principle-based and it is expected to be applied to assurance engagements other than audits and reviews of historical financial information. However, we note that much of the content of ISAE 3000 would be equally relevant for inclusion in the Framework Statement which covers all assurance engagements. For example, the Appendix to the proposed ISAE 3000 on pages 75 to 77 of the Exposure Draft is duplicated and also appears as Appendix 4 to the Framework Statement on pages 114 to 115 of the Exposure Draft.

We believe that the generic principle-based type content of the proposed ISAE 3000 should appear as part of the Framework Statement. The IAASB should also reconsider the status placed on the Framework Statement. We believe the Framework Statement should have an elevated mandatory status as it should contain the core principles to which the detailed specific standards on different subject matter should be aligned. We also note that despite the discussion on the different authority of the two statements included in pages 11 and 12 of the Exposure Draft, the content of ISAE 3000 includes similar guidance to that included in the Framework Statement yet only ISAE 3000 guidance will be mandatory.

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- (b) Objective of assurance engagements – level of comfort or confidence in the subject matter

We believe that a discussion of the wider issue of the objective of assurance engagements; namely, confidence in the subject matter particularly from the perspective of the intended users of the practitioner's report, should be included in the Framework Statement. The discussion on pages 82 to 83 of the Exposure Draft just focuses on a description of the engagement from the practitioner's perspective.

We believe what a user wants from the practitioner's report is "comfort or confidence" in the subject matter that has been presented to him. The follow up question is, what "level of comfort" is actually provided by the practitioner's report? We believe that the Exposure Draft does not adequately address this issue of the "level of comfort" in both the proposed revisions to the Framework Statement and ISAE 3000. The use of the terms "reasonable assurance" and "limited assurance" per se are not informative enough on the level of assurance provided.

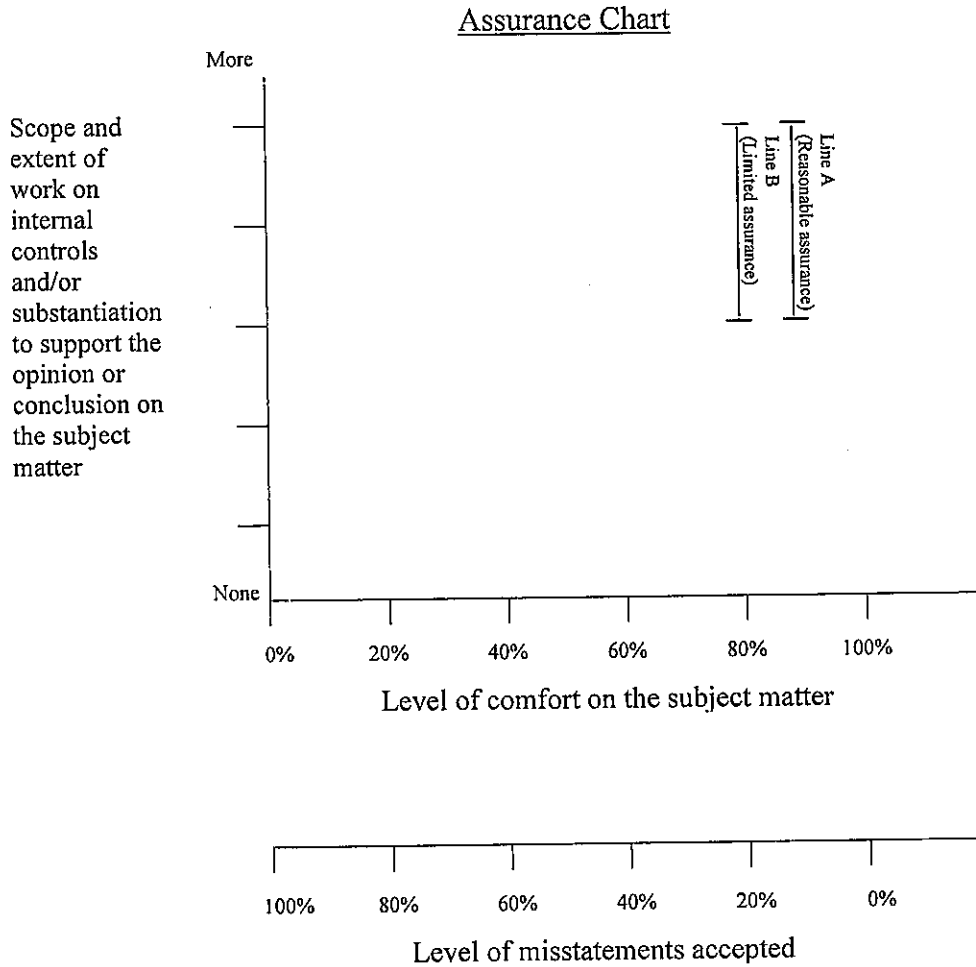
We believe that a detailed discussion of this issue should be incorporated into the guidance and preferably in the Framework Statement. There should be a full description and analysis of what is the level of confidence provided under different assurance engagements and the considerations taken into account in determining it. This analysis could include a discussion of some of the matters mentioned under points (b) and (c) of this letter.

