

# PAS 07 - Decision- making in Audit

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# Practical Audit

- PAS 01 – Chemistry in Audit
- PAS 02 – Rule of Law in Audit
- PAS 03 – Stakeholders in Audit
- PAS 04 – Consolidation in Audit
- PAS 05 – Financial Instruments in Audit
- PAS 06 – Reporting Attitude in Audit
- **PAS 07 – Decision-making in Audit**

PAS O - Orientation

PAS Z – Statements + Financial + Entity

- **What everyday we do about decision-making, and how they relate to Auditing?**
- **Try to find out various methods or rules in making decisions?**

The secret of success

Two words: Right decision

How to make right decisions:

One word: Experience

How to get experience:

Two words: Wrong decisions

In short, the secret of success is to  
Do Your Own Decisions.  
Professional level does not have syllabus.



Warren Buffett:

The first question I always ask myself about “buying a business” is:

Do the owners love the money or do they love the business?

Because the day after I buy a business, if the owners love the money, they’re gone.

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“Dr Stanley Ho never gambles.” is a gimmick or not?



# Decision-quality

- Insight & Perspective
- Timeliness (short or long term, quick or lasting)
- Compassionate & Communicate
- Speedy and flexible
- Strategic and political
- Under pressure
- Personal value & 3i
- Individually & Collectively
- All in all - Dimension





## Something Other Than Decision-making

- Effective Execution
- Your Taste & Interest
- Risky Level in Life
- Speed
- CPA is not everything





In reality: How many  
right decisions out of  
one hundred for a  
success person (you)  
now making???

# Know Our Client

Giving them secret score:

A to E Grade

- management attitude
- rationalization (attitude), opportunity & pressure (incentive)
- business & industrial
- system & internal control (& level of management override)
- response & interaction



# KNOW YOURSELF

- wisdom
- knowledge
- experience
- chemistry (4C)
- surreal





Learn from the past and  
plan for the days to come.

#### HKSA39 Financial Instruments - Impairment Loss

61 In addition to the types of events in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

#### HKSA37 Provisions

14 A provision shall be recognised when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

84 For each class of provision, an entity shall disclose:

- (a) the carrying amount at the beginning and end of the period;
- (b) additional provisions made in the period, including increases to existing provisions;
- (c) amounts used (ie incurred and charged against the provision) during the period;
- (d) unused amounts reversed during the period; and
- (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

Comparative information is not required.

85 An entity shall disclose the following for each class of provision:

- (a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
- (b) An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48; and
- (c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

86 Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:

- (a) an estimate of its financial effect, measured under paragraphs 36-52;
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) the possibility of any reimbursement.



89 Where an inflow of economic benefits is probable, an entity shall disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36-52.

91 Where any of the information required by paragraphs 86 and 89 is not disclosed because it is not practicable to do so, that fact shall be stated.

92 In extremely rare cases, disclosure of some or all of the information required by paragraphs 84-89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.



HKSA	D-Points	Benchmark	Max & Min
39.61 Financial Instruments - Impairment loss	Significant	5% on Profit or Loss 5% on Total Assets	For Grade C client (may increase up to 10% for A or B client, may decrease down to 0% for D or E client)
	Prolonged	Two years	Max: Three years
36 Impairment	Recoverable amount	Received for "Trade or other Receivables" or other monetary items	
37.14 Provisions	Obligation (legal or constructive)	Have or Have not	D or E client be subject to more audit tests
37.84 & 37.85	Movement (presentation) & Description (disclosures)	All or Nothing	Detail should be appropriate to the nature and amount
37.91	Not practicable disclosure of contingencies	The fact should be stated	??? Apply to all clients ???
37.92	Extreme cases - disclosure be expected prejudice seriously the position	Need not disclose information, but the general nature of the dispute, the fact & the reason	Zero % allowance (Departure effect on non compliance)

HKSA	D-Points	Benchmark	Max & Min
16.67 PPE	Useful life ended	Derecognition	Otherwise, doing audit tests on residual schedule
16.31 PPE - Revaluation	Sufficient regularity	Three to Five Years	Volatile change: Every Year for Properties???
28.6 & 28.37(c) & (d) Investments in Associates	Associate or Not an associate	20% - 50% presumption of significant influence via direct or indirect (subsidiary only) holding of voting power	If presumption is overcome, the reasons must be disclosed.
Other Kind of Investments	Proof of proper ownership and classification	Private HK Co Overseas Co Public	
Private HK Co	Priority of Proof	Statute Book Certificate Minutes Stamped Documents	
Overseas Private Investments			
Control			
Related Parties			

HKAS 16 - PPE

6 Useful life is:

(a) the period over which an asset is expected to be available for use by an entity; or  
the number of production or similar units expected to be obtained from the asset by an entity.

50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

51 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

67 The carrying amount of an item of property, plant and equipment shall be derecognised:

- (a) on disposal; or
- (b) when no future economic benefits are expected from its use or disposal.

