



June 2011

To: **Members of the Hong Kong Institute of CPAs**
All other interested parties

**INVITATION TO COMMENT ON EXPOSURE DRAFT ON
REVISED PRACTICE NOTE 600.1 *REPORTS BY AUDITORS*
*UNDER THE HONG KONG COMPANIES ORDINANCE***

Comments to be received by 31 July 2011

The Hong Kong Institute of Certified Public Accountants' (Institute) Auditing and Assurance Standards Committee (AASC) is seeking comments on the Exposure Draft which has been posted on the Institute's website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/auditing-assurance/exposure-drafts/>.

The AASC has embarked on a project to align the extant Practice Notes (PN) with the development of the auditing and assurance pronouncements recently issued. As part of the project, the proposed revised PN 600.1 has been updated to align with the relevant assurance pronouncements such as clarified Hong Kong Standards on Auditing (HKSA) and Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" (HKSAE 3000).

The key revisions are:

- References have been revised to reflect the clarified HKSA;
- Additional guidance in regards to the auditor's reporting on distributions and redemption or purchase of own shares (paragraphs 33 – 43 and Appendix 1);
- Elevation of guidance in Industry Guideline 3.406 *Banks and Deposit-Taking Companies – The Amended Section 161B and Section 161BA of the Companies Ordinance* to revised PN 600.1 (paragraphs 44 – 54 and Appendix 2);
- Examples 1.1 and 1.2 of Appendix 1 have been revised to align with HKSAE 3000;
- Example 1.3 of Appendix 1 has been revised to align with the clarified HKSA;
- Example 2.1 of Appendix 2 has been revised to align with HKSAE 3000; and
- Examples 2.2 and 2.3 of Appendix 2 have been revised to align with clarified HKSA.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the Exposure Draft to be considered, comments on the exposure draft are requested by the due date shown above.



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

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

June 2011
Exposure Draft

Response Due Date
31 July 2011

ED of Proposed Revised PN 600.1

Reports by Auditors under the Hong Kong Companies Ordinance



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

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ED of Proposed Revised Practice Note 600.1 "Reports by Auditors under the Hong Kong Companies Ordinance"

This Exposure Draft may be filed in the "Exposure Drafts, Invitations to Comment" section of Volume III of the Institute Members' Handbook.

The Exposure Draft can also be found on the Institute's website at:

<http://www.hkicpa.org.hk/en/standards-and-regulations/standards/auditing-assurance/exposure-drafts/>.



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

PN 600.1
Issued December 1994; revised
September 2004; revised []

Practice Note 600.1

Reports by Auditors under the Hong Kong Companies Ordinance



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

PRACTICE NOTE 600.1
REPORTS BY AUDITORS UNDER
THE HONG KONG COMPANIES ORDINANCE

(Issued December 1994; revised September 2004 (name change); revised [] 2011)

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Practice Note (PN) 600.1 “Reports by Auditors under the Hong Kong Companies Ordinance” should be read in the context of the “Preface to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services” which sets out the application and authority of PNs.

PRACTICE NOTE
600.1
REPORTS BY AUDITORS UNDER
THE HONG KONG COMPANIES ORDINANCE

The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.

Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.

Introduction

1. In this Practice Note all the sections mentioned below are in respect of the Hong Kong Companies Ordinance (Companies Ordinance) unless otherwise stated.
2. This Practice Note gives guidance on the application of Hong Kong Engagement Standards on reports by an auditor issued under the Companies Ordinance.

Requirement of auditors to report

3. An auditor of a company incorporated under the Companies Ordinance has a statutory duty to make a report to the members of the company on the company's annual financial statements.
4. Specifically, the auditor is required to report on every balance sheet and profit and loss account and on all group financial statements laid before the company in general meeting during the tenure of office.
5. The Companies Ordinance requires the auditor to state in the auditor's report whether, in the auditor's opinion, a true and fair view is given:
 - a. in the balance sheet, of the state of the company's affairs at the end of the accounting period;
 - b. in the profit and loss account (if not framed as a consolidated profit and loss account), of the company's profit or loss for the accounting period; and
 - c. in the case of group financial statements, of the state of affairs and profit or loss of the company and its subsidiaries dealt with by those financial statements.
6. In considering whether the financial statements give a true and fair view, it will be necessary for the auditor to take account, inter alia, of the financial reporting framework adopted. Reference should be made to paragraphs A13 of HKSA 200 in respect of compliance with relevant requirements.
7. As explained in paragraph A13 of HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," 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.

8. The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:
- a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
 - b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.
- The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in a. or b. above.
9. Normally, companies incorporated in Hong Kong prepare their financial statements in accordance with Hong Kong Financial Reporting Standards (HKFRSs). HKFRSs describe methods of accounting approved by the Council of the HKICPA for application to all financial statements intended to give a true and fair view.
10. The auditor is also required to state whether, in the auditor's opinion, the financial statements have been properly prepared in accordance with the provisions of the Companies Ordinance. In this context, the expression “properly prepared” includes compliance with the requirements of the Companies Ordinance with respect to the form and content of the balance sheet and profit and loss account and any additional information to be provided by way of notes to the financial statements, in addition to an overriding requirement that the financial statements should give a true and fair view.
11. An example auditor's report for a company incorporated in Hong Kong is included in Appendix – Illustration 1 of HKSA 700 “Forming an Opinion and Reporting on Financial Statements”. A suggested Chinese translation of an unqualified auditor's report based on HKSA 700 is provided on the HKICPA's website for reference.

