

Glossary  
Issued October 2007

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Effective upon issue

# **Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

**GLOSSARY OF TERMS RELATING TO HONG KONG STANDARDS ON  
QUALITY CONTROL, AUDITING, ASSURANCE  
AND RELATED SERVICES<sup>1</sup>**

(Effective upon issue)

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*Access controls*—Procedures designed to restrict access to on-line terminal devices, programs and data. Access controls consist of “user authentication” and “user authorization.” “User authentication” typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. “User authorization” consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect:

- (a) Unauthorized access to on-line terminal devices, programs and data;
- (b) Entry of unauthorized transactions;
- (c) Unauthorized changes to data files;
- (d) The use of computer programs by unauthorized personnel; and
- (e) The use of computer programs that have not been authorized.

*Accounting estimate*—An approximation of the amount of an item in the absence of a precise means of measurement.

*Accounting records*—Generally include the records of initial entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; journal entries and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

*Adverse opinion*—(see Modified auditor’s report)

*Agreed-upon procedures engagement*—An engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures may misinterpret the results.

*Analytical procedures*—Evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

*Annual report*—A document issued by an entity, ordinarily on an annual basis, which includes its financial statements together with the auditor’s report thereon.

*Anomalous error*—(see Audit sampling)

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<sup>1</sup> In the case of public sector engagements, the terms in this glossary should be read as referring to their public sector equivalents.

*Applicable financial reporting framework*—The financial reporting framework adopted by management in preparing the financial statements that the auditor has determined is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulations.

*Application controls in information technology*— Manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data.

*Appropriateness*—The measure of the quality of evidence, that is, its relevance and reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions.

*Assertions*—Representations by management, explicit or otherwise, that are embodied in the financial statements.

*Assess*—Analyze identified risks of to conclude on their significance. “Assess,” by convention, is used only in relation to risk. (also see Evaluate)

*Assistants*—Personnel involved in an individual audit other than the auditor.

*Association*—(see Auditor association with financial information)

*Assurance*—(see Reasonable assurance)

*Assurance engagement*—An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria (also see Subject matter information). Under the “Hong Kong Framework for Assurance Engagements” there are two types of assurance engagement a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement.

*Reasonable assurance engagement*—The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner’s conclusion.

*Limited assurance engagement*—The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner’s conclusion.

*Assurance engagement risk*—The risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.

*Attendance*—Being present during all or part of a process being performed by others; for example, attending physical inventory taking will enable the auditor to inspect inventory, to observe compliance of management’s procedures to count quantities and record such counts and to test-count quantities.

*Audit documentation*—The record of audit procedures performed,<sup>2</sup> relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “workpapers” are also sometimes used).

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<sup>2</sup> Audit procedures performed include audit planning, as addressed in HKSA 300 “Planning an Audit of Financial Statements.”

*Audit evidence*—All of the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence includes the information contained in the accounting records underlying the financial statements and other information.

*Audit firm*—(see Firm)

*Audit matters of governance interest*—Those matters that arise from the audit of financial statements and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Audit matters of governance interest include only those matters that have come to the attention of the auditor as a result of the performance of the audit.

*Audit of financial statements*—The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. An audit of financial statements is an assurance engagement (see Assurance engagement).

*Audit opinion*—(see Opinion)

*Audit risk*—Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risk of material misstatement (or simply, the “risk of material misstatement”) (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (“detection risk”). The risk of material misstatement has two components: inherent risk and control risk (as described at the assertion level below). Detection risk is the risk that the auditor’s procedures will not detect a misstatement that exists in an assertion that could be material, individually or when aggregated with other misstatements.

*Inherent risk*—Inherent risk is the susceptibility of an assertion to a misstatement, that could be material, individually or when aggregated with other misstatements assuming that there were no related internal controls.

*Control risk*—Control risk is the risk that a misstatement that could occur in an assertion and that could be material, individually or when aggregated with other misstatements, will not be prevented or detected and corrected on a timely basis by the entity’s internal control.

*Audit sampling*—The application of audit procedures to less than 100% of items within an account balance or class of transactions such that all sampling units have a chance of selection. This will enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can use either a statistical or a non-statistical approach.

*Anomalous error*—An error that arises from an isolated event that has not recurred other than on specifically identifiable occasions and is therefore not representative of errors in the population.

*Confidence levels*—The mathematical complements of sampling risk.

*Expected error*—The error that the auditor expects to be present in the population.

*Non-sampling risk*—Arises from factors that cause the auditor to reach an erroneous conclusion for any reason not related to the size of the sample. For example, most audit evidence is persuasive rather than conclusive, the auditor might use inappropriate procedures, or the auditor might misinterpret evidence and fail to recognize an error.

*Non-statistical sampling*—Any sampling approach that does not have the characteristics of statistical sampling.

*Population*—The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. A population may be divided into strata, or sub-populations, with each stratum being examined separately. The term population is used to include the term stratum.

*Sampling risk*—Arises from the possibility that the auditor's conclusion, based on a sample may be different from the conclusion reached if the entire population were subjected to the same audit procedure.

*Sampling unit*—The individual items constituting a population, for example checks listed on deposit slips, credit entries on bank statements, sales invoices or debtors' balances, or a monetary unit.

*Statistical sampling*—Any approach to sampling that has the following characteristics:

- (a) Random selection of a sample; and
- (b) Use of probability theory to evaluate sample results, including measurement of sampling risk.

*Stratification*—The process of dividing a population into subpopulations, each of which is a group of sampling units which have similar characteristics (often monetary value).

*Tolerable error*—The maximum error in a population that the auditor is willing to accept.

*Total error*—Either the rate of deviation or total misstatement.

*Auditor*—The engagement partner. The term "auditor" is used to describe either the engagement partner or the audit firm. Where it applies to the engagement partner, it describes the obligations or responsibilities of the engagement partner. Such obligations or responsibilities may be fulfilled by either the engagement partner or a member of the audit team. Where it is expressly intended that the obligation or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used. (The term "auditor" may be used when describing related services and assurance engagements other than audits. Such reference is not intended to imply that a person performing a related service or assurance engagement other than an audit need necessarily be the auditor of the entity's financial statements.)

*Existing auditor*—The auditor of the financial statements of the current period.

*External auditor*—Where appropriate the term "external auditor" is used to distinguish the external auditor from an internal auditor.

*Incoming auditor*—The auditor of the financial statements of the current period, where either the financial statements of the prior period have been audited by another auditor (in this case the incoming auditor also known as a successor auditor), or the audit is an initial audit engagement.

*Internal auditor*—A person performing an internal audit.

*Other auditor*—An auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component, which is included in the financial statements audited by the principal auditor. Other auditors include affiliated firms, whether using the same name or not, and correspondents, as well as unrelated auditors.

*Predecessor auditor*—The auditor who was previously the auditor of an entity and who has been replaced by an incoming auditor.

*Principal auditor*—The auditor with responsibility for reporting on the financial statements of an entity when those financial statements include financial information of one or more components audited by another auditor.

*Proposed auditor*—An auditor who is asked to replace an existing auditor.

*Successor auditor*—An auditor replacing an existing auditor (also known as an incoming auditor).

*Auditor association with financial information*—An auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor's name in a professional connection.

*Comparatives*—Comparatives in financial statements, may present amounts (such as financial position, results of operations, cash flows) and appropriate disclosures of an entity for more than one period, depending on the framework. The frameworks and methods of presentation are as follows:

- (a) Corresponding figures where amounts and other disclosures for the preceding period are included as part of the current period financial statements, and are intended to be read in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship to the current period figures.
- (b) Comparative financial statements where amounts and other disclosures for the preceding period are included for comparison with the financial statements of the current period, but do not form part of the current period financial statements.

*Comparative financial statements*—(see Comparatives)

*Compilation engagement*—An engagement in which accounting expertise, as opposed to auditing expertise, is used to collect, classify and summarize financial information.

*Component*—A division, branch, subsidiary, joint venture, associated company or other entity whose financial information is included in financial statements audited by the principal auditor.

