

Circular on Reporting on the Audit of Schools

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A. Introduction

1. There are different types of schools in Hong Kong, such as aided schools, Direct Subsidy Scheme (DSS) schools, government schools and private schools. The schools may be managed by an Incorporated Management Committee (IMC), established under section 40BN or 40BX of the Education Ordinance in respect of the school, or a non-incorporated management committee (referred to as non-IMC hereafter). There are different accounting and reporting requirements for different types of schools.
2. The purpose of this Circular is to provide guidance to auditors in relation to audits of financial statements of aided and DSS schools (irrespective of whether they are IMC or non-IMC schools), which are required to comply with the accounting requirements of the Education Bureau (EDB). This guidance is not applicable to the audit of aided and DSS schools with management committees incorporated under the Hong Kong Companies Ordinance, or who themselves are incorporated under the Hong Kong Companies Ordinance, as their financial statements are required to comply with the Hong Kong Companies Ordinance and they should be prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs).

Requirements applicable to IMC schools

3. In accordance with subsection (1) of section 40BB of the Education Ordinance (EO), an IMC shall:
 - (a) maintain proper books of account and other financial and accounting records as stipulated in –
 - (i) the code of aid for primary schools, the code of aid for secondary schools or the code of aid for special schools (as may be applicable)¹; or
 - (ii) such instructions as may be given by the Permanent Secretary for Education for the purposes of this paragraph from time to time;

¹ The code of aid specifically applicable to an aided IMC school is Code of Aid for Aided Schools.

- (b) cause to be prepared for each accounting year of the committee statements of the accounts of the committee; and
 - (c) submit the statement of accounts to the Permanent Secretary for Education at such time and in such manner as the Permanent Secretary for Education may specify.
4. In accordance with subsection (4) of section 40BB of the EO, the auditor appointed by the IMC under subsection (3) of section 40BB of the EO shall:
- (a) audit the accounts prepared under subsection (1) of section 40BB of the EO;
 - (b) report as to -
 - (i) whether such account and balance sheet present fairly the financial transactions of the IMC during the accounting year to which the account and balance sheet relate; and
 - (ii) the financial position of the IMC at the end of that year, subject to such qualification (if any) as he thinks fit;
 - (c) submit the report to the Permanent Secretary for Education at such time as the Permanent Secretary for Education may specify;
 - (d) be entitled to require such information and explanations as he considers necessary for discharging his duties; and
 - (e) comply with such directions as may be given by the Permanent Secretary for Education for the purposes of this paragraph from time to time.

Additional EDB reporting requirements applicable to both IMC and non-IMC schools

5. In addition to the above requirements in the EO, the EDB issues circular memoranda and reference notes for auditors for both IMC and non-IMC schools (both aided and DSS schools) regarding the auditor's reporting requirements, which also require auditors to state in their reports whether in their opinion the school financial statements give a true and fair view of (or present fairly) the state of the school's affairs as at the accounting year end date and of its results for the accounting year then ended. The EDB issues reporting requirements from time to time and the auditor should obtain a complete list of relevant reporting requirements from the School.

B. Compliance with the accounting requirements of the EDB

6. It has been identified by the Institute's Auditing and Assurance Standards Committee (AASC), in consultation with the EDB, that financial statements of aided and DSS schools 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 schools' financial statements.
7. 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.
8. The accounting requirements of the EDB, 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 government subventions by schools. 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.
9. As explained in paragraph A13 of HKSA 200, where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the HKSAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. 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 framework.
10. In accordance with the requirements of the EO and EDB as stated in paragraphs 4 and 5 above respectively, the auditors of schools are to provide a "present fairly" opinion or a "true and fair view" opinion. However, as explained in paragraph 8 above, because the financial reporting framework used by schools is a compliance framework, the auditor is unable to state whether the school's financial statements "present fairly" or provide a "true and fair view".
11. In this regard, the AASC, together with the EDB, have developed a two-part report to address the relevant reporting requirements, within the constraints of HKSAs. The first part of the report would address whether the financial statements "present fairly" in accordance with HKFRSs or give a "true and fair view" in accordance with HKFRSs. The second part of the report would state whether the financial statements "are prepared, in all material respects, in accordance with" the requirements set by the EDB.

12. The Appendix to this Circular contains an example Independent Auditor's Report ("audit report") that is based on HKSA 800 (Revised) (which is effective for audits of financial statements for periods ending on or after 15 December 2016). In general, the financial year end of schools is 31 August, thus the revised reporting requirements are effective for audits of financial statements for years beginning on or after 1 September 2016 and ending on or after 31 August 2017.
13. The example audit report in the Appendix illustrates a "disclaimer" of opinion with respect to whether the financial statements "present fairly" or "give a true and fair view of" the financial transactions in accordance with HKFRSs and an unqualified opinion with respect to the EDB's requirements. The "disclaimer" of opinion is based on the premise that auditors cannot express an opinion on the financial statements as to whether they present fairly or give a true and fair view of the financial transactions of the school as the financial statements of the school have not been prepared in accordance with HKFRSs and the IMC or non-IMC has not quantified the departures of the financial statements from HKFRSs and it is not practical for the auditor to quantify these departures.
14. If the auditor is of the opinion that proper books of accounts have not been kept by the school, or if the balance sheet and income and expenditure account are not in agreement with the books of accounts, or if the auditor fails to obtain all the information and explanations which, to the best of their knowledge and belief, are necessary for the purpose of their audit, they should make appropriate qualifications in their reports. An example of the potential qualification wording is included in the example audit report in the Appendix.
15. 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, other than non-compliance with HKFRSs, that may 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. Conclusion

16. The Institute and the AASC may issue further guidance where appropriate as a result of any developments arising from discussions with the EDB.
17. The AASC welcomes your comments and feedback, which should be sent to commentletters@hki CPA.org.hk, for the attention of the Standard Setting Department.

Date of Circular: 20 October 2016

APPENDIX

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 management committee of the school in accordance with the accounting requirements of the EDB (that is, a special purpose framework). Management committee does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in HKSA 210.¹
- The auditor has concluded an unmodified (i.e., "clean") opinion on compliance with the accounting requirements of the EDB is appropriate based on the audit evidence obtained.
- The management committee has referred to the EDB's accounting requirements rather than Hong Kong Financial Reporting Standards ("HKFRSs") when preparing the financial statements, where it is not practicable for the auditor to quantify the departures of the financial statements from HKFRSs. (i.e., a disclaimer of opinion on compliance with HKFRSs is appropriate).²
- 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*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).³
- 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 701.⁴
- The auditor has determined that there is no other information (i.e., the requirements of HKSA 720 (Revised)⁵ do not apply).
- Those responsible for oversight of the financial reporting process differ from those responsible for the preparation of the financial statements.⁶

¹ HKSA 210, *Agreeing the Terms of Audit Engagements*

² Consideration should be given to other types of opinion (e.g. adverse, except for or unqualified opinion) in other instances depending on the circumstances. The Basis for Disclaimer of Opinion and Opinion wordings may need to be aligned with the requirements of the EDB issued from time to time. If there are new reporting requirements issued by the EDB, the auditor needs to consider the implications to the audit report and include additional audit procedures as appropriate.

³ HKSA 570 (Revised), *Going Concern*

⁴ HKSA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*

⁵ HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

⁶ HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraphs 35 and A44

- The auditor has other reporting responsibilities required according to the circulars issued by the EDB.

INDEPENDENT AUDITOR'S REPORT

To the [Incorporated][School]⁷ Management Committee of ABC School

Report on the Audit of the Financial Statements⁸

Opinion

We have audited the financial statements of ABC School ("the School") set out on pages to....., which comprise the [balance sheet][statement of financial position]⁹ as at [year end date of the financial statements] and the [income statement][statement of comprehensive income]⁹ for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Compliance with Hong Kong Financial Reporting Standards – Disclaimer of Opinion

Because of the significance of the matter described in the *Basis for Disclaimer of Opinion on Compliance with Hong Kong Financial Reporting Standards* section of our report, we do not express an opinion on the financial statements as to whether they [present fairly][give a true and fair view of]¹⁰ the financial transactions of the School during the year ended [year end date of the financial statements] in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

Compliance with the accounting requirements of the EDB

In our opinion:

- (i) the financial statements are prepared, in all material respects, in accordance with the accounting requirements of the [Code of Aid,]¹¹ relevant letters, circulars and guidelines issued by the EDB and such instructions as may be given by the Permanent Secretary for Education and reflect the financial transactions of the School during the year ended [year end date of the financial statements] and the financial position of the School as at [year end date of the financial statements];
- (ii) during the year ended [year end date of the financial statements], the School has used the government [subventions][subsidies]¹² in accordance with the

⁷ Use "Incorporated Management Committee" for management committee incorporated under the Education Ordinance or "School Management Committee" for non-incorporated management committee.