#### Revaluation

31 After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

34 The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

#### HKAS 28 - Investments in Associates

6 If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

37 The following disclosures shall be made:

(c) the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence;

(d) the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting or potential voting power

HKSA	D-Points	Benchmark	Max & Min
Foreign Currency	Denominated in Non-Functional Currency		
Change in Accounting Policies or Estimates	Prospectively or Retrospectively		
Inventories	NRV be Reversible		
Revenue	Agency / Risks & Rewards		
Finance Lease	Risks & Rewards		
Intangible Asset	Internally Generated		

Tomorrow, you will need more decision-making in accounting.

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### **Conceptual Framework for Financial Reporting 2010**

The objective of the conceptual framework project is to create a sound foundation for future accounting standards that are **principles-based**, internally consistent and internationally converged.

The Council recognises that in a limited number of cases there may be a conflict between the *Conceptual Framework* and a HKFRS and Accounting Guideline. In those cases where there is a conflict, the requirements of the HKFRS and Accounting Guideline prevail over those of the *Conceptual Framework*. As, however, the Council will be guided by the *Conceptual Framework* in the development of future Standards or Guidelines and in its review of existing Standards or Guidelines, the number of cases of conflict between the *Conceptual Framework* and HKFRSs and Accounting Guidelines will diminish through time.

## HKSA: Standard on Auditing

Materiality  
Sample Sizes for Different Tests  
Judgement & Justification  
Attitude of Professional Skepticism  
Integrity  
Control  
Fraud





Range of turnover or gross assets	Percentage of turnover or gross assets	Materiality ranges
HK\$0 to HK\$7.5 m	3%	HK\$1 - HK\$225k
HK\$7.5 m to HK\$ 15 m	2.5%	HK\$225k - HK\$375k
HK\$15 m to HK\$ 30 m	2%	HK\$375k - HK\$600k
HK\$30 m to HK\$ 50 m	1.5%	HK\$600K - HK\$750k
Over HK\$ 50 m	1%	over HK\$750k

	L	M	H								
L	20	25	30								
M	25	30	35								
H	30	35	40								
					L	M	H				
				L	13	17	20				
				M	17	20	23				
				H	20	23	26				
									L	M	H
								L	10	13	15
								M	13	15	18
								H	15	18	20

From HKICPA's Manual: The determination of what is material is a matter of [professional judgement](#). The percentage benchmarks set out are intended to provide guidance in exercising that judgement. They [should not be used as a formula to 'calculate' materiality](#).

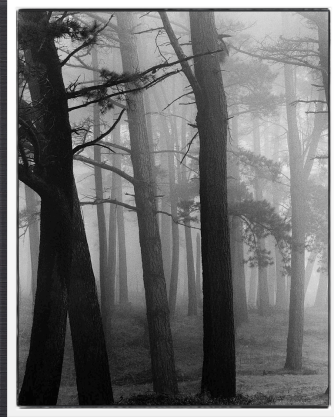
#### PLANNING MEMORANDUM

An audit plan has been developed in order to reduce risk to an acceptably low level.

The overall strategy and audit plan have been properly documented in a planning memorandum.

The audit has been planned with an [attitude of professional skepticism](#) recognising that circumstances may exist that cause the financial statements to be materially misstated.

The engagement team collectively has the appropriate capabilities, competence and time to perform the audit engagement in accordance with professional standards and regulatory and legal requirements, and to enable an auditor's report that is appropriate in the circumstances to be issued.



## INTEGRITY

Are there any circumstances or events that cast doubt on the integrity of the client's owners, board members or management?

Consider the following:

- a) Convictions and regulatory sanctions;
- b) Suspicion of illegal acts or fraud;
- c) Ongoing investigations;
- d) Negative publicity;
- e) Management membership of professional organisations that are not in good standing;
- f) Close association with people / companies with questionable ethics; and
- g) Information deliberately withheld or where we were intentionally misled.

# CONTROL

## Evaluation of control environment

Consider whether management has created and maintained a culture of honesty and ethical behaviour.

Consider whether the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

Consider whether those other components are not undermined by deficiencies in the control environment.

Consider whether there is potential for dominant influence to be exerted over the company by any related party.





## FRAUD

Where there are indications of fraud:

**Evaluate** the implications of the misstatement in relation to other aspects of the audit.

**Consider** the reliability of management representations.

**Recognise** that an instance of fraud is unlikely to be an isolated occurrence.

**Consider** whether management are involved and if so the implications for the risk assessment and on the nature, timing and extent of audit procedures undertaken.

**Consider** whether there is evidence of collusion involving employees, management and third parties and the effect on the reliability of evidence obtained.

# BASIC INSTINCT

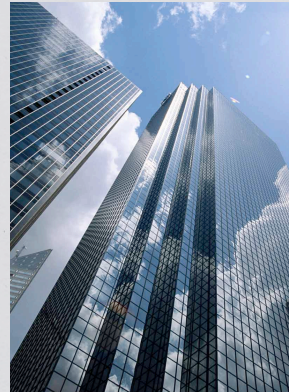
- Compliance
- Consistency
- Clarity
- Disclosure
- Doubt
- Evidence





# Clarified Auditing Standards

- \* HKSA 265 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
- \* HKSA 320 - Performance Materiality for Probability of Aggregate Undetected Misstatements
- \* HKSA 505 - Oral Response is not an External Confirmation
- \* HKSA 580 - Doubts as to Reliability of Written Representations







Now, join to the real  
world of CPA mission

never ended