We believe that the level of comfort or confidence required is normally determined by the users and, in some cases, by the regulators. Once set, this effectively determines the degree of misstatement or error in the subject matter that will be accepted. This in turn will determine the amount of work required to be done by the practitioner.

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This can be best illustrated by the following chart.



As can be seen from the above chart if the “level of comfort” or confidence required in the subject matter is high, the expected scope of work required by the practitioner in terms of the nature, timing and extent of his work in obtaining evidence to substantiate that the subject matter is in accordance with the measurement criteria and necessary disclosures will normally be high. Conversely, where the level of comfort or confidence required in the subject matter is low, the amount of work expected of the practitioner should be less.

The above chart also shows that the “level of misstatements accepted” by both users and the practitioner should be the inverse of the required level of comfort or confidence.

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We believe that to prevent any misunderstanding of the level of comfort that the practitioner is providing to users of his report, the practitioner should disclose in his report the level of comfort or confidence on the subject matter reported on. This level of comfort should be the same level of comfort the practitioner himself has obtained on the subject matter based on the results of his work. We believe the disclosure should be a specific percentage or if deemed more appropriate a range of percentages within a narrow band of just a few percentage points for the report to be meaningful. We believe that the level of comfort that is expected to be provided by a reasonable assurance engagement, such as an audit, would fall into a point in Line A of the chart on page 4. The rationale for this is explained further below under point (c).

(c) Materiality and the resulting level of assurance or comfort provided

Pages 96 to 97 of the Exposure Draft discusses “Materiality” and paragraph 66 of the proposed revised Framework Statement states that:

“Materiality is relevant when planning and performing the assurance engagement, including when determining the nature, timing and extent of procedures, and when evaluating whether the subject matter information is free of misstatement. Professional judgments about materiality are made in light of surrounding circumstances, but are not affected by the level of assurance, that is, for the same intended users, materiality for a reasonable assurance engagement is the same as for a limited assurance engagement because materiality is based on the information needs of intended users.”

Paragraph A84 on page 55 of the Exposure Draft on the proposed ISAE 3000 also states that:

“Professional judgments about materiality are made in light of surrounding circumstances, but are not affected by the level of assurance, that is, for the same intended users, materiality for a reasonable assurance engagement is the same as for a limited assurance engagement because materiality is based on the information needs of intended users.”

We do not agree with the current drafting of above paragraphs of the Exposure Draft and take the view that perhaps the contrary is more true. That is, we believe that materiality “is affected by the level of assurance” although we would accept that materiality should be based on the information needs of users, and surrounding circumstances will also have an impact.

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We believe it would be very misleading to convey to readers that materiality for a “reasonable assurance engagement” is the same as that for a “limited assurance engagement” and we strongly believe that users should be educated on the differences.

As set out in page 111 of the Exposure Draft, a distinguishing feature between a “reasonable assurance engagement” and a “limited assurance engagement” is that:

“..... procedures are more limited than for a reasonable assurance engagement, and consequently they do not enable the practitioner to obtain the assurance necessary to become aware of all significant matters that might be identified in a reasonable assurance engagement.”

As the work is more limited, the level of assurance or comfort in the subject matter provided by a limited assurance engagement would and should be less than that provided in a reasonable assurance engagement. This difference can be illustrated by reference to the chart on page 4 above. We believe that the level of comfort that theoretically may be provided for a limited assurance engagement could fall in a point somewhere in Line B. This however assumes that the level of comfort required in the subject matter is 80 percent.