Information required by the Companies Ordinance

12. In relation to the requirements of the Companies Ordinance, the auditor is concerned with the following matters in addition to the overriding requirement as to the true and fair view of the financial statements mentioned above:
- a. whether the financial statements comply with the sections of the Companies Ordinance dealing with the form and content of financial statements (sections 123, 125 and 126, together with the disclosure requirements set out in the Tenth Schedule);
 - b. whether the financial statements disclose certain information as follows:
 - i. directors' emoluments, pensions and compensation for loss of office (section 161); and
 - ii. loans to directors and officers (section 161B).

The auditor is required under the Companies Ordinance to provide in the auditor's report the information listed in b. above if it is not disclosed in the financial statements.

Exception reporting

13. The auditor is also required under the Companies Ordinance to report by exception if the auditor is unable to be satisfied that:
- a. proper books of account have been kept (section 141(4)(a));
 - b. proper returns adequate for the purposes of their audit have been received from branches not visited (section 141(4)(a));
 - c. the financial statements are in agreement with the books and the returns received from branches (section 141(4)(b)); and
 - d. they have obtained all the information and explanations which they considered necessary (section 141(6)).

The absence of any comment in the auditor's report in respect of these matters is equivalent to a positive affirmation by the auditors that they are satisfied with each of them. If they are not so satisfied, they must qualify their report.

14. In considering whether proper books of account have been kept, the auditor should assess whether the provisions of section 121 have been complied with. If the company has not kept such records, the auditor must qualify the auditor's report accordingly. In this situation the auditor will normally need to state in the auditor's report that:
 - a. the scope of the audit work was limited;
 - b. the auditor has not obtained all the information and explanations which the auditor considered necessary; and
 - c. the auditor was unable to determine whether proper books of account had been kept.

Dating of the auditor's report

15. The Companies Ordinance requires that, following the approval of financial statements by the board of directors, the balance sheet is signed by two of the directors of the company on behalf of the board. The auditor should not sign or date the auditor's report earlier than the date on which the complete financial statements were approved by the directors. The auditor shall sign and date the auditor's report on financial statements in accordance with paragraphs 40 and 41 of HKSA 700.

Auditor's reports on group financial statements

16. Under section 124, holding companies have to publish "group accounts" (subject to certain exemptions set out in the Companies Ordinance). "Group accounts" is an all embracing term covering the combination of the information shown in the financial statements of the holding company and its subsidiaries.
17. The report which the auditor is required to give on group financial statements necessitates the auditor stating:
 - a. whether the group financial statements have been properly prepared in accordance with the provisions of the Companies Ordinance; and
 - b. whether the group financial statements give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group.

The auditor should report on the financial statements of a holding company and on the relevant group financial statements in a single report. An example auditor's report for a company incorporated in Hong Kong submitting group financial statements is included in Appendix – Illustration 3 of HKSA 700.

18. The auditor of the holding company is required to report that the group financial statements have been audited in accordance with HKSAs. Thus, 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 HKSAs (e.g. ISAs or other local audit requirements or standards equivalent to HKSAs or ISAs) 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 HKSAs.
19. Relevant guidance for audit of group financial statements is included in HKSA 600 "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)".
20. The following additional guidance is given in respect of qualifications on group financial statements:
 - a. *holding company qualification affecting group financial statements*

When reporting on group financial statements, the auditor is required to report on the financial position of both the holding company and the group. When a qualification relates to both the holding company's own balance sheet and to the consolidated balance sheet, it will be unnecessary to distinguish between the holding company's financial position and the group's financial position. Where a qualification only relates to the holding company's own balance sheet but not to the consolidated balance sheet, or

vice versa, the opinion paragraph will have to be worded accordingly, and care should be taken to ensure that the opinion is expressed in clear and unequivocal terms.

b. *subsidiary company qualification affecting group financial statements*

Where the financial statements of a subsidiary contain a qualification which is not eliminated on consolidation and is material to the consolidated figures, it will be necessary to consider:

- i. whether the qualification affects the holding company's own balance sheet; and
- ii. whether it affects the consolidated balance sheet and the consolidated profit and loss account.

In either event the auditor's report on the group financial statements must be worded to include whatever reference is appropriate to the items which have been the subject of qualification. However, it is not adequate just to repeat the audit qualification of the subsidiary's financial statements.

c. *qualification of group financial statements only*

Even though the auditor's reports of individual group companies may be unqualified, if, in the auditor's opinion, the group financial statements as a whole do not give a true and fair view, it may be necessary to qualify the auditor's report on the group financial statements.

Example modified auditor's report on group financial statements can be found in Appendix – Illustration 2 of HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report".

