

Technical Bulletin

Guidance to the Auditor when Responding to Questions at an Annual General Meeting

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

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HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

TECHNICAL BULLETIN

**GUIDANCE TO THE AUDITOR WHEN RESPONDING TO QUESTIONS
AT AN ANNUAL GENERAL MEETING**

(Issued March 2012)

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INTRODUCTION

1. The purpose of this Technical Bulletin ("AATB") is to provide guidance to the auditor on responding to questions at an Annual General Meeting ("AGM") of a company listed on The Stock Exchange of Hong Kong Limited ("the Stock Exchange").
2. The Stock Exchange in October 2011 amended the Main Board/GEM Listing Rules relating to the Corporate Governance Code ("the revised Code") and associated Listing Rules. One of the amendments is the new provision (E.1.2) in the revised Code that an issuer's management should ensure the external auditor attend the AGM to answer questions about the conduct of the audit, the preparation and content of the auditor's report, the accounting policies and auditor independence. The revised Code is effective from 1 April 2012, and accordingly an auditor is expected to attend and answer questions at an AGM that is held on or after 1 April 2012.
3. This AATB has been prepared in consultation with the Stock Exchange and the staff of the Securities and Futures Commission.

DEFINITION

4. "Those charged with governance" - The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. For discussion of the diversity of governance structures, see paragraphs A1-A8 of HKSA 260 *Communication with Those Charged with Governance*.

In the context of this AATB, those charged with governance include those persons accountable for the preparation for, and conduct of, an AGM. For some entities, in addition to the directors, this may include management, for example, the company secretary.

QUESTIONS TO THE AUDITOR AT THE AGM

5. In accordance with E.1.2 of the revised Code, the management of a company should ensure the company's auditor¹ attends the AGM to answer questions relevant to:
 - (i) the conduct of the audit;
 - (ii) the preparation and content of the auditor's report;
 - (iii) the accounting policies adopted by the company in relation to the preparation of the financial statements; and
 - (iv) the independence of the auditor in relation to the conduct of the audit.

¹ For the purpose of this AATB, "the company's auditor " means:
(a) the person who is the engagement partner; or
(b) the director responsible for the performance of the audit engagement if it is a corporate practice; or
(c) a person representing the auditor who is in a position to answer questions about the audit.

AUDITOR'S RESPONSIBILITIES IN RESPONDING TO QUESTIONS

6. Section 141(7) of the Hong Kong Companies Ordinance² (the "Ordinance") states that while holding office, the auditor is entitled to attend any general meeting of the company and to receive all notices and other communications which any member of the company is entitled to receive. The auditor is entitled to be heard at the meeting but only on any part of the business which concerns him/her as the auditor. Whilst the Ordinance gives the auditor the right to attend the AGM, the provisions in the revised Code do not govern the auditor directly. An auditor may seek legal advice or professional consultation in respect of his/her responsibilities in responding to questions. The auditor's responsibilities in responding to questions at an AGM should be established in writing.
7. In contrast to the responsibilities of those charged with governance for all aspects of the business, the auditor has specific responsibilities which are established by the Ordinance, but which may be extended when agreed with the company as part of the terms of the engagement. Shareholders may not be generally familiar with the scope of an audit. Therefore, without due consideration of the role of the auditor, there is the risk that questions from shareholders may be directed to the auditor on matters that should be addressed by those charged with governance.
8. The auditor does not respond to questions dealing with issues beyond the scope of the audit mandate and/or questions relating to matters that are the responsibility of those charged with governance. Therefore it is important that the auditor, together with the chair of the AGM and those charged with governance, adequately prepare for their participation at an AGM. If the auditor is asked to respond to inappropriate questions or if responses are not understood in an appropriate context, there is the risk that any answers provided could be misleading.
9. In general, the auditor does not have responsibility for the statements made by management or those charged with governance. However if, during the AGM, the auditor concludes that, in his/her view, management or those charged with governance have made a statement that is materially inconsistent with the audited financial statements or the information obtained during the audit, or it is concluded by the auditor to be a material misstatement of fact, the auditor would bring this to the attention of management or those charged with governance present at the AGM. It is the responsibility of management or those charged with governance to consider whether any correction of the statement should be made (either during or after the AGM as appropriate). However if the inconsistency would constitute a fact that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor would refer to HKSA 560 *Subsequent Events* for guidance.