It is for the above reasons that we believe the IAASB should determine and clearly set out in its guidance the level of comfort in the subject matter provided by various types of assurance engagements. Both the comfort level and materiality level should also be disclosed in the practitioner’s report so that there is no misunderstanding by both practitioners and readers of their reports.

An example of the standard wording used in reports for review engagements, which is a limited assurance engagement, is provided in ISRE 2410 as follows:-

“Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity.” A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.”

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The standard wording therefore emphasizes the differences between an audit and a review. However, in current guidance there is no readily available comparison of the key differences of the type of work required in an audit engagement vis-a-vis review engagement and it would be useful if the IAASB produces such a document. This could be used to explain to users, in simple layman terms, the major differences. At **Appendix B**, we have taken the opportunity start this process and set out a possible alternative presentation that may be considered to replace Appendix 3 on pages 110 and 111 of the Exposure Draft.

Moving on to reasonable assurance engagements, for the purpose of the chart on page 4 we have determined that the level of comfort provided by an audit engagement on the subject matter should be somewhere around 90 percent and the scope and amount of work required by the auditor should fall into a point on Line A. Where internal controls are tested and determined to be effective and can be relied upon, the level of substantive work can be reduced. How this 90 percent comfort or assurance level was arrived at is discussed further below.

The specimen audit report included in International Standard of Auditing No. 700 – “Forming an opinion and reporting on financial statements”, indicates that an audit report should contain the following statement:

“Auditor’s Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. 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.”

Paragraph 67 on page 97 of the Exposure Draft discusses material misstatements and states that:

“Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence relevant decisions of intended users taken on the basis of the subject matter information. The practitioner’s consideration of materiality is a matter of professional judgment, and is affected by the practitioner’s perception of the common information needs of intended users as a group.”

The current International Standard on Auditing No. 320 “Audit Materiality” provides some guidance on materiality but does not provide a bright-line test on what is regarded as material. Nevertheless, we understand that it is common practice for auditors to adopt a materiality level of 10 percent but we also note

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that some may be more conservative and adopt a materiality level of 5 percent. Therefore, any misstatement at or above 5 or 10 percent would normally be regarded as material. We believe that the IAASB should, in conjunction with the International Accounting Standards Board, develop bright-line tests for various assurance engagements. Using the above examples as a base of the level of error accepted, we believe that an audit engagement is thus designed to provide to both the practitioner and readers of his report a level of comfort or assurance on the subject matter of around 90 or 95 percent.

(d) Terminology and the scope and meaning of “assurance”

We note from page 103 of the Exposure Draft that the previous categorization of the types of assurance opinions that can be given; namely, “positive assurance” and “negative assurance” will be discontinued. Although we agree that the term “negative assurance” was difficult to understand, we believe that the idea of encapsulating the type of conclusion or opinion provided by the practitioner in a few words was useful and should be continued.

As an alternative for the two terms, the IAASB may wish to consider terms such as “positive affirmation” to replace “positive assurance” and “reserved affirmation” to replace “negative assurance”. We believe the word “affirmation” reflects the fact that the practitioner has concluded that the subject matter is consistent with the measurement criteria and the use of the words “reserved affirmation” appropriately conveys the point that there are limits on the affirmation provided because the scope of the work is more restricted or limited. Including in the terms the specific level of assurance or percentage comfort provided should also be considered.

We also consider that the new term “direct engagement” should be reconsidered as the nature of the engagement is not immediately apparent. The nature of these engagements is described on page 83 of the Exposure Draft and in substance these will represent engagements where the practitioner plays a dual role in that the practitioner participates in compiling or preparing the subject matter information as well as providing a level of assurance on the subject matter. An alternative term that could be considered by the IAASB could be “hybrid compilation/assurance engagements” which would reflect the exact nature of the work.

Moreover, although “agreed upon procedures engagements” (“AUPs”) are not currently regarded as being “assurance engagements”, we believe that in substance they do provide some level of assurance to their intended users as this is one of the reasons for their existence. The major differentiating feature of AUPs from other assurance engagements is that the scope of work is determined by the user together with the practitioner rather than being determined by the

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practitioner alone. Some may argue that an AUP in some sense provides a greater level of assurance to the intended user as the user has specifically determined the tests required to be done by the practitioner and the practitioner needs to submit a detailed report on his findings to the user. In this connection, the IAASB may wish to reconsider whether the criteria set out in paragraph 28 on page 87 of the Exposure Draft is essential for all “assurance engagements”. That is, the IAASB should perhaps reconsider whether it is absolutely necessary for an assurance engagement to involve at least three parties; a responsible party, the practitioner and intended users.

We would also recommend that defined terms should be specifically identified either by using bold type or a specific type font to indicate that the term has a specific and defined meaning. This will promote consistency in the IAASB’s standards and should reduce the need to repeat definitions in each individual standard.

(e) Summary of work performed

Paragraphs A150 to A153 on pages 70 to 71 of the Exposure Draft explain that procedures may vary in assurance engagements and that a summary of work performed in the practitioner’s report would be useful to provide users with a better understanding of the work undertaken which formed the basis for the practitioner’s conclusion.

We agree with this proposal and believe that all assurance reports should be expanded to include more specific details on the nature, extent and timing of work performed as this will assist in reducing the user expectation gap and prevent any misunderstanding by users. We note that the IAASB is separately consulting on this aspect and look forward to seeing the results of the consultation.

(f) Engagement risk

Pages 97 to 99 of the Exposure Draft discusses the meaning of “engagement risk” but on page 84 and page 110 reference to engagement risk is used to differentiate a “reasonable assurance engagement” from a “limited assurance engagement”. We believe that the key distinguishing feature between the two types of engagements is the level of assurance provided as seen from the perspective of the user. “Engagement risk” on the other hand would include risks specific to the practitioner and judgements made when he undertakes his work.

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(g) Underlying subject matters

Pages 116 and 117 to the Exposure Draft provides a very useful matrix on the possible types of subject matter on which practitioners may be asked to provide assurance. The IAASB may wish to consider expanding it to also include references to the specific standards and guidance to provide a useful quick reference guide to practitioners.

(h) HKICPA preface statement to standards on quality control, auditing, review, other assurance and related services

During our examination of the Exposure Draft, we noted that the Institute's preface statement has not adopted word-for-word the international equivalent issued by the IAASB. The Institute may wish to consider whether its local statement should be further updated.

We hope that the above comments are useful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited



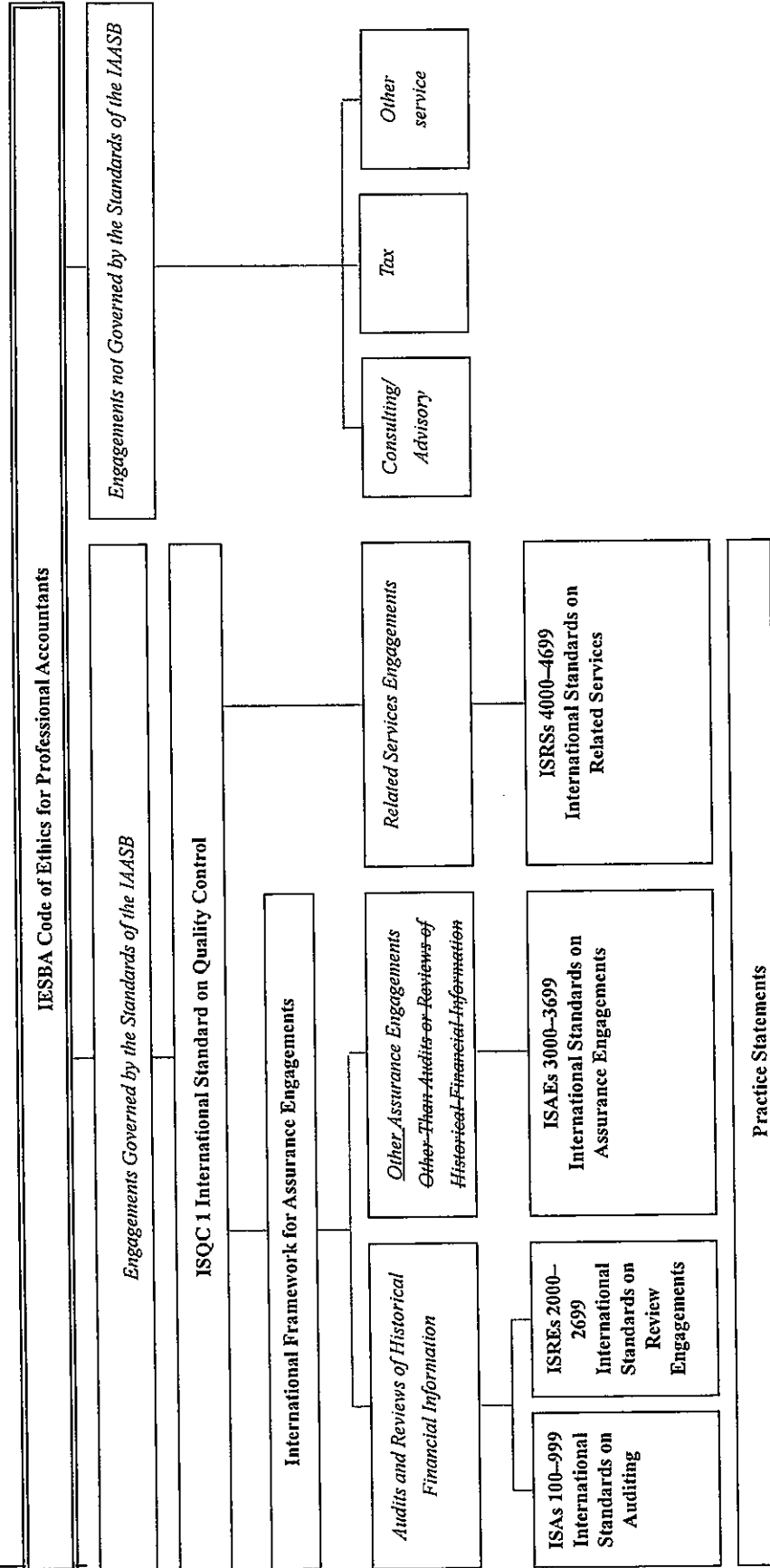
Colin Chau
Senior Vice President
Listing Division

CC/el

c.c. Mr. Mark Dickens JP – Head of Listing

Pronouncements Issued by the IAASB, and Their Relationship to Each Other and the IESBA Code of Ethics

This Appendix illustrates the ambit of pronouncements issued by the IAASB, and their relationship to each other and to the IESBA Code of Ethics for Professional Accountants.



Comparison of Reasonable Assurance and Limited Assurance Engagements

Comfort level required by intended users	(90%) [As determined by the IAASB]	(80%) [As determined by the IAASB]
Level of assurance provided	Reasonable assurance	Limited assurance
Key features of engagement	“Positive Affirmation” on subject matter	“Reserved Affirmation” on subject matter
	Engagement intended to detect material fraud or error	Engagement may not be relied on to detect whether material fraud or error exists
	Practitioner making the report <u>is</u> aware of <u>all</u> significant matters affecting the subject matter	Practitioner making the report <u>is not</u> aware of <u>all</u> significant matters affecting the subject matter
	Detailed scope of work determined by the practitioner alone and not by the intended users	Detailed scope of work determined by the practitioner alone and not by the intended users
	Scope, nature and extent of testing to substantiate the “subject matter” is <u>high</u> , and complies with specific standards applicable to the subject matter	Scope, nature and extent of testing to substantiate the “subject matter” is <u>less than</u> that required under a reasonable assurance engagement, and complies with specific standards applicable to the subject matter
	[The IAASB should list key work required which differentiates the engagement from others]	[The IAASB should list key work required which differentiates the engagement from others]
Example engagements	Attestation engagement (e.g. statutory audit of historical financial information such as annual financial statements)	Attestation engagement (e.g. review of historical financial information such as an interim report)
	Hybrid compilation / assurance engagement (e.g. reporting accountants report on a prospectus for a listing in Hong Kong)	Hybrid compilation / assurance engagement (e.g. Proforma financial information indicating the effect of a major acquisition transaction)

The above table should be expanded to the left to cater for different levels of assurance that may be developed in the future. In particular, the IAASB may wish to consider the level of assurance that will or may be provided under ISA 3000 engagements vis-a-vis audit and review engagements and how reporting on investment circular standards will fit into its diagram at Appendix A.