*Component of a complete set of financial statements*—The applicable financial reporting framework adopted in preparing the financial statements determines what constitutes a complete set of financial statements. Components of a complete set of financial statements include: a single financial statement, specified accounts, elements of accounts or items in a financial statement.

*Comprehensive basis of accounting*—A comprehensive basis of accounting comprises a set of criteria used in preparing financial statements which applies to all material items and which has substantial support.

*Computer-assisted audit techniques*—Applications of auditing procedures using the computer as an audit tool (also known as CAATs).

*Computer information systems (CIS) environment*—Exists when a computer of any type or size is involved in the processing by the entity of financial information of significance to the audit, whether that computer is operated by the entity or by a third party.

*Confidence levels*—(see Audit sampling)

*Confirmation*—A specific type of inquiry that is the process of obtaining a representation of information or of an existing condition directly from a third party.

*Continuing auditor*—(see Auditor)

*Control activities*—Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control.

*Control environment*—Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.

*Control risk*—(see Audit risk)

*Corporate governance*—(see Governance)

*Corresponding figures*—(see Comparatives)

*Criteria*—The benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

*Suitable criteria*—Exhibit the following characteristics:

- (a) **Relevance:** relevant criteria contribute to conclusions that assist decision-making by the intended users.
- (b) **Completeness:** criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
- (c) **Reliability:** reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
- (d) **Neutrality:** neutral criteria contribute to conclusions that are free from bias.
- (e) **Understandability:** understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

*Current period figures*—Amounts and other disclosures relating to the current period.

*Database*—A collection of data that is shared and used by a number of different users for different purposes.

*Date of the financial statements*—The date of the end of the latest period covered by the financial statements, which is normally the date of the most recent balance sheet in the financial statements subject to audit.

*Date of approval of the financial statements*—The date on which those with the recognized authority assert that they have prepared the entity's complete set of financial statements, including the related notes, and that they have taken responsibility for them. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that a complete set of financial statements has been prepared, and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalizing its financial statements in view of its management and governance structures. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that

sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of the HKSA is the earlier date on which those with the recognized authority determine that a complete set of financial statements has been prepared.

*Date of the auditor's report*—The date selected by the auditor to date the report on the financial statements. The auditor's report is not dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements.<sup>3</sup> Sufficient appropriate audit evidence includes evidence that the entity's complete set of financial statements has been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

*Date the financial statements are issued*—The date that the auditor's report and audited financial statements are made available to third parties, which may be, in many circumstances, the date that they are filed with a regulatory authority.

*Detection risk*—(see Audit risk)

*Disclaimer of opinion*—(see Modified auditor's report)

*Electronic Data Interchange (EDI)*—The electronic transmission of documents between organizations in a machine-readable form.

*Emphasis of matter paragraph(s)*—(see Modified auditor's report)

*Employee fraud*—Fraud involving only employees of the entity subject to the audit.

*Encryption (cryptography)*—The process of transforming programs and information into a form that cannot be understood without access to specific decoding algorithms (cryptographic keys). For example, the confidential personal data in a payroll system may be encrypted against unauthorized disclosure or modification. Encryption can provide an effective control for protecting confidential or sensitive programs and information from unauthorized access or modification. However, effective security depends upon proper controls over access to the cryptographic keys.

*Engagement documentation*—The record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers" are sometimes used). The documentation for a specific engagement is assembled in an engagement file.

*Engagement partner*—The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

*Engagement letter*—An engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities to the client and the form of any reports.

*Engagement quality control review*—A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.

*Engagement quality control reviewer*—A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report.

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<sup>3</sup> In rare circumstances, law or regulation also identifies the point in the financial statement reporting process at which the audit is expected to be complete.



*Engagement team*—All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.

*Entity's risk assessment process*—A component of internal control that is the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.

*Environmental matters*—

- (a) Initiatives to prevent, abate, or remedy damage to the environment, or to deal with conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily);
- (b) Consequences of violating environmental laws and regulations;
- (c) Consequences of environmental damage done to others or to natural resources; and
- (d) Consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners).

*Environmental performance report*—A report, separate from the financial statements, in which an entity provides third parties with qualitative information on the entity's commitments towards the environmental aspects of the business, its policies and targets in that field, its achievement in managing the relationship between its business processes and environmental risk, and quantitative information on its environmental performance.

*Environmental risk*—In certain circumstances, factors relevant to the assessment of inherent risk for the development of the overall audit plan may include the risk of material misstatement of the financial statements due to environmental matters.

*Error*—An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

*Evaluate*—Identify and analyze the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. "Evaluation," by convention, is used only in relation to a range of matters, including evidence, the results of procedures and the effectiveness of management's response to a risk. (also see Assess)

*Existing auditor*—(see Auditor)

*Expected error*— (see Audit sampling)

*Experienced auditor*—An individual (whether internal or external to the firm) who has a reasonable understanding of (a) audit processes, (b) HKSA's and applicable legal and regulatory requirements, (c) the business environment in which the entity operates, and (d) auditing and financial reporting issues relevant to the entity's industry.

*Expert*—A person or firm possessing special skill, knowledge and experience in a particular field other than accounting and auditing.

*External audit*—An audit performed by an external auditor.

*External auditor*—(see Auditor)

*External confirmation*—The process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements.

*Fair value*—The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

*Financial statements*—A structured representation of the financial information, which ordinarily includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term can refer to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.

*Firewall*—A combination of hardware and software that protects a WAN, LAN or PC from unauthorized access through the Internet and from the introduction of unauthorized or harmful software, data or other material in electronic form.

*Firm*—A sole practitioner, partnership or corporation or other entity of professional accountants.

*Forecast*—Prospective financial information prepared on the basis of assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).

*Fraud*—An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Two types of intentional misstatement are relevant to the auditor: misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets (also see Fraudulent financial reporting and Misappropriation of assets).

*Fraudulent financial reporting*—Involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.

*General IT-controls*—Policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT-controls commonly include controls over data center and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.

*General purpose financial statements*—Financial statements prepared in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users.

*Going concern assumption*—Under this assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

*Governance*—Describes the role of persons entrusted with the supervision, control and direction of an entity. Those charged with governance ordinarily are accountable for ensuring that the entity achieves its objectives, financial reporting, and reporting to interested parties. Those charged with governance include management only when it performs such functions.

*Government business enterprises*—Businesses that operate within the public sector ordinarily to meet a political or social interest objective. They are ordinarily required to operate commercially, that is, to make profits or to recoup, through user charges a substantial proportion of their operating costs.

*Incoming auditor*—(see Auditor)

*Independence*<sup>4</sup>—Comprises:

- (a) Independence of mind—the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- (b) Independence in appearance—the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

*Information system relevant to financial reporting*—A component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.

*Inherent risk*—(see Audit risk)

*Initial audit engagement*—An audit engagement in which either the financial statements are audited for the first time; or the financial statements for the prior period were audited by another auditor.

*Inquiry*—Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, throughout the entity or outside the entity.

*Inspection (as an audit procedure)*—Examining records or documents, whether internal or external, or tangible assets.

*Inspection (in relation to completed engagements)*—Procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures;

*Intended users*—The person, persons or class of persons for whom the practitioner prepares the assurance report. The responsible party can be one of the intended users, but not the only one.

*Interim financial information or statements*—Financial information (which may be less than a complete set of financial statements as defined above) issued at interim dates (usually half-yearly or quarterly) in respect of a financial period.

*Internal auditing*—An appraisal activity established within an entity as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.

*Internal auditor*—(see Auditor)

*Internal control*—The process designed and effected by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Internal control consists of the following components:

- (a) The control environment;
- (b) The entity's risk assessment process;
- (c) The information system, including the related business processes, relevant to financial reporting, and communication;

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<sup>4</sup> As defined in the HKICPA *Code of Ethics for Professional Accountants*.

- (d) Control activities; and
- (e) Monitoring of controls.

*Investigate*—Inquire into matters arising from other procedures to resolve them.

*IT environment*—The policies and procedures that the entity implements and the IT infrastructure (hardware, operating systems, etc.) and application software that it uses to support business operations and achieve business strategies.

*Limited assurance engagement*—(see Assurance engagement)

*Limitation on scope*—A limitation on the scope of the auditor's work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). A scope limitation may be imposed by circumstances (for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed desirable.

*Listed entity*<sup>5</sup>—An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

*Local Area Network (LAN)*—A communications network that serves users within a confined geographical area. LANs were developed to facilitate the exchange and sharing of resources within an organization, including data, software, storage, printers and telecommunications equipment. They allow for decentralized computing. The basic components of a LAN are transmission media and software, user terminals and shared peripherals.

*Management*—Comprises officers and others who also perform senior managerial functions. Management includes those charged with governance only in those instances when they perform such functions.

*Management fraud*—Fraud involving one or more members of management or those charged with governance.

*Management representations*—Representations made by management to the auditor during the course of an audit, either unsolicited or in response to specific inquiries.

*Material inconsistency*—Exists when other information contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

*Material misstatement of fact*—Exists in other information when such information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented.

*Material weakness*—A weakness in internal control that could have a material effect on the financial statements.

*Materiality*—Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cutoff point rather than being a primary qualitative characteristic which information must have if it is to be useful.

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<sup>5</sup> As defined in the HKICPA *Code of Ethics for Professional Accountants*.

*Misappropriation of assets*—Involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.

*Misstatement*—A misstatement of the financial statements that can arise from fraud or error (also see Fraud and Error).

*Modified auditor's report*—An auditor's report is considered to be modified if either an emphasis of matter paragraph(s) is added to the report or if the opinion is other than unqualified:

*Matters that Do Not Affect the Auditor's Opinion*

*Emphasis of matter paragraph(s)*—An auditor's report may be modified by adding an emphasis of matter paragraph(s) to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph(s) does not affect the auditor's opinion. The auditor may also modify the auditor's report by using an emphasis of matter paragraph(s) to report matters other than those affecting the financial statements.

*Matters that Do Affect the Auditor's Opinion*

*Qualified opinion*—A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion.

*Disclaimer of opinion*—A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

*Adverse opinion*—An adverse opinion is expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

*Monitoring (in relation to quality control)*—A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.

*Monitoring of controls*—A process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control.

*National practices (auditing)*—A set of guidelines not having the authority of standards defined by an authoritative body at a national level and commonly applied by auditors in the conduct of an audit, review, other assurance or related services.

*National standards (auditing)*—A set of standards defined by law or regulations or an authoritative body at a national level, the application of which is mandatory in conducting an audit, review, other assurance or related services.

*Network firm*<sup>6</sup>—An entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally.

*Noncompliance*—Refers to acts of omission or commission by the entity being audited, either intentional or unintentional, that are contrary to the prevailing laws or regulations.

*Non-sampling risk*—(see Audit sampling)

*Non-statistical sampling*—(see Audit sampling)

*Observation*—Consists of looking at a process or procedure being performed by others, for example, the observation by the auditor of the counting of inventories by the entity's personnel or the performance of control activities.

*Opening balances*—Those account balances which exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions of prior periods and accounting policies applied in the prior period.

*Opinion*—The auditor's report contains a clear written expression of opinion on the financial statements. An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (also see Modified auditor's report)

*Other auditor*—(see Auditor)

*Other information*—Financial or non-financial information (other than the financial statements or the auditor's report thereon) included – either by law or custom – in the annual report.

*Overall audit strategy*—Sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

*Partner*—Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

*PCs or personal computers (also referred to as microcomputers)*—Economical yet powerful self-contained general purpose computers consisting typically of a monitor (visual display unit), a case containing the computer electronics and a keyboard (and mouse). These features may be combined in portable computers (laptops). Programs and data may be stored internally on a hard disk or on removable storage media such as CDs or floppy disks. PCs may be connected to on-line networks, printers and other devices such as scanners and modems.

*Personnel*—Partners and staff.

*Planning*—Involves establishing the overall audit strategy for the engagement and developing an audit plan, in order to reduce audit risk to an acceptably low level.

*Population*—(see Audit sampling)

*Post balance sheet events*—(see Subsequent events)

*Practitioner*—A professional accountant in public practice.

*Predecessor auditor*—(see Auditor)

*Principal auditor*—(see Auditor)

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<sup>6</sup> As defined in the HKICPA Code of Ethics for Professional Accountants

*Professional accountant*<sup>7</sup>—An individual who is a member of the Hong Kong Institute of Certified Public Accountants.

*Professional accountant in public practice*<sup>8</sup>—A professional accountant, irrespective of functional classification (e.g., audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.

*Professional skepticism*—An attitude that includes a questioning mind and a critical assessment of evidence.

*Professional standards*—HKICPA engagement standards, as defined in the HKICPA's "Preface to the Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services," and relevant ethical requirements, which ordinarily comprise Parts A, B and D of the HKICPA *Code of Ethics for Professional Accountants* and relevant national ethical requirements.

*Programming controls*—Procedures designed to prevent or detect improper changes to computer programs that are accessed through on-line terminal devices. Access may be restricted by controls such as the use of separate operational and program development libraries and the use of specialized program library software. It is important for on-line changes to programs to be adequately documented, controlled and monitored.

*Projection*—Prospective financial information prepared on the basis of:

- (a) Hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a startup phase or are considering a major change in the nature of operations; or
- (b) A mixture of best-estimate and hypothetical assumptions.

*Proposed auditor*—(see Auditor)

*Prospective financial information*—Financial information based on assumptions about events that may occur in the future and possible actions by an entity. Prospective financial information can be in the form of a forecast, a projection or a combination of both. (see Forecast and Projection)

*Public sector*—National governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises).

*Qualified opinion*—(see Modified auditor's report)

*Quality controls*—The policies and procedures adopted by a firm designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.

*Reasonable assurance (in the context of quality control)*—A high, but not absolute, level of assurance.

*Reasonable assurance (in the context of an audit engagement)*—A high, but not absolute, level of assurance, expressed positively in the auditor's report as reasonable assurance, that the information subject to audit is free of material misstatement.

*Reasonable assurance engagement*—(see Assurance engagement)

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<sup>7</sup> As defined in the HKICPA *Code of Ethics for Professional Accountants*

<sup>8</sup> As defined in the HKICPA *Code of Ethics for Professional Accountants*

*Recalculation*—Consists of checking the mathematical accuracy of documents or records.

*Related party*— A party is related to an entity if:

- (a) Directly, or indirectly through one or more intermediaries, the party:
  - (i) Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
  - (ii) Has an interest in the entity that gives it significant influence over the entity; or
  - (iii) Has joint control over the entity;
- (b) The party is an associate (as defined in HKAS 28, “Investments in Associates”) of the entity;
- (c) The party is a joint venture in which the entity is a venturer (see HKAS 31, “Interest in Joint Ventures”);
- (d) The party is a member of the key management personnel of the entity or its parent;
- (e) The party is a close member of the family of any individual referred to in (a) or (d);
- (f) The party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) The party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

*Related party transaction*— A transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

*Related services*—Comprise agreed-upon procedures and compilations.

*Reperformance*—The auditor’s independent execution of procedures or controls that were originally performed as part of the entity’s internal controls, either manually or through the use of CAATs.

*Responsible party*—The person (or persons) who:

- (a) In a direct reporting engagement, is responsible for the subject matter; or
- (b) In an assertion-based engagement, is responsible for the subject matter information (the assertion), and may be responsible for the subject matter.

The responsible party may or may not be the party who engages the practitioner (the engaging party).

*Review (in relation to quality control)*—Appraising the quality of the work performed and conclusions reached by others.

*Review engagement*—The objective of a review engagement is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor’s attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.



*Review procedures*—The procedures deemed necessary to meet the objective of a review engagement, primarily inquiries of entity personnel and analytical procedures applied to financial data.

*Risk assessment procedures*—The audit procedures performed to obtain an understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement at the financial statement and assertion levels.

*Risk of material misstatement*—(see Audit Risk)

*Sampling risk*—(see Audit sampling)

*Sampling unit*—(see Audit sampling)

*Scope of an audit*—The audit procedures that, in the auditor's judgment and based on the HKSA's, are deemed appropriate in the circumstances to achieve the objective of the audit.

*Scope of a review*—The review procedures deemed necessary in the circumstances to achieve the objective of the review.

*Scope limitation*—(see Limitation on scope)

*Segment information*—Information in the financial statements regarding distinguishable components or industry and geographical aspects of an entity.

*Significance*—The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner's report; or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.

*Significant risk*—A risk that requires special audit consideration.

*Small entity*—Any entity in which:

- (a) There is concentration of ownership and management in a small number of individuals (often a single individual); and
- (b) One or more of the following are also found:
  - (i) Few sources of income;
  - (ii) Unsophisticated record-keeping; and
  - (iii) Limited internal controls together with the potential for management override of controls.

Small entities will ordinarily display characteristic (a), and one or more of the characteristics included under (b).

*Special purpose auditor's report*—A report issued in connection with the independent audit of financial information other than an auditor's report on financial statements, including:

- (a) A complete set of financial statements prepared in accordance with an other comprehensive basis of accounting;

- (b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement;
- (c) Compliance with contractual agreements; and
- (d) Summarized financial statements.

*Staff*—Professionals, other than partners, including any experts the firm employs.

*Statistical sampling*—(see Audit sampling)

*Stratification*—(see Audit sampling)

*Subject matter information*—The outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.

*Subsequent events*— Hong Kong Accounting Standard (HKAS) 10, “Events After the Balance Sheet Date,” deals with the treatment in financial statements of events, both favorable and unfavorable, that occur between the date of the financial statements (referred to as the “balance sheet date” in the HKAS) and the date when the financial statements are authorized for issue and identifies two types of events:

- (a) Those that provide evidence of conditions that existed at the date of the financial statements; and
- (b) Those that are indicative of conditions that arose after the date of the financial statements.

*Substantive procedures*—Audit procedures performed to detect material misstatements at the assertion level; they include:

- (a) Tests of details of classes of transactions, account balances; and disclosures and
- (b) Substantive analytical procedures.

*Successor auditor*—(see Auditor)

*Sufficiency*—Sufficiency is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the risk of misstatement and also by the quality of such audit evidence.

*Suitable criteria*—(see Criteria)

*Suitably qualified external person (for the purpose of HKSQC 1)*—An individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, other assurance or related services engagements, or of an organization that provides relevant quality control services.

*Summarized financial statements*—Financial statements summarizing an entity’s annual audited financial statements for the purpose of informing user groups interested in the highlights only of the entity’s financial performance and position.

*Supplementary information*—Information that is presented together with the financial statements that is not required by the applicable financial reporting framework used to prepare the financial statements, normally presented in either supplementary schedules or as additional notes.

*Supreme Audit Institution*—The public body of a State which, however designated, constituted or organized, exercises by virtue of law, the highest public auditing function of that State.

*Test*—The application of procedures to some or all items in a population.

*Tests of control*—Tests performed to obtain audit evidence about the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

*Those charged with governance*—(see Governance)

*Tolerable error*—(see Audit sampling)

*Total error*—(see Audit sampling)

*Transaction logs*—Reports that are designed to create an audit trail for each on-line transaction. Such reports often document the source of a transaction (terminal, time and user) as well as the transaction's details.

*Uncertainty*— A matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

*Understanding of the entity and its environment*—The auditor's understanding of the entity and its environment consists of the following aspects:

- (a) Industry, regulatory, and other external factors, including the applicable financial reporting framework.
- (b) Nature of the entity, including the entity's selection and application of accounting policies.
- (c) Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements.
- (d) Measurement and review of the entity's financial performance.
- (e) Internal control.

*Unqualified opinion*—(see Opinion)

*Walk-through test*—Involves tracing a few transactions through the financial reporting system.

*Wide Area Network (WAN)*—A communications network that transmits information across an expanded area such as between plant sites, cities and nations. WANs allow for on-line access to applications from remote terminals. Several LANs can be interconnected in a WAN.

*Working papers*—The material prepared by and for, or obtained and retained by, the auditor in connection with the performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.