⁸ The sub-title "Report on the Audit of the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

⁹ Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

¹⁰ Use "present fairly" for schools managed by Incorporated Management Committee as stated in the Education Ordinance or "give a true and fair view of" for schools managed by Non-incorporated Management Committee as stated in the circulars issued by the EDB.

¹¹ Applicable to aided schools only.

¹² "Subventions" is used for aided schools and "subsidies" is used for DSS schools.

rules and ambits of the government grants as promulgated in [the Code of Aid,]¹¹ the relevant letters, circulars and guidelines issued by the EDB; and

- (iii) the balances of individual grant accounts as at [year end date of the financial statements] are, in all material respects, correct.

Basis for Opinion

Basis for Disclaimer of Opinion on Compliance with Hong Kong Financial Reporting Standards

In accordance with the agreed terms of engagement, our responsibility is to consider whether the financial statements have been properly prepared in accordance with the EDB's [Code of Aid and its]¹¹ related accounting instructions. The [IMC][SMC] has referred to the EDB's accounting requirements rather than HKFRSs when preparing the financial statements, and has not quantified the departures of these financial statements from HKFRSs. As it is not practicable for us to quantify the departures, we are unable to fulfil our other responsibility to opine as to whether the financial statements [present fairly][give a true and fair view of]¹⁰ the financial transactions of the School.

Basis for Opinion on Compliance with the accounting requirements of the EDB

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") issued by the 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 School 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 audit opinion on compliance with the accounting requirements of the EDB.

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 which has been designed to meet the requirements of the EDB and accordingly is not intended to [present fairly][give a true and fair view of]¹⁰ the financial transactions of the School in accordance with HKFRSs, or any other framework designed to provide fair presentation. The financial statements are prepared to assist the School to meet the requirements of the EDB. As a result, the financial statements may not be suitable for another purpose¹³. Our opinion is not modified in respect of this matter.

¹³ 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 [Incorporated][School] Management Committee and Those Charged with Governance for the financial statements

The [IMC][SMC] of the School is responsible for the preparation of the financial statements in accordance with the accounting requirements of the EDB, which require the financial statements to be prepared in accordance with its [Code of Aid and other]¹¹ related accounting instructions, and for such internal control as the [IMC][SMC] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the [IMC][SMC] is responsible for assessing the School's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the [IMC][SMC] either intends to liquidate the School or to cease operations, or has no realistic alternative but to do so.

In addition, the [IMC][SMC] is responsible to ensure the School has used the government [subventions][subsidies]¹² in accordance with the applicable rules issued by the EDB and the correctness of the balances of individual grant accounts.

Those charged with governance are responsible for overseeing the School's financial reporting process.⁶

Auditor's Responsibilities for the Audit of the Financial Statements

Compliance with Hong Kong Financial Reporting Standards

Our responsibility is to conduct an audit of the School's financial statements in accordance with HKSAs issued by the HKICPA and to issue an auditor's report. However, because of the matter described in the *Basis for Disclaimer of Opinion on Compliance with Hong Kong Financial Reporting Standards* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements on compliance with Hong Kong Financial Reporting Standards.

Compliance with the accounting requirements of the EDB

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 HKSAs 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. In addition, we are also engaged to report as to whether the School has used the government [subventions][subsidies]¹² in accordance with the applicable rules issued by the EDB and whether the balances of individual grant accounts are, in all material respects, correct.

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSA's expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

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 School's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the [IMC][SMC].
- Conclude on the appropriateness of the [IMC][SMC]'s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the School's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the School to cease to continue as a going concern.

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.

In forming our opinion on the use of government [subventions][subsidies]¹², our opinion thereon was based on the evidence obtained during the course of our audit of the financial statements, and when reporting on the balances of individual grant accounts, we report as to whether they are, in all material respects, correct in so far as the balances agree to the books and records made available to us.

Report on Other Legal and Regulatory Requirements

[In respect of [describe the nature], in our opinion, [certain books of accounts have not been kept by the School,] [the balance sheet and income statement are not in agreement with the books of accounts];

In respect of [describe the nature], we have not obtained all the information and explanations that we considered necessary for the purpose of our audit.]¹⁴

XYZ & Co.

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

[Auditor address]

[Date]

¹⁴ According to the circulars issued by the EDB, the auditors are also required to report by exception if they are unable to satisfy themselves regarding the above.

Example paragraph for notes to the financial statements

Basis of preparation

- 1 These financial statements have been prepared in accordance with the accounting requirements of [the Code of Aid,]¹¹ the relevant letters, circulars and guidelines issued by the EDB.
- 2 The significant accounting policies are set out below: