

## **Circular on Reporting to Grantees of the Language Fund**

**This Circular is intended to be used as general guidance for practising members of the Hong Kong Institute of Certified Public Accountants (Institute). The Institute DOES NOT accept any responsibility or liability, and DISCLAIMS all responsibility and liability, in respect of the Circular and any consequences that may arise from any person acting or refraining from action as a result of any materials in the Circular.**

### **A. Introduction**

1. Pursuant to the Grant Agreement made between the Permanent Secretary for Education Incorporated ("Grantor") and the Grantee in respect of each Language Fund ("LF") sponsorship project with grant not exceeding \$1,000,000, the Grantee is required to prepare "project accounts" (containing the Income and Expenditure Statement, Balance Sheet and Notes, and an independent auditor's report on them) with unaudited supplementary information appended to the project accounts and a report of factual findings in connection with the internal controls of the Grantee in respect of each project upon completion or termination. The Grantee is required to submit an independent auditor's report on the "project accounts" and a report of factual findings in connection with the internal controls established by the Grantee within three months upon completion of the project or the date of termination. The Grantee is required to appoint a practising member to perform such engagements.
2. The objectives of such engagements are for the auditor:
  - a) to express an audit opinion on whether the project accounts are prepared, in all material respects, in accordance with the LF financial reporting requirements as set out in the "Language Fund Accounting Policies"; and
  - b) to issue a report of factual findings in connection with the internal controls established by the Grantee.
3. The purpose of this Circular is to provide guidance to practising members when undertaking such engagements.

### **B. Audit of the project accounts**

4. The Institute's Auditing and Assurance Standards Committee (AASC), in consultation with the LF, has determined that the project accounts are special purpose financial statements (i.e. financial statements prepared in accordance with a special purpose framework). Therefore, Hong Kong Standard on Auditing (HKSA) 800 (Revised), *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* applies to the audit of these project accounts.
5. According to paragraph 6(b) of HKSA 800 (Revised), a special purpose framework is a financial reporting framework designed to meet the financial

information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.

6. The accounting requirements set out in the Language Fund Accounting Policies, as they currently stand, do not conform to all HKFRSs, and consist primarily of a list of specific rules and conventions to be applied, and disclosures to be made for the purpose of monitoring the use of the grant(s) by the Grantee. Accordingly, with reference to paragraph 13(a) of HKSA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, such financial reporting framework is considered to be a compliance framework.
7. As explained in paragraph A13 of HKSA 200, where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the relevant framework applied.
8. Appendix 1 to this Circular contains an example independent auditor's report that is based on HKSA 800 (Revised). The reporting requirements are effective for audits of financial statements of the projects with applications being granted on or after 25 June 2015 with completion dates of the projects ending on or after 15 December 2016.
9. Auditors are reminded that the attached example audit report is illustrative only and that they would need to use their professional judgment to ascertain the exact circumstances of each audit engagement. There may be circumstances that result in a modified opinion or the need to add emphasis of matter paragraphs. In such circumstances, the example audit reports will need to be modified to reflect the auditor's opinion in accordance with HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* or HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

### **C. Report of Factual Findings**

10. The objective of the report of factual findings is set out in paragraph 2(b) above. In consultation with the LF, it has been determined that an agreed-upon procedures engagement conducted in accordance with Hong Kong Standard on Related Services 4400 *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information* and the guidance provided in this Circular would generally be suitable for this reporting.
11. The Grantee is required to adhere to the LF General Guidelines and to establish appropriate internal controls for the approved items stipulated in Schedule I to the Grant Agreement. The main internal controls expected to be implemented by Grantees are set out in the LF's "Summary on Internal Controls for Language Fund Sponsorship Projects".
12. The specific procedures on internal controls established will vary from Grantee to Grantee. An auditor shall discuss and agree with the Grantee the relevant procedures to be performed on the internal controls identified in the LF's

"Summary on Internal Controls for Language Fund Sponsorship Projects".

13. As the auditor simply provides a report of the factual findings of agreed-upon procedures, no assurance is expressed. Instead, the users of the report assess for themselves the procedures and findings reported by the auditor and draw their own conclusions as to whether the internal controls established by the Grantee are, in all material respects, in accordance with the terms and conditions of the Grant Agreement.
14. The terms and conditions of the grant are contained in the Grant Agreement Documents which consist of:
  - a) the Grant Agreement (the project proposal, the approved budget and the LF General Guidelines are incorporated); and
  - b) all instructions and correspondences issued by the LF to the Grantee in respect of the project.
15. In case of any ambiguity regarding the terms and conditions of the grant that has a significant effect upon the auditor's reporting on the subject matters, the auditor should seek clarification from the LF.
16. Appendix 2 to this Circular contains an example report of factual findings that is based on HKSRS 4400. The auditor is reminded that it provides an illustrative example only. The auditor is required to agree with the Grantee on the actual procedures specific to the Grantee. This report should be submitted together with the independent auditor's report on the project accounts and the reporting requirements are effective for audits of financial statements of the projects with applications being granted on or after 25 June 2015.

## **Conclusion**

17. The Institute may issue further guidance where appropriate as a result of any developments arising from discussions with the LF.
18. The AASC welcomes your comments and feedback, which should be sent to the Standard Setting Department at: [commentletters@hki CPA.org.hk](mailto:commentletters@hki CPA.org.hk).

Date of Circular: 20 October 2016

## APPENDIX 1

### Example Independent Auditor's Report

#### **Based on HKSA 800 (Revised), *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks***

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- The financial statements have been prepared by the Grantee in accordance with the financial reporting requirements of the LF. Grantee does not have a choice of financial reporting frameworks. The Grantee is responsible to treat the project's assets and liabilities in accordance with the requirements as set out in the "Language Fund Accounting Policies" issued by the LF, where going concern is considered not relevant as the grant is a one off in nature for the Grantee to carry out a non-recurrent project.
- The applicable financial reporting framework is a compliance framework.
- The terms of the audit engagement reflect the description of Grantee's responsibility for the financial statements in HKSA 210.<sup>1</sup>
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Distribution and use of the auditor's report are restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>2</sup>
- The auditor has determined that there is no other information (i.e., the requirements of HKSA 720 (Revised)<sup>3</sup> do not apply).
- Those responsible for oversight of the financial reporting process differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law or regulation.

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

<sup>2</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>3</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*.

## INDEPENDENT AUDITOR'S REPORT

To the [Management]<sup>4</sup> of [Name of Organisation]<sup>5</sup> ("Grantee")

### Opinion

We have audited the financial statements of ABC Project ("Project") set out on pages ..... to....., which comprise the balance sheet as at [Completion Date] and the income and expenditure statement for the period from [Commencement Date] to [Completion Date], and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements of the Project for the period from [Commencement Date] to [Completion Date] are prepared, in all material respects, in accordance with the financial reporting requirements of the Language Fund ("LF") as set out in its "Language Fund Accounting Policies".

### Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing (HKSA's) issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Grantee in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Emphasis of Matter - Basis of Accounting and Restriction on Distribution and Use

We draw attention to Note 1 to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Grantee in complying with the financial reporting requirements of the LF. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the Grantee and the LF and should not be distributed to or used by parties other than the Grantee or the LF<sup>6</sup>. Our opinion is not modified in respect of this matter.

### Other Matter

We have not performed any audit procedures to verify the authenticity of the supplementary and unaudited information provided by [management]<sup>4</sup> of the Grantee in the financial statements.

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<sup>4</sup> The addressee should be the management body of the organization, e.g. Board of Directors, Trustees.

<sup>5</sup> The organization should be the one defined as the Grantee in the Agreement.

<sup>6</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

## **Responsibilities of [Management]<sup>4</sup> and Those Charged with Governance for the Financial Statements<sup>7</sup>**

[Management]<sup>4</sup> of the Grantee is responsible for the preparation of the financial statements in accordance with the financial reporting requirements of the LF, as set out in its "Language Fund Accounting Policies", and for such internal control as [management]<sup>4</sup> determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Those charged with governance are responsible for overseeing the Grantee's financial reporting process.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Grantee's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by [management]<sup>4</sup>.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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<sup>7</sup> Throughout this illustrative auditor's report, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

XYZ & Co.

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

[Auditor Address]

[Date]

**Example paragraph for notes to the financial statements**

**Basis of preparation**

- 1 These financial statements have been prepared in accordance with the financial reporting requirements as set out in the "Language Fund Accounting Policies" issued by the LF.
- 2 The significant accounting policies are set out below:

## APPENDIX 2

### Example Report of Factual Findings

#### **Based on HKRSR 4400 *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information***

#### **REPORT OF FACTUAL FINDINGS**

To the [Management]<sup>8</sup> of [Name of Organisation]<sup>9</sup> ("Grantee")

We have performed the procedures agreed with you and enumerated below with respect to the internal controls established by the Grantee for ABC Project ("Project") during the period from [Commencement Date] to [Completion Date].

Our engagement was undertaken in accordance with the Hong Kong Standard on Related Services 4400, "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). The procedures were performed solely to assist you in evaluating the internal controls established by the Grantee in accordance with the terms and conditions of the Grant Agreement entered into with the Language Fund ("LF") and are summarized as follows:

Procedures	Factual Findings	[Exceptions]
1. We obtained the Project Operation Manual (OM) from the Grantee and discussed with [specify the title of management] whether the policies and procedures have been established for: <ul style="list-style-type: none"> <li>• expenditure</li> <li>• cash and bank</li> <li>• procurement</li> <li>• staffing and recruitment</li> <li>• non-financial assets handling</li> <li>• disclosure of conflicts of interest</li> </ul>	1. We obtained the OM from the Grantee and understood that the Grantee [has / has not yet] established formal policies and procedures. An extraction of the procedures is appended to this Report.	<i>[Detail the exceptions.]</i>

<sup>8</sup> The addressee should be the management body of the organization, e.g. Board of Directors, Trustees.

