

**PRACTICE NOTE
600.2
AUDIT APPROACH TO COMPANIES APPLYING
SECTION 141D OF THE COMPANIES ORDINANCE**

*(Issued October 1998; revised August 2002, September 2004 (name change) and December 2005)**

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* PN 600.2 is applicable to an audit of a company applying section 141D of the Companies Ordinance for periods beginning before 1 January 2005. For periods beginning on or after 1 January 2005, the applicable Practice Note is PN 900 "Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard". Where such a company early adopts the Small and Medium-sized Entity Financial Reporting Standard for a period beginning before 1 January 2005, the applicable Practice Note is PN 900.

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The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist auditors in applying Statements of Auditing Standards (SASs) and Standards on Assurance Engagements (SAEs) of general application to particular circumstances and industries.

They are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in SASs and SAEs, even though they may be developed without the full process of consultation and exposure used for SASs and SAEs. Auditors 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 Companies Ordinance unless otherwise stated.
2. This Practice Note gives guidance on the applicability of SASs to the audit of companies applying section 141D. The Practice Note has been prepared on the basis of legal advice as to the status of an audit opinion under section 141D.
3. Section 141D exempts certain private companies from complying with the full disclosure requirements of the Companies Ordinance. In particular, companies which take advantage of these exemptions do not have to produce financial statements which show a true and fair view of the state of the company's affairs and of its profit or loss for the year. Instead the auditors are required to report on whether the company's balance sheet and accompanying notes show a true and correct view of the state of the company's affairs. Details of the exemptions are summarised in Appendix 1 but reference should be made to the Companies Ordinance for the exact requirements.
4. A profit and loss account is still required to be prepared by a company applying section 141D and attached to its balance sheet and accompanying notes, even though the auditors' report covers only the balance sheet and accompanying notes due to the lack of exemption from sections 122(1) and 129C. Nevertheless as an exemption from section 123 is granted to companies applying section 141D, any profit and loss account prepared may often be minimal.
5. There is no statutory definition of either a "true and fair view" or a "true and correct view" and consequently no clear legal explanation of the difference, if any, between the two. It appears, however, that the two concepts do differ from each other and that the fact that balance sheets and accompanying notes show a true and correct view does not necessarily mean that they also show a true and fair view. This Practice Note therefore gives guidance on the extent of audit work necessary to reach an opinion on balance sheets and accompanying notes of companies applying section 141D.

Applicability of Accounting and Auditing Standards

6. Although the Foreword to Statements of Standard Accounting Practice (Accounting Standards), Interpretations and Accounting Guidelines does not refer to the applicability of Accounting Standards to balance sheets and accompanying notes which show a true and correct view, it is the HKICPA's opinion that the requirements of Accounting Standards should be applied to such balance sheets and accompanying notes except that, to the extent that the Accounting Standards prescribe disclosure requirements, these do not override the exemptions granted under section 141D. An analysis of the applicability of Accounting Standards issued up to July 2002 to balance sheets and accompanying notes of companies applying section 141D is included in Appendix 2.
7. SASs apply whenever an audit is carried out, except where otherwise stated in the SAS concerned. It appears that all the SASs would be applicable to the audit of companies applying section 141D.

Audit procedures

8. SAS 100.3 of SAS 100 "Objective and general principles governing an audit of financial statements" states that auditors should conduct an audit in accordance with SASs. The same procedures would be adopted for all audits regardless of the extent to which disclosure must be made in the financial statements. Thus, whilst the auditors' report is limited to the balance sheet and accompanying notes of a company applying section 141D, the auditors would still carry out the appropriate tests on profit and loss account items to ensure that the net results for the year, incorporated in the balance sheet, are true and correct.
9. In addition to carrying out the essential audit procedures contained in SASs, the auditors would ensure:
 - a. that the company is entitled to take advantage of the exemptions permitted under section 141D(3);
 - b. that the shareholders have entered into a new unanimous written agreement for the particular financial year under review; and
 - c. that the balance sheet and accompanying notes contain the information required under the Eleventh Schedule of the Companies Ordinance.

