



Technical FAQ on Audit of Financial Statement

This Technical FAQ, which is based on the facts and assumptions supplied, is intended for general guidance only and is subject to the [HKICPA Staff Policy on Handling Technical Queries](#). The material in this Technical FAQ represents the personal views of the author and does not constitute an authoritative pronouncement by or on behalf of the HKICPA, and it shall not be relied on by any person in connection with any investigation or disciplinary proceedings or the HKICPA or any other legal proceedings. Any person who applies or relies on this Technical FAQ for the purpose of any accounting treatment, any auditing or professional procedures or any other purpose whatsoever does so at his own risk. The Institute and the authors DO NOT accept any responsibility or liability and DISCLAIM all responsibility and liability, in respect of this Technical FAQ and any consequences that may arise from any person using or relying on this Technical FAQ.

The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkcpa.org.hk

Question 1 – We are engaged to prepare a report for our client to obtain funds from the Government. We are requested to express an opinion as to whether the Grantee has complied with, in all material respects, the requirements set by the Government (including the requirements to keep proper books and records and to prepare proper income and expenditure account), and all the terms and conditions as specified in the Grant Agreement, the Application Guidelines and the Government's requirements, directions and orders relating to the programme/ project prescribed or made in writing during the duration of the programme/ project.

We have concerns that the above reporting requirements are too broad, can we issue such kind of report? If not, what kinds of report can we issue in accordance with the Hong Kong reporting framework?

Answer

You are recommended to discuss with your client on the reporting requirements such as any governing law or regulation, the applicable financial reporting framework and the level of assurance required for the auditor's report. You are also recommended to clarify these with the relevant Government departments.

The "Hong Kong Framework for Assurance Engagements" (the Framework) would be helpful in explaining the elements and objectives of an assurance engagement. In paragraph 3 of the Framework, it defines assurance engagements and identifies the objectives of the two types of assurance engagements a practitioner is permitted to perform. This Framework calls these two types reasonable assurance engagements and limited assurance engagements. Footnote 2 further states that for assurance engagements regarding historical financial information in particular, reasonable assurance engagements are called audits, and limited assurance engagements are called reviews.



You are also referred to the "Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements" (the Preface). Paragraphs 12- 14 of the Preface state that:

12. Hong Kong Standards on Auditing (HKSA) are to be applied in the audit of historical financial information.
13. Hong Kong Standards on Review Engagements (HKSR) are to be applied in the review of historical financial information.
14. Hong Kong Standards on Assurance Engagements (HKSAE) are to be applied in assurance engagements other than audits or reviews of historical financial information.

For each type of engagements mentioned in above, you are referred to the relevant standards for the reporting requirements.

Finally, you may also refer to the following guidance: 1) PN 850 "Reporting on Flag Days and General Charitable Fund-raising Activities Covered by Public Subscription Permits issued by the Social Welfare Department" and the link is: http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumell/pn850.pdf; 2) "Circular on Reporting to Grantees of the Quality Education Fund" and the link is: http://www.hkicpa.org.hk/file/media/section6_standards/standards/Audit-n-assurance/tech-bull-circular/cir_qef.pdf.

Question 2 – Is a Hong Kong registered CPA firm allow to issue and sign an auditor's report on the financial statements of an overseas incorporated company? Any laws or professional standards governing this?

Answer

Members are recommended to check the relevant law or regulation governing the audit and accounting requirements in the overseas country.

Members are also referred to the "Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements" (the Preface) for guidance. In particular, paragraphs 36-39 provide guidance where a Hong Kong CPA is engaged to perform audits of overseas companies. Where the financial statements of an overseas enterprise are to be incorporated into Hong Kong financial statements, the audit of the overseas enterprise should conform to HKSA in so far as this is necessary to ensure that the audit of the Hong Kong financial statements as a whole is in accordance with HKSA.

There may be circumstances, however, where an audit is being carried out of an overseas enterprise for purposes other than Hong Kong reporting. In these cases, the audit should conform to appropriate standards as follows:

- (a) where the local audit requirements and standards are properly codified and defined, the audit may conform to those standards; and
- (b) in the absence of such local requirements and standards, the audit should conform to HKSA or International Standards on Auditing or other auditing standards established by an organization that is authorized or recognized to promulgate auditing standards.



Question 3 – Hong Kong Financial Reporting Standard 12 (Revised in Dec 2012) required the disclosure of financial information of the company's associates in its financial statements. How can the company's auditor deal with the situations where only management accounts of the associates (assume material to the group) are available and no audited financial statements are available? How about both management accounts and audited financial statements are not available? Does the company's auditor need to issue a qualified opinion or just remark in disclosure paragraph?

Answer

As defined in paragraph 9 of HKSA 600 (Clarified) "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)", a "component" is an entity or business activity for which group or component management prepares financial information that should be included in the group financial statements.

It is stated in paragraph 11 that the group engagement partner is responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and applicable legal and regulatory requirements, and whether the auditor's report that is issued is appropriate in the circumstances. As a result, the auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. It is further explained in paragraph A8 that although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings, conclusions or opinions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.

As explained in paragraph A9, when the group audit opinion is modified because the group engagement team was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Modification paragraph in the auditor's report on the group financial statements describes the reasons for that inability without referring to the component auditor, unless such a reference is necessary for an adequate explanation of the circumstances.

Paragraph 26 also states that for a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on its behalf, shall perform an audit of the financial information of the component using component materiality.

Members may also refer to the Financial and Auditing Alert, No. 17 "Audits of group financial statements – HKSA 600" and No.18 "Documentation requirements for group auditors and practical implications for auditor regulation in Hong Kong" issued by the Institute for further information. The link to the Financial and Auditing Alerts is: <http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/financial-and-auditing-alert/> .



Question 4 – For a corporate practice, when signing an auditor's report, does the signature in the auditor's report need to be the same as the specimen signature which previously filed with the Institute?

Answer

As stated in footnote 20a of HKSA 700 (Clarified) "Forming an Opinion and Reporting on Financial Statements", for a corporate practice, the auditor's report is signed by a director of the practice, who must be a professional accountant holding a current practising certificate. The auditor's report states the name of the corporate practice and the location of its office and is signed in the name of the corporate practice. The auditor's report also identifies the director responsible for the performance of the audit engagement contemplated by such report, and states his/her full name as appearing in his/her practising certificate and the practising certificate number. It is not a mandatory requirement for the holder of a practising certificate to file specimen signature for signing audit reports with the Institute.

Question 5 – According to paragraph 13 of HKSA 710 (Clarified) "Comparative Information—Corresponding Figures and Comparative Financial Statements", it states that,

If the financial statements of the prior period were audited by a predecessor auditor and the auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:

(a) That the financial statements of the prior period were audited by the predecessor auditor;

(b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and

(c) The date of that report. (Ref: Para. A7).

In Hong Kong, is there any specific prohibition by law or regulation from referring to the predecessor auditor's report on the corresponding figures? If yes, where to find them?

Is there any further elaboration on the meaning of "referring" to the predecessor auditor's report on the corresponding figures? If in performing the audit procedure mentioned in paragraph 7.(a) of HKSA 710, the comparative information is checked to the amounts and other disclosures presented in the prior period's audited financial statements, is it a kind of "referring"?

Answer

In Hong Kong, the submission of statutory financial statements of Hong Kong incorporated companies to regulatory bodies (e.g. Company Registry, Inland Revenue Authority, etc) are made in accordance with the Hong Kong Companies Ordinance in general. In this regard, we are not aware that there is such prohibition in the Hong Kong Companies Ordinance.



As stated in paragraph A7 of HKSA 710, an illustrative example of the auditor's report if the prior period financial statements were audited by a predecessor auditor and the auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures is contained in Illustration 3 of the Appendix. In Illustration 3, the example wording under "Other Matter" paragraph is:

"Other Matter

The financial statements of the Company for the year ended 31 December 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1."

Paragraph 7 sets out the requirements for the auditor to perform audit procedures to determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified.

Question 6 – What are the requirements for an engagement quality control reviewer?

Answer

The requirements for engagement quality control review are set out in paragraphs 35 – 44 of HKSQC 1 (Clarified) "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements". In particular, paragraphs 39 - 41 and A47 - A50 provide guidance on the criteria for the eligibility of engagement quality control reviewers.

Paragraph 39 requires that the firm shall establish policies and procedures to address the appointment of engagement quality control reviewers and establish their eligibility through:

- (a) The technical qualifications required to perform the role, including the necessary experience and authority; and
- (b) The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.

The firm is also required to establish policies and procedures designed to maintain objectivity of the engagement quality control reviewer. The firm's policies and procedures shall provide for the replacement of the engagement quality control reviewer where the reviewer's ability to perform an objective review may be impaired.

Members are also referred to HKSA 220 (Clarified) "Quality Control for an Audit of Financial Statements". Paragraphs 19 to 22, A23 to A31 provide guidance on engagement quality control review. These paragraphs are for audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required.



Question 7 – Is there any standard regulating the number of years for keeping the audit evidence?

Answer

The requirements for the retention period of engagement documentation are set out in HKSQC 1 (Clarified) "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements". It is stated in paragraph 47 that the firm shall establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.

Further guidance is given in paragraphs A60 and A61, the needs of the firm for retention of engagement documentation, and the period of such retention, will vary with the nature of the engagement and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements.

In the specific case of audit engagements, the retention period would ordinarily be no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report.

Question 8 – Are electronic working papers and review signatures being acceptable as audit evidence?