<sup>9</sup> The organization should be the one defined as the Grantee in the Agreement.

<b>A. Internal Controls on Expenditure</b>		
<p><i>[Select the relevant procedures from the extracted OM covering expenditure and describe the procedures performed.] Examples provided below are for reference only</i></p> <p>2. [For a sample of [number] expenditure invoices we checked whether the invoices are reviewed by [title of management] based on the supporting documents provided by the Grantee and we reported if the expenditure was made in accordance with the approved budget.]</p>	<p><i>[Describe the findings of the procedure]</i></p>	
<p>3. [We obtained a list of expenditure which exceeded the budget from the Grantee and checked whether these items are reviewed by [title of management] and we reported if there are any items with variances which exceeded the established limits.]</p>	<p><i>[Describe the findings of the procedure]</i></p>	
<p>4. [For a sample of [number] expenditures we checked whether the goods are received or services are rendered before making payments based on the supporting documents provided by the Grantee.]</p>	<p><i>[Describe the findings of the procedure]</i></p>	

<p>5. [For a sample of [number] expenditures we checked whether the accounting entries in the ledger are made in accordance with section [ ] of the OM and the supporting documents.]</p>	<p><i>[Describe the findings of the procedure]</i></p>	
<p><b>B. Internal Controls on Cash and Bank</b></p>		
<p>6. We sighted [bank statements/bank passbook/] to check whether a separate bank account was established for keeping and operating the LF grant; and a separate account in the accounting system was set up for recording the grant expenditures and receipts of the Project.</p>	<p>6. We found that there was a separate bank account established for keeping and operating the LF grant; and a separate account in the accounting system was set up for recording the grant expenditures and receipts of the Project.</p>	
<p>7. <i>[Select the relevant procedures from the extracted OM covering bank reconciliation and describe the procedures performed.]</i></p>	<p><i>[Describe the findings of each of the procedures]</i></p>	
<p>8. <i>[Select the relevant procedures from the extracted OM covering cash payments and describe the procedures performed.]</i></p>	<p><i>[Describe the findings of each of the procedures]</i></p>	
<p><b>C. Internal Controls on Procurement</b></p>		
<p>9. <i>[Select the relevant procedures from the extracted OM covering Staff Administration and Procurement Matters and describe the procedures performed.]</i></p>	<p><i>[Describe the findings of each of the procedures]</i></p>	

10. <i>[Select the relevant procedures from the extracted OM covering the outsourcing of services to Grantee/Project team members or their direct relatives and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	
11. <i>[Select the relevant procedures from the extracted OM covering the maintenance of procurement documentation and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	
<b>D. Internal Controls on Staffing and Recruitment</b>		
12. <i>[Select the relevant procedures from the extracted OM covering the staffing of the Project and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	
13. <i>[Select the relevant procedures from the extracted OM covering the recruitment process and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	
14. <i>[Select the relevant procedures from the extracted OM covering the granting of award in the form of cash allowance to the Project leader or the principal investigator and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	
<b>E. Internal Controls on Non-Financial Assets Handling</b>		
15. <i>[Select the relevant procedures from the</i>	<i>[Describe the findings of</i>	

<i>extracted OM covering the identification of non-financial assets purchased for the Project and describe the procedures performed.]</i>	<i>each of the procedures]</i>	
16. <i>[Select the relevant procedures from the extracted OM covering the recording of non-financial assets acquired and disposed on the "Assets Register" and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	
<b>F. Other Internal Controls</b>		
17. <i>[Select the relevant procedures from the OM covering the submission of financial information and describe the procedures performed.]</i>	<i>[Describe the findings of each of the procedures]</i>	

Because the above procedures do not constitute an assurance engagement made in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the HKICPA, we do not express any assurance on the internal controls established by the Grantee. We have not performed any additional procedures to verify the authenticity of any information provided by you to us.

Had we performed additional procedures or had we performed an assurance engagement in respect of the internal controls established by the Grantee during the period from [Commencement Date] to [Completion Date] in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the second paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties, except that we agree that a copy of this report may be provided to the LF. We expressly disclaim any liability or duty to any other party for the content in this report. This report relates only to the items specified above and does not extend to any financial statements of [Name of Organisation], taken as a whole.

XYZ & Co.

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

Hong Kong

Date

\* Delete as appropriate