The auditors' report

10. Auditors are required to comply with the requirements of SAS 600 "Auditors' reports on financial statements" in the conduct of any audit, including that of balance sheets and accompanying notes of companies applying section 141D.
11. In particular section 141D(1)(e) requires the auditors' report to state:
 - i. whether or not the auditors have obtained all the information and explanations which they have required; and
 - ii. whether, in their opinion, the balance sheet (together with the notes thereon) referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them, and as shown by the books of the company.
12. There is no requirement for the auditors to report on the profit and loss account, since a company applying section 141D is exempt from the requirements of section 141(3). The profit and loss account is therefore considered to be "the other information" as defined in SAS 160 "Other information in documents containing audited financial statements".
13. Appendix 3 to SAS 600 contains an example of an unqualified auditors' report for a company applying section 141D.
14. Where the auditors are unable to give an affirmative opinion, the requirements relating to qualified auditors' reports in SAS 600 should be complied with. Consequently the auditors refer to all material matters about which they have reservations in a separate paragraph or paragraphs. In particular the balance sheet amounts involved should be quantified where this is relevant and practicable and the qualification should leave the reader in no doubt as to its meaning and its implications for an understanding of the balance sheet.
15. It should be noted that, whilst the suggested auditors' report makes no reference to compliance with the disclosure provisions of the Companies Ordinance, the auditors still have an obligation under sections 161 and 161B to give details in their report of directors' remuneration and loans to officers to the extent that the information is not provided in the balance sheet and accompanying notes or the profit and loss account of a company applying section 141D.

Appendix 1

Exemptions

Section 141D(1) exempts certain private companies as defined in section 29 from complying with the following requirements of the Companies Ordinance:

- S121(2) Books of account to give a true and fair view of the state of the company's affairs and to explain its transactions.
- S123 Balance sheet to give a true and fair view of the state of affairs of the company as at the end of its financial year.
- Profit and loss account of a company to give a true and fair view of the profit or loss of the company for the financial year.
- Balance sheet and profit and loss account to comply with the Tenth Schedule of the Companies Ordinance, so far as applicable.
- S129 Statement in company's financial statements of identities and places of incorporation of companies, other than subsidiaries, whose shares it holds, and particulars of those shares.
- S129A Statement in subsidiary company's financial statements of name and place of incorporation of its ultimate holding company.
- S129D Directors' report to be attached to balance sheet. (NB Section 141D(1)(c) does make certain provisions for a limited directors' report.)
- S129E Directors' report to show corresponding amounts for preceding financial year for items included under authority of proviso to section 141C.
- S141(3) Auditors' report to state whether the financial statements have been prepared in accordance with the provisions of the Companies Ordinance and whether in their opinion the financial statements give a true and fair view.

Appendix 2

Applicability of Accounting Standards issued up to July 2002 to balance sheets and accompanying notes of companies applying section 141D

1. The following Statements of Standard Accounting Practice (SSAPs) issued by the HKICPA are not applicable:
 - a. SSAP 1 "Presentation of financial statements"
 - b. SSAP 5 "Earnings per share"
 - c. SSAP 15 "Cash flow statements"
 - d. SSAP 18 "Revenue"
 - e. SSAP 20 "Related party disclosures"
 - f. SSAP 25 "Interim financial reporting"
 - g. SSAP 26 "Segment reporting"
 - h. SSAP 27 "Accounting for group reconstructions"
 - i. SSAP 30 "Business combinations"
 - j. SSAP 32 "Consolidated financial statements and accounting for investments in subsidiaries".
2. Although SSAP 1 is not applicable, its requirements on the structure and content of balance sheet are suitable for adoption, and the disclosure of accounting policies followed in dealing with material or critical income statement and balance sheet items are still required for giving a true and correct view.
3. In general all other SSAPs issued by the HKICPA are applicable. However there are certain sections of these SSAPs which are not considered relevant, in particular:
 - a. those prescribing income statement disclosures;
 - b. those dealing with treatment in consolidated financial statements; and
 - c. those dealing with the income statement disclosure requirements in relation to an investing company which does not prepare group accounts as contained in SSAP 10 "Accounting for investments in associates" and SSAP 21 "Accounting for interests in joint ventures".