Answer

As defined in paragraph 6 of HKSA 230 (Clarified) "Audit Documentation", "Audit file" is one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

The requirements for engagement documentation are set out in paragraphs 45 – 47 of HKSQC 1 (Clarified) "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements". It is stated in paragraph 46 that the firm shall establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.

Paragraphs A57 and A58 provides further guidance on the controls that the firm may designs and implements to avoid unauthorized alteration or loss of engagement documentation; and to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.



Question 9 – In Practice Note 810.1 "Insurance Brokers - Compliance with the Minimum Requirements specified by the Insurance Authority under Sections 69(2) and 70(2) of the Insurance Companies Ordinance", Appendix 1 lists out the objectives and recommended procedures for the purpose of reporting on compliance with the Minimum Requirements.

Under 2. Professional indemnity insurance, the recommended procedure for objective (iii) is to obtain the latest audited financial statements and determine whether the deductibles exceed the broker's net asset value. What is the meaning of "deductibles"?

Under 3. Keeping of separate client accounts, the recommended procedure for objective (ii) is to obtain documentary evidence of the notification and acknowledgement to determine whether it is sufficient for the provisions of section 71. To what extent of audit evidence / documentation that the members need to obtain to complete this required recommended procedure, e.g. Is there a need to send a formal letter to the financial institution? If yes, send by which party (auditor or client)? Are there any sample letters?

Under 3. Keeping of separate client accounts, one of the recommended procedures for objective (iii) is to test reconciliations between the monies in the client account and the insurance broking debtors and creditors (at an individual client level), on a sample basis. Refer to an individual client level, does it mean the insurance broker should keep separate accounting records for each individual client or keep as a whole with detailed client's breakdown?

Answer

Regarding the meaning of "deductibles" under item 2.(iii) in Appendix 1, the term "deductibles" is not defined in PN 810.1. But it generally means the amount of the claim that the insured must pay before the insurance cover will operate. Sometimes it is called an "Excess". Sometimes this deductible is imposed by insurers because of the nature of the risk and in other cases it is voluntary and premium reduction can be allowed.

For item 3.(ii), members are referred to paragraph 19 of PN 810.1 which states that there should also be evidence that the provisions of section 71 have been notified to and acknowledged by the financial institution with which the "client account" is maintained. In circumstances where the financial institution has not acknowledged the receipt of the provisions of section 71, evidence that the provisions of section 71 have been notified should still be maintained. In addition there should be evidence that the financial institution has provided the insurance broker with information (as evidence that the financial institution has acted on the provisions of section 71).

Generally, documentary evidence such as bank statements and correspondence from the bank are expected. Our understanding is that some banks are reluctant to acknowledge receipt of the provisions of section 71. Hence, the bank should be able to provide some form of correspondence with the relevant information such as name of the financial institution, name of the insurance broker and names and account number of client accounts maintained at the financial institution with word "client account" clearly stated. It is not expected that the auditor performs additional external confirmation.



For item 3(iii), members should refer to paragraph 21 of PN 810.1 where it says, based on the legal advice obtained by the Insurance Authority, section 71 only requires the insurance broker to keep client monies in a bank account separate from his own monies and not to use client monies for any purpose other than for the purposes of the clients, the law does not require insurance broker to keep separate accounts for individual clients. Although the Insurance Companies Ordinance does not require insurance brokers to keep separate accounts for individual clients, it is of utmost importance that the broker maintains records of the balances due from/to individual clients and reconciles these balances (on a client by client basis) sufficiently regularly to ensure client monies are properly kept in client accounts (see section 3 "Keeping of separate client accounts of Appendix 1). While it is management's responsibility to ensure that balances due from/to individual clients are reconciled sufficiently regularly, the auditor should base on the size and complexity of the broker's operations and use professional judgement when assessing this.

Question 10 – In Practice Note 840 "The Audit of Solicitors' Accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules", there is a requirement to circularize client accounts on a test basis as stated in point 12 of Appendix 2. Is there any requirement to circularize client accounts for balances at two different dates? For example: for year-end balance and a random date during the year.

Answer

There is no explicit requirement to have the client accounts ledger balances circularized at two different dates, only the obtaining of bank confirmations at two dates. Appendix 2 is an indication of what is required by the Accountant's Report Rules (Rules); the extent of work to be done will be decided in the light of the systems examinations, any weaknesses revealed and any other available evidence. If anything is discovered which indicates that the Rules are not being complied with a more detailed examination will be necessary.

For more detailed guidance, members may refer to "Questions and Answers on the Seminar on Solicitors' Accounts Rules and Practice Note 840 Reporting Engagements held on 24 July 2009" posted at the Institute's website: http://www.hkicpa.org.hk/file/media/section6_standards/technical_resources/pdf-file/tech-bulletin/qa-sar-pn840.pdf.