Subsidiaries' and associated companies' financial statements audited by other auditors

21. The group auditor is fully responsible for the auditor's opinion on the group financial statements. In accordance with paragraph 11 of HKSA 600, the auditor's report on the group financial statements shall not refer to the fact that the financial statements of some subsidiaries or associated companies have been audited by other auditors. Further guidance is included in paragraph 11 of HKSA 600.
22. However, the directors of the holding company may consider it is useful to disclose the information that the financial statements of some of the companies in the group have been audited by other auditors and the materiality of those companies to the group. A common way to disclose this information is to include in the schedule of principal subsidiaries and associated companies, which of those companies have been audited by the other auditors. It is also useful to indicate thereon the significance to the group of the companies that have been so audited by reference to the amount of their assets, turnover or profits or losses before taxation.

Dates of financial statements of subsidiaries

23. In accordance with paragraph 37 of HKSA 600, if the group financial statements include the financial statements of a component with a financial reporting period-end that differs from that of the group, the auditor of the holding company shall evaluate whether appropriate adjustments have been made to those financial statements in accordance with the applicable financial reporting framework.
24. It will also be necessary to consider whether this affects the true and fair view. The following factors should be taken into account:
 - a. the significance of the proportion of the group represented by the subsidiaries not having coterminous year ends;
 - b. the length of the period between the subsidiary and holding company year ends;
 - c. whether significant movements have taken place between the two dates in either:
 - i. the subsidiaries' profits or losses, so as to affect the group results; or
 - ii. the subsidiaries' balance sheets, which might show abnormal movement in cash or other balances so as to affect the state of affairs of the group.

In cases where the subsidiaries represent a material part of the group and the subsidiaries' financial statements are drawn up to a date more than three months before the holding company year end, the auditor should consider whether the true and fair view is prejudiced and whether the auditor's report should be qualified accordingly.

Identification of financial statements audited

25. Frequently one or more of the following accompany the financial statements in the company's annual report:
- a. directors' report;
 - b. chairman's statement; and
 - c. information supplementary to the financial statements.

To indicate that the auditor is neither responsible for nor reporting on such statements, it is usual for the auditor to be specific as to the actual financial statements on which the auditor is reporting by identifying the page numbers containing the financial statements as follows:

"We have audited the financial statements of ABC Limited set out on pages to".

26. Although the auditor is not responsible for the additional statements referred to in paragraph 25 above, there could be a belief on the part of the reader that the auditor has in fact been satisfied that the information is accurate or at least not misleading. The auditor should therefore ensure that the additional information is not materially inconsistent or misleading before signing the auditor's report (see HKSA 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements").

Special classes of companies

27. Certain classes of companies (banking and insurance companies) are exempted by Part III of the Tenth Schedule from disclosing in their financial statements certain of the matters which are required by the Tenth Schedule to be disclosed in the financial statements of other companies. Where a company has availed itself of any of the relevant exemptions, it is necessary to state in the auditor's report whether the financial statements have been prepared in accordance with provisions of the Companies Ordinance applicable to the special class of companies concerned. Whilst it is acknowledged that the financial statements of such companies which have been drawn up after availing themselves of these exemptions do not, for that reason only, necessarily fail to give the true and fair view required by the Companies Ordinance, the true and fair view in such circumstances is necessarily dependent on the level of disclosure as required in Hong Kong Financial Reporting Standards. It is therefore appropriate for the auditors of such entities to adopt the wording of section 141(3)(b) and to relate the true and fair view specifically to the basis on which the financial statements have been prepared.
28. Where a company has availed itself of any of the exemptions, this should be appropriately disclosed in the financial statements. However, if the exemptions result in the financial statements not complying with Hong Kong Financial Reporting Standards and hence affecting the true and fair view of the financial statements, the auditor's report shall be qualified in accordance with HKSA 705.
29. The auditor's report on the financial statements of banking and insurance companies which do not take advantage of the permitted disclosure exemptions available under Part III of the Tenth Schedule, is expressed in true and fair view terms similar to other companies incorporated under the Companies Ordinance. If the financial statements do not give a true and fair view, the auditor's report shall be qualified in accordance with HKSA 705.
30. Section 141D empowers shareholders of certain private companies to waive compliance with various requirements as to disclosures in financial statements. Where a company avails itself of the provisions of section 141D, the auditor's report shall be modified as set out in that section. An example of an auditor's report given under section 141D is included in Appendix 1 to Practice Note (PN) 900 (Clarified) "Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard".

Companies limited by guarantees and unlimited companies

31. These types of companies are normally subject to the same provisions in respect of financial statements and audits as companies limited by shares. Where these types of companies do not have a share capital, the auditor's report should be addressed to members rather than shareholders.

Other reports arising from the auditor's report

32. The Companies Ordinance requires the auditor to give other report arising from the normal auditor's report. The report arising under section 79G(4) is discussed in paragraphs 33 to 37 below.

Distributions (section 79G(4))

33. The Companies Ordinance prohibits all companies from making a distribution otherwise than out of profits available for the purpose. Where a qualified auditor's report has been given on the last annual financial statements the company's ability to make a distribution, by reference to those financial statements, could be in doubt, and the company may not proceed to do so unless the auditor has made a statement under section 79G(4) concerning the company's ability to make the distribution. For the purpose of this additional statement a qualified auditor's report is specified by section 79G(3) as a report which is not without qualification to the effect that in the auditor's opinion the financial statements have been properly prepared in accordance with the Companies Ordinance.
34. According to section 79G(4) of the Companies Ordinance, the auditor shall state in writing (either at the time of the auditor's report or subsequently) whether, in the auditor's opinion, the matter in respect of which the auditor's report is qualified is material for determining, by reference to those financial statements, whether the distribution would contravene the relevant section. Therefore, in planning and performing this work, the auditor should refer to the principles in the Hong Kong Standard on Assurance Engagements (HKSAE) 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" applicable to assurance engagements. The terms of this engagement should be agreed in writing with the company.
35. Although section 79G(4) allows the auditor to state the opinion in writing either at the time of the auditor's report or subsequently, in view of the two different standards involved (that is HKSAs in the normal auditor's report and HKSAE 3000 in the report under section 79G(4)), a separate statement should be made for reporting under section 79G(4) rather than reflecting in the auditor's report.
36. The auditor's statement under section 79G(4) will incorporate the following elements:
- a. *Title* - The auditor's statement should have a title that clearly indicates that it is the report of an independent auditor.
 - b. *Addressee* - the statement should be addressed to the members and sent to the company secretary.
 - c. *Introductory Paragraph* - the auditor refers to the audit which will have been carried out in accordance with HKSAs issued by the HKICPA and state the date on which the auditor's opinion was expressed and that the auditor's opinion was qualified. The auditor is required under section 79G(4) to state whether in the auditor's opinion, the subject matter of the qualification of the auditor's report is material for determining, by reference to those financial statements, whether the distribution would contravene section 79F.
 - d. *Directors' Responsibility* - this section describes and summarises the directors' responsibility with respect to the financial statements referred to in the introductory paragraph. The description should include an explanation that directors are also responsible for considering whether the company, subsequent to the reporting period, has sufficient distributable profits to make a distribution at the time the distribution is made.

- e. *Auditor's Responsibility* - the auditor should state that the auditor's responsibility is to report whether, in the auditor's opinion, the subject matter of the qualification of the auditor's report on the financial statements is material for determining, by reference to those financial statements, whether the distribution would contravene section 79F. The auditor should state that the engagement was performed in accordance with HKSAE 3000 and with reference to this practice note.
- f. *Conclusion* - the auditor must state whether in the auditor's opinion the subject matter of the qualification is material for determining whether proposed distributions, and those which have not yet been proposed, are permitted. A qualification is not material for this purpose if the financial effect of the matters giving rise to qualification could not be such as to reduce the distributable profits below the levels required for the purpose of such distributions. The level of the proposed or potential distribution should always be quantified in the opinion.

Where the maximum effect of a qualification is unquantifiable, it would normally be material for distribution purposes unless the auditor can conclude that the effect of the qualification on the distributable profits could only be favourable. A disclaimer of opinion on the financial statements as a whole would be material as the auditor would be unable to form an opinion on the amount at which the company's distributable profits are stated.
- g. *Signature of the Auditor* – the auditor's statement should be signed.
- h. *Date of the Auditor's Statement* - the date used should be that on which the statement is signed. In any case the statement must be available to be laid before the company in general meeting before the distribution in question is made, and so the statement will have to be signed by that date.

An example auditor's statement under section 79G(4) is set out as Example 1 in Appendix 1.

- 37. The report under section 79G(4) can only be made by the auditor who reported on the last annual financial statements.

Other reports required by the Companies Ordinance

- 38. Other special statutory reports may be required of the auditor that do not arise from the audit of the annual financial statements. Some of these are summarised in paragraphs 39 to 43 below.

Redemption or purchase by a private company of its own shares out of capital (section 49K(5))

- 39. Where a private company redeems or purchases its own shares wholly or partly out of capital, this must be approved by a special resolution of the company to which special voting rules apply. In addition, the Companies Ordinance requires the directors to make a statement in the prescribed form specifying the capital payment permitted by section 49I(3). A factor in computing the capital payment permitted by the Companies Ordinance must be the amount of the company's distributable profits, determined by the directors by reference to financial statements prepared as at any date within the three months prior to the date of their statement. The relevant financial statements for this purpose are such as to enable a reasonable judgement to be made as to the amounts of profits, losses, assets and liabilities, provisions, share capital and reserves. In the directors' statement, they must also state that, having made full inquiry into the affairs and prospects of the company, they have formed the opinion:
 - a. that there will be no grounds on which the company could be found to be unable to pay its debts immediately after the date on which the payment out of capital is proposed to be made (for this purpose the directors must take account of all the company's prospective and contingent liabilities); and
 - b. that, having regard to their intentions with respect to the management of the company's business during the year immediately following that date and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to continue to carry on business as a going concern throughout the year, and that accordingly the company will be able to pay its debts as they fall due throughout that year.

The directors' statement must be delivered to the Registrar of Companies and must be available at the meeting at which any special resolution is to be proposed approving the payment out of capital.

40. The auditor is required to make a report regarding the directors' statement to be attached to the statement. According to section 49K(5), the auditor is required to state in the report that:
- a. the auditor has inquired into the company's state of affairs;
 - b. the amount specified in the directors' statement as the permissible capital payment for the shares in question is, in the auditor's opinion, properly determined in accordance with sections 49I and 49J; and
 - c. the auditor is not aware of anything to indicate that the opinion expressed by the directors in their statement as to any of the matters mentioned in section 49K(3) is unreasonable in all the circumstances.

In planning and performing this work, the auditor should refer to the principles in HKSAE 3000 applicable to assurance engagements.

41. The auditor's report will incorporate the following elements:
- a. *Title* - The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.
 - b. *Addressee* - the report should be addressed to the directors.
 - c. *Introductory paragraph* - the report concerns the directors' statement.
 - d. *Directors' Responsibility* - this section describes and summarises the directors' responsibility with respect to the directors' statement referred to in the introductory paragraph. The description should include an explanation that directors are also required to state that, having made full inquiry into the affairs and prospects of the company, they have formed the opinion as set out in section 49K(3) of the Companies Ordinance.
 - e. *Auditor's Responsibility* - the auditor should state the auditor's responsibility according to section 49K(5) of the Companies Ordinance. The auditor should state that the engagement was performed in accordance with HKSAE 3000 and with reference to this practice note. The Companies Ordinance requires that the report shall state that the auditor has inquired into the company's state of affairs. The Companies Ordinance does not prescribe the scope of the work to be carried out by the auditor, but it will involve, as a minimum, a review of the bases for the directors' statement.
 - f. *Conclusion* - the auditor is required to state that:
 - i. the auditor has inquired into the company's state of affairs;
 - ii. the amount specified in the directors' statement as the permissible capital payment for the shares in question is, in the auditor's opinion, properly determined in accordance with sections 49I and 49J; and
 - iii. the auditor is not aware of anything to indicate that the opinion expressed by the directors in their statement as to any of the matters mentioned in section 49K(3) is unreasonable in all the circumstances.
 - g. *Use of this report* - the auditor should explain that the report is solely for submission by the company to the Registrar of Companies and is not intended to be, and should not be used by anyone for any other purpose.
 - h. *Signature of the Auditor* - the auditor's report should be signed.
 - i. *Date of the Auditor's Report* - the directors' statement and therefore the attached report by auditor are required to be made in the week before the resolution is passed specifying the amount of the permissible capital payment for the shares in question. The report by auditor should not be dated earlier than the date of the directors' statement to which it relates. The date of the auditor's report is the date on which the auditor signs the report expressing the auditor's opinion.

There is no provision for the report to be qualified. The auditor should not issue any report unless the auditor's opinion is unqualified. An example auditor's report under section 49K(5) is set out as Example 2 in Appendix 1.

Distributions by listed companies: the use of initial financial statements (section 79I(4))

42. Paragraphs 33 to 37 of this Practice Note describe the statement required where a company wishes to make a distribution and a qualified auditor's report has been given on the annual financial statements. A company may wish to make a distribution during its first accounting reference period or after the end of that period but before the financial statements for that period have been laid before a general meeting. "Initial financial statements" must be prepared for this purpose which, in the case of a listed company, are required to comply with section 123 and the Tenth Schedule with respect to the form and content of the balance sheet and profit and loss account and any additional information to be provided by way of notes to the financial statements. Group financial statements are not required. The initial financial statements must be approved by and signed on behalf of the directors in the same manner as annual financial statements, and must be delivered to the Registrar of Companies.
43. In the case of a listed company, the auditor is required to make a report on the initial financial statements. The report will incorporate the following elements:
- a. *Title* - The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.
 - b. *Addressee* - the Companies Ordinance does not state to whom the report should be addressed; in the absence of any other requirement it may be addressed to the directors.
 - c. *Introductory Paragraph* - the report is concerned with the initial financial statements. The period covered by the initial financial statements and the accounting principles adopted should be identified.
 - d. *Directors' Responsibility* - the directors are responsible for the preparation of initial financial statements under section 79I.
 - e. *Auditor's Responsibility* - the auditor is responsible for expressing an opinion on whether the financial statements have been properly prepared. The audit of the initial financial statements should be carried out in accordance with HKSAs. The auditor shall explain the auditor's responsibilities as described in paragraphs 28 to 33 of HKSA 700.
 - f. *Auditor's Opinion* - the auditor must state whether, in the auditor's opinion, the financial statements have been properly prepared within the meaning of section 79I(2). For these purposes, the term "properly prepared" means that the financial statements must give a true and fair view of the state of the company's affairs at the balance sheet date and of its profit or loss for the relevant period, and must comply with the provisions of section 123 and the Tenth Schedule subject to such modifications as are necessary because the financial statements do not relate to a financial year.

If the opinion above is qualified, the auditor must state whether the matter giving rise to the qualification is material for determining whether the distribution is permitted (see paragraph 36 above).
 - g. *Signature of the Auditor* - the auditor's report should be signed.
 - h. *Date of the Auditor's Report* - the same principles apply for initial financial statements as for annual financial statements (see HKSA 700).

An example auditor's report under section 79I(4) is set out as Example 3 in Appendix 1.

Statement of loans to officers (section 161B and 161BA)

44. Section 161B sets out the requirements for disclosure of certain particulars of every relevant transaction entered into or every guarantee entered into or every security provided by the company in the financial statements. For simplicity, the term of "transactions" is used to refer to any of these transactions. In this section, "relevant transaction", in relation to a company, means a loan or quasi-loan made to, or a credit transaction entered into for –

- a. a person who, whether or not he was a director or other officer of the company or a director of its holding company at the time the loan, quasi-loan or credit transaction was made or entered into, is such an officer or director at any time during the financial year in respect of which the accounts are made up; or
- b. a body corporate in which a director of the company, at any time during the financial year, held (jointly or severally or directly or indirectly) a controlling interest, whether or not such controlling interest was so held at the time the loan, quasi-loan or credit transaction was made or entered into,

being a loan, quasi-loan or credit transaction that either is made or entered into during that financial year or, if made or entered into before it, is outstanding at any time during that financial year.

There is no definition for "controlling interest" in the Companies Ordinance. The auditor may refer to Hong Kong Accounting Standard 24 "Related Party Disclosures" for guidance.

- 45. An authorized institution or its holding company is exempt from disclosing particulars of certain transactions in the financial statements if they satisfy the conditions set out in section 161B(8). Instead, in the case of an authorized institution, particulars of these transactions are reproduced in a publicly available statement as required in section 161BA(2).
- 46. According to section 161BA(2), an authorized financial institution shall make available a statement:
 - a. containing particulars of exempted transactions;
 - b. the particulars being those which would have been shown in the financial statements under section 161B but for the exemption; or
 - c. if there are no such transactions, a statement to that effect; and
 - d. the statement shall be made available for inspection by members of the authorized institution at the annual general meeting; and
 - e. to the members of the public at the same place as its register of members for a minimum of 14 days before and 7 days after the annual general meeting.
- 47. According to section 161BA(3), it shall be the duty of the auditor of the authorized institution by whom the financial statements are examined to examine the statement referred in above before it is made available for inspection and to make a report on the statement; and a copy of the report shall be annexed to the statement before it is so made available. It is important to note that the auditor must also report on nil statements i.e. where there are no exempt transactions and thus a report to that effect is made in the statement by the directors.
- 48. Section 161BA(4) requires that the auditor's report shall state whether in the opinion of the auditor the statement contains the particulars required by section 161BA(2) and where the opinion is that it does not, the auditor shall include in the report, so far as the auditor is reasonably able to do so, a statement giving the required particulars.
- 49. In planning and performing this work, the auditor should refer to the principles in HKSAE 3000. Normally the procedures will be undertaken and auditor's report will be issued in conjunction with the statutory audit of the annual financial statements. However as the nature of the work of and the auditor's report on the section 161BA statement is different to those of the statutory audit, it is important that the authorized institution be made aware of this difference. At the same time the client should be asked to take reasonable steps to ensure that the authorized institution complies with the requirements concerning the statement, inspection and copying of the statement and public notification of the date of the annual general meeting.
- 50. Where the auditor is of the opinion that the statement does not comply with section 161BA(2), there are also ramifications for the auditor's report on the financial statements. These arise because the information in the statement is required as a substitute for disclosure of essentially the same information in the audited financial statements. It is stated in section 161B(12) that if the financial statements do not comply with the requirements of section 161B, it shall be the duty of the auditor of the company to include in the auditor's report on the financial statements so far

as the auditor is reasonably able to do so, a statement giving the required particulars.

51. Example report and letters in relation to sections 161B and 161BA are set out in Appendix 2.
52. Particulars of all other transactions which do not qualify for exemption under section 161B(8) will continue be disclosed in the financial statements of the authorized institution and its holding company in accordance with the requirements of section 161B and thus will be subject to audit.
53. The actual wording of the lead-in to the relevant exemption in section 161B(8) is - "this section shall not require" - which is permissive rather than mandatory. Thus it appears that authorized institutions may choose not to take advantage of the exemption and disclose details of all transactions including those which would be exempt under section 161B(8). However the wordings of section 161BA dealing with the statement are not permissive and thus the statement (section 161BA(2)) and the auditor's report (section 161BA(3) and (4)) are not optional and must be prepared in all circumstances.
54. According to sections 161B(9) and 161B(10), both the authorized institution and its holding company are required to disclose in the financial statements the aggregate data on all transactions whether exempt or not.

APPENDIX 1

Example reports in relation to sections 49K, 79G and 79I of the Hong Kong Companies Ordinance

The purpose of this Appendix is to provide examples of reports and is for illustration.

- 1.1 Auditor's statement on a company's ability to make a distribution where auditor's report was qualified
- 1.2 Report when a private company wishes to redeem or purchase its own shares out of capital
- 1.3 Report on initial financial statements when a listed company wishes to make a distribution

Example 1.1 – Auditor's statement on a company's ability to make a distribution where auditor's report was qualified

**INDEPENDENT AUDITOR'S STATEMENT
TO THE MEMBERS OF XYZ LIMITED
PURSUANT TO SECTION 79G(4)¹ OF THE HONG KONG COMPANIES
ORDINANCE**

We have audited the financial statements of XYZ Limited for the year ended 31 December 20X1 in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants and have expressed a qualified opinion thereon in our report dated [date]. Pursuant to section 79G(4) of the Hong Kong Companies Ordinance (the Ordinance), we have been requested to state in writing whether, in our opinion, the matter in respect of which our report is qualified is material for determining, by reference to those financial statements, whether the distribution would contravene the relevant section of the Ordinance.

Directors' Responsibility

The directors are responsible for the preparation of the aforesaid financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. They are also responsible for considering whether the company, subsequent to the year ended 31 December 20X1, has sufficient distributable profits to make a distribution at the time the distribution is made.

Auditor's Responsibility

Our responsibility is to report whether, in our opinion, the subject matter of our qualification of our auditor's report on the financial statements for the year ended 31 December 20X1 is material for determining, by reference to those financial statements, whether the distribution proposed by the company is permitted under section 79F of the Ordinance.² We are not required to form an opinion on whether the company has sufficient distributable reserves to make the distribution proposed at the time it is made.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 600.1 "Reports by Auditor under the Hong Kong Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants. We have performed such procedures as we considered necessary to evaluate the effect of the qualified opinion for the determination of profits available for distribution.

Conclusion

Based on the foregoing, in our opinion, the subject matter of the qualification is not material for determining, by reference to those financial statements, whether the [distribution of HK\$.][interim/final dividend for the year ended 31 December 20X1 of HK\$] proposed by the company is permitted under section 79F of the Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
[Auditor's address]
Date of the auditor's statement

¹ Section 79G(4) applies where the last annual financial statements are used. Where initial financial statements are used a similar report is prepared based on the report in Example 3 of this Appendix.

² 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

Notes:

1. As an alternative the auditor's statement might be expressed in terms of the company's ability to make potential distributions up to a specific level. This may be particularly appropriate where the amount of the dividend has not yet been determined. In such circumstances the opinion paragraph would be worded as follows:

"Based on the foregoing, in our opinion, the subject matter of the qualification is not material for determining, by reference to those financial statements, whether a distribution of not more than HK\$ by the company is permitted under section 79F of the Ordinance."

2. As a further alternative the auditor's statement might be expressed in terms of the company's ability to make "any distribution". In such circumstances the opinion paragraph would be worded as follows:

"Based on the foregoing, in our opinion, the subject matter of the qualification is not material for determining by reference to those financial statements, whether any distribution proposed by the company is permitted under section 79F of the Ordinance."

3. Where the auditor concludes that the subject matter of the qualification is material to either a specific distribution which is proposed or to any distribution, then an adverse opinion is given. In such circumstances the opinion paragraph would be worded as follows:

"Adverse opinion

Based on the foregoing, in our opinion, the subject matter of the qualification is material for determining, by reference to those financial statements, whether the [distribution of HK\$.....][interim/ final dividend for the year ended 31 December 20X1 of HK\$][any distribution] proposed by the company is permitted under section 79F of the Ordinance."

Example 1.2 - Report when a private company wishes to redeem or purchase its own shares out of capital

**INDEPENDENT AUDITOR'S REPORT
TO THE DIRECTORS OF XYZ LIMITED
PURSUANT TO SECTION 49K(5) OF THE HONG KONG COMPANIES
ORDINANCE**

Pursuant to section 49K(5) of the Hong Kong Companies Ordinance ("the Ordinance"), we have been requested to report on the attached statement of the directors ("the statement") dated [date], prepared in connection with the company's proposed [purchase][redemption] of (number) [ordinary][preferred] shares by a payment out of capital.

Directors' Responsibility

The directors are responsible for the preparation of the statement in the prescribed form specifying the capital payment permitted by section 49I(3) of the Ordinance. In the statement, the directors must also state that, having made full inquiry into the affairs and prospects of the company, they have formed the opinion as set out in section 49K(3) of the Ordinance.

Auditor's Responsibility

It is our responsibility to report on the statement based on our work performed.³

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 600.1 "Reports by Auditor under the Hong Kong Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants. We have inquired into the state of the company's state of affairs with [management] so far as it is necessary for us to review the bases for the statement and performed other procedures as we considered necessary to provide a basis for our conclusion.

Conclusion

Based on the foregoing,

- i. in our opinion the amount of HK\$ specified in the statement as the permissible capital payment for the shares to be [purchased][redeemed] is properly determined in accordance with sections 49I and 49J of the Ordinance; and
- ii. we are not aware of anything to indicate that the opinion expressed by the directors in the statement as to any of the matters mentioned in section 49K(3) of the Ordinance is unreasonable in all the circumstances.

Use of this Report

This report is intended solely for submission by the company to the Registrar of Companies and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.

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

[Auditor's address]

Date of the auditor's report

³ 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

**Example 1.3 - Report on initial financial statements
when a listed company wishes to make a distribution based on
HKSA 700 “Forming an Opinion and Reporting on Financial Statements”
- effective for audits of financial statements for periods beginning on or after
15 December 2009**

**INDEPENDENT AUDITOR'S REPORT
TO THE DIRECTORS OF XYZ LIMITED
UNDER SECTION 79I(4) OF THE HONG KONG COMPANIES ORDINANCE**

We have audited the initial financial statements of XYZ Limited set out on pages to which comprise the [balance sheet][statement of financial position]⁴ as at [Date], and the [income statement][statement of comprehensive income], statement of changes in equity and [cash flow statement][statement of cash flows] for the period from [Date] to [Date], and a summary of significant accounting policies and other explanatory information.

Directors' Responsibilities for the Initial Financial Statements

The directors are responsible for the preparation of initial financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of initial financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these initial financial statements based on our audit⁵. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the initial financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the initial financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the initial financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of initial financial statements that give a true and fair view 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the initial financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the initial financial statements give a true and fair view of the state of the Company's affairs as at [Date], and of its [profit][loss] and cash flows for the period from [Date] to [Date] in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

ABC & Co.

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

[Auditor's address]Date of the auditor's report

⁴ Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

⁵ 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

APPENDIX 2

Example report and letters in relation to sections 161B and 161BA of the Hong Kong Companies Ordinance

The purpose of this Appendix is to provide examples of report and letters for illustration.

- 2.1 Independent assurance report on statement of loans to officers under section 161BA
- 2.2 Specimen insert in an audit engagement letter
- 2.3 Specimen insert in a representation letter from management

**Example 2.1 - Independent assurance report
on statement of loans to officers under section 161BA**

**INDEPENDENT ASSURANCE REPORT ¹
TO THE MEMBERS OF [NAME OF AUTHORIZED FINANCIAL INSTITUTION]**

We have audited the financial statements of [Name of Authorized Financial Institution] ("the Institution") for the year ended 31 December 20X1 in accordance with Hong Kong Standards on Auditing and have issued a report thereon dated [date]. Pursuant to sections 161BA(3) and (4) of the Hong Kong Companies Ordinance ("the Ordinance"), we have been requested to examine the statement of loans to officers ("the statement") as set out in Appendix [] for the year ended 31 December 20X1 and to state whether in our opinion the statement contains the particulars required by section 161BA(2) of the Ordinance.

Directors' Responsibilities

The directors are responsible for the preparation of a statement containing the particulars required by section 161BA(2) of the Ordinance.

Auditor's Responsibility

It is our responsibility to express a conclusion, based on our work, on this statement and to report our conclusion to you. ²

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 600.1 "Reports by Auditor under the Hong Kong Companies Ordinance" issued by the Hong Kong Institute of Certified Public Accountants. We have performed such procedures as we considered necessary to provide a basis for our conclusion.

Conclusion

Based on the foregoing, in our opinion, the statement for the year ended 31 December 20X1 contains the particulars required by section 161BA(2) of the Ordinance.

ABC & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
Hong Kong
Date³

¹ The report is also applicable to a "NIL" statement.

² 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

³ It is preferable for the report to be dated the same day as the audit report on the statutory financial statements.

Example 2.2 - Specimen insert in an audit engagement letter

This specimen is written as an insert in the example audit engagement letter provided as Appendix 1 to HKSA 210 "Agreeing the Terms of Audit Engagements".

Statement of loans to officers

- [].1 As the company is an authorized financial institution within the meaning of the Companies Ordinance ("Ordinance") we are required by section 161BA of that Ordinance to examine and report on the statement of loans to officers (the "statement") prepared by the company under that section.
- [].2 The statement is to contain the stipulated particulars of loans which are not required to be disclosed in the statutory financial statements by reason of section 161B(8) and if there are no such loans, the company is required to make a statement to that effect.
- [].3 In discharge of our duties we shall
 - (a) examine the statement in order to express an opinion on whether the statement contains the particulars of relevant loans required by section 161BA(2) of the Ordinance; and
 - (b) where in our opinion the statement does not contain the particulars required by the Ordinance we shall include these particulars in our report so far as we are reasonably able to do so.
- [].4 As directors of the company you are responsible for taking reasonable steps to ensure compliance with sections 161B and 161BA including preparation of this statement and the associated register.
- [].5 You should also ensure that
 - (a) our assurance report is annexed to the statement;
 - (b) the statement is made available for inspection by members and the public; and
 - (c) a public notice of the date of the annual general meeting of the company is made in a recognized English and a recognized Chinese newspaper.

Example 2.3 - Specimen insert in a representation letter from management

1. Insert the following in the first paragraph of the illustrative representation letter provided in Appendix 2 to HKSA 580 "Written Representations".

"..... and your examination of the statement of loans to officers for the year ended 31 December 20X1 for the purpose of expressing an opinion as to whether the Statement of Loans to Officers contains the particulars required by section 161BA(2) of the Companies Ordinance."

2. Insert the following after the section of "Financial Statements" in the illustrative representation letter provided in Appendix 2 to HKSA 580 "Written Representations".

- **"Statement of Loans to Officers** *We confirm that the financial statements and the statement of loans to officers comply with the disclosure requirements under sections 161B and 161BA of the Companies Ordinance in respect of disclosures relating to loans or quasi-loans granted to, or credit transactions entered into for, or guarantees entered into or security provided in connection with such loans, quasi-loans or credit transactions entered into for, the Bank's/Company's directors or officers or its [holding company's]/[holding companies'] directors during the year."*