AGM PLANNING

10. Adequate planning and preparation for the AGM enables authoritative responses to be provided to questions raised. The auditor prepares for questions that may be received either in writing before the AGM or verbally at the AGM.
11. The chair of the AGM should be familiar with the responsibility and authority of the auditor and those charged with governance, and with matters arising from the financial statements, to ensure that inappropriate questions do not delay proceedings. A question is inappropriate if the person to whom it has been directed is not able to respond with an appropriate level of authority.

² For a company incorporated in Hong Kong, see section 141 of the Ordinance. For a company incorporated outside Hong Kong, reference should be made to other legislation which imposes on such persons responsibilities comparable to those imposed on an auditor by the Ordinance. Where there is no such equivalent legislation in a jurisdiction outside Hong Kong, the relevant provisions in the Main Board/GEM Listing Rules or professional standards apply.

12. The auditor assists the AGM planning process by meeting with the chair and directors in an AGM planning meeting, and/or by having discussions with directors, management, and/or audit committee members, to ascertain whether there are particular issues which are likely to be of interest.
13. The auditor gains an understanding from management of the arrangement of appropriate representatives from the company who would attend the AGM (e.g. those charged with governance, independent non-executive directors, audit committee members).
14. The auditor ascertains the protocol for questions at the AGM from the chair of the AGM prior to the meeting. Usually, the chair will communicate to the meeting the protocol for presenting questions and, as a rule, questions are to be addressed to the chair who can direct them to the appropriate respondent.
15. The auditor agrees with the chair of the AGM prior to the meeting the language to be used when responding to questions and requests the company to make the necessary arrangements if different languages are anticipated.
16. Questions directed to the auditor may not be within the scope of the audit or the auditor's responsibilities. The auditor refers such questions to the chair of the AGM. If the question is about an area where the responsibility is divided between the auditor and those charged with governance, the auditor endeavours to respond and invites the chair to consider the question as well. Where the auditor plans to ask those charged with governance to respond to a written question³ directed to the auditor, the auditor informs the chair of the intention. This enables those charged with governance to provide an appropriate response at the AGM.
17. If written questions³ are received before the AGM, the company will pass these questions to the auditor. The auditor ensures that responses to such questions are prepared prior to the meeting. Where written questions have been received, the auditor considers whether a written response to the meeting is appropriate.
18. Adequate planning is imperative to identify areas of potential interest to ensure that questions directed to the auditor at the AGM can be properly addressed.
19. In connection with the possible attendance at the AGM of non-shareholders, the auditor ensures that for the purpose of responding to questions at the AGM, the release of the auditor from the confidentiality obligation with regard to these non-shareholders is laid down in advance.

It is recommended that:

- the release be requested in writing;
 - the auditor includes the release in the engagement letter for the audit; and
 - the release be requested every year (if not already included in the engagement letter for the audit).
20. The auditor may need to consider confidentiality obligations which may be imposed by other relevant laws and regulators, e.g. the PRC State Secrets Law.

³ A company may put in place its own arrangements if it wishes to do so, for shareholders to submit written questions to the auditor, via the company prior to an AGM. Additional guidance is provided in paragraphs 50 to 55.

CONTEXT

21. Shareholders are to be made aware of the limitations of the auditor's role at the outset of an AGM or before shareholders ask the auditor questions. Accordingly, the auditor first conveys at the outset to the meeting or before shareholders ask questions the context within which the auditor's response is provided by explaining key aspects of an audit which include:
- (a) The auditor conducts an audit in accordance with Hong Kong Standards on Auditing (HKSAAs) or International Standards on Auditing (ISAs), where applicable.
 - (b) The auditor is not responsible for the preparation of the financial statements that give a true and fair view. This is the responsibility of those charged with governance.
 - (c) The auditor provides reasonable, not absolute, assurance that the financial statements taken as a whole are free from material misstatement.
 - (d) The objective of an audit of financial statements is to enable the auditor to express an opinion as to whether the financial statements give a true and fair view in accordance with the applicable financial reporting framework, such as Hong Kong Financial Reporting Standards (HKFRSs).
 - (e) The audit involves performing procedures to obtain audit evidence about amounts and disclosures in the financial statements.
 - (f) The auditor determines the procedures required to conduct an audit in accordance with HKSAAs, having regard to the requirements of these HKSAAs, the Ordinance and other legislation, if applicable, and the terms of the audit engagement, when appropriate.
 - (g) The auditor exercises professional judgement in selecting audit procedures to be performed. Audit procedures include the assessment of the risks of material misstatement of the financial statements whether due to fraud or error. In making such risk assessments, the auditor considers internal control relevant to the company's preparation of the 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 company's internal control.
 - (h) The audit involves a systematic examination for which audit-based skills, which include skills such as analysis of financial information, knowledge of internal control structure, risk assessment, sample selection, knowledge of accounting standards and other aspects of reporting, are required.
 - (i) The auditor's report does not provide assurance in relation to individual elements of the financial statements, or other aspects of operations such as the adequacy of the company's systems of internal control or the selection of accounting policies.
 - (j) The auditor makes reference to the wordings in the auditor's report where the auditor has clarified to whom the auditor is responsible (with reference to Professional Risk Management Bulletin No. 2 — Auditor's Duty of Care To Third Parties and The Audit Report). Notwithstanding any answers the auditor gives or statements the auditor makes, the auditor shall not have any liability, responsibility or duty of care towards any individual shareholders or third parties.
22. The auditor agrees with the company at the AGM planning stage the approach for conveying the information set out in paragraph 21 above e.g. verbally at the AGM itself, or providing written information to be circulated together with the Notice of Meeting to shareholders before the AGM.

23. In addition, the auditor explains at the outset to an AGM or before shareholders ask any questions that they may not be able to answer questions that are outside the context explained and the auditor may refer questions to others at an AGM for this reason.

RESPONSES TO QUESTIONS

24. The auditor responds to questions relevant to the conduct of the audit, the preparation and content of the auditor's report, the accounting policies adopted by the company in relation to the preparation of the financial statements and the independence of the auditor. The auditor is not able to provide an authoritative response to questions dealing with issues that go beyond the scope of the audit mandate and/or questions which should have been addressed to those charged with governance, and therefore such questions are declined by the auditor. Paragraphs 26–43 below discuss a number of factors which the auditor takes into account when considering responses to questions.
25. The auditor ensures that his/her responses to questions asked are reflected correctly and completely in the minutes of the AGM.

The Conduct of the Audit

(i) *Audit Approach and Audit Plan*

26. HKSA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing* requires the auditor to plan and perform an audit by exercising professional judgement and with an attitude of professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.
27. In accordance with HKSA 300 *Planning an Audit of Financial Statements*, the auditor exercises professional judgement to assess audit risk and to design audit procedures to ensure audit risk is reduced to an acceptable level. The auditor's assessment of risk requires as prerequisites both a "knowledge of the business" (economy, industry, company operations, management, legislation and regulation) and an assessment of materiality. When shareholders raise questions relating to the audit approach or audit plan it is possible that they will not have an understanding of these prerequisites, nor of their significance to the audit process. Similarly shareholders' perceptions of risk may vary considerably. Therefore the auditor informs the meeting about the auditor's approach to risk with reference to HKSA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and HKSA 330 *The Auditor's Responses to Assessed Risks*.
28. It is possible that shareholders may not be familiar with the relevant statutory requirements governing an audit of financial statements. Responses to questions at an AGM provide an opportunity to inform shareholders of the requirements mandated by HKSAs, relevant requirements of the Ordinance and the professional and ethical standards⁴ governing auditors. It provides further opportunity to explain that adherence to HKSAs and professional ethics promote quality in the audit process and commitment to due care.

(ii) *Audit Procedures*

29. Questions which relate to specific audit procedures and/or in relation to specific parts of the financial statements are addressed by reference to the fact that the auditor's report relates to the financial statements taken as a whole. In this context, it is not appropriate for the auditor to address individual audit procedures or financial statements components. The auditor indicates that the nature of audit procedures result in many types of audit evidence being obtained and drawn upon to provide sufficient appropriate audit evidence with which to form an opinion on a set of financial statements. Discussion of particular procedures in isolation could be misleading.

⁴ See Hong Kong *Code of Ethics for Professional Accountants* issued by the HKICPA.

30. The auditor may find it useful to refer also to the *Preface to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, which sets out how these standards are to be understood, interpreted and applied, to explain that HKSAs contain mandatory requirements relating to the planning, conduct and reporting of an audit. Each HKSA describes the procedures to be performed for various aspects of the audit, and is relevant only as an integral component of the whole audit process.

(iii) *Internal Control*

31. The auditor ensures that responses given in respect of questions on internal control are provided within the context of the financial statement audit. An audit of financial statements conducted in accordance with HKSAs is not designed to, and therefore does not, provide sufficient appropriate evidence on which to base an opinion on the adequacy of the internal control structure. To obtain evidence on which to base an opinion on internal control would require the application of audit procedures beyond the scope of an audit of financial statements.

32. In particular, the auditor communicates clearly that assurance is not provided on internal control, but rather that control procedures are examined only to the extent that reliance thereon might reduce other audit work. An auditor engaged to report on the financial statements has no responsibility under HKSAs to understand and evaluate the internal control structure beyond that level sufficient for the planning and development of an effective audit approach unless there is specific statutory, regulatory or additional contractual requirement to the contrary. Questions regarding internal control are to be addressed to those charged with governance who are responsible for ensuring that an adequate internal control structure exists. (See also paragraph 21(g) above.)

(iv) *Fraud*

33. The auditor responds to question about fraud with reference to HKSA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

34. The auditor explains that according to HKSA 240⁵, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the company and management. An auditor conducting an audit in accordance with HKSAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with HKSAs.

35. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Although fraud is a broad legal concept, for the purposes of the HKSAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually been perpetrated. The auditor is required to bring any such matters to the attention of management and/or those charged with governance in accordance with HKSA 240, and as such, questions regarding fraud are to be addressed to those charged with governance.

⁵ HKSA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs 2 to 5.

The Preparation and Content of the Auditor's Report

(i) *Report on the Financial Statements*

36. The auditor responds to questions about the auditor's report by referring to the auditor's report included with the financial statements. Where necessary, the auditor explains the meaning of the terms used in the auditor's report.
37. The audit provides assurance on the financial statements taken as a whole. Hence individual items are audited within the framework of materiality appropriate to the financial statements as a whole, rather than a materiality level appropriate to a specific individual item. Since audit procedures are not directed towards providing assurance on specific items, the auditor explains why providing such information might be misleading, and ordinarily explains, in general terms, the requirements of HKSA's. The auditor may conclude by referring the question to the chair.
38. Shareholders may be interested in errors detected by the auditor and/or disagreements with management. The auditor explains the significance of an unmodified report to indicate that any errors or disagreements have been resolved satisfactorily and that such items are considered in the context of materiality appropriate to the financial statements as a whole.

(ii) *Report on Other Legal and Regulatory Requirements*

39. In some cases, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility to express an opinion on the financial statements.
40. When the audit is conducted pursuant to the Ordinance, sections 141(4) and 141(6) also requires the auditor to report whether proper books of account have been kept and if the auditor fails to obtain all the information and explanations which are necessary for the purpose of the audit. These items are referred to in the auditor's report if there is cause for concern; alternatively, silence in the auditor's report indicates satisfaction.
41. The auditor responds to questions relating to these other matters by reference to the auditor's report.

The Accounting Policies Adopted by the Company in relation to the Preparation of the Financial Statements

42. Shareholders may request the auditor to comment on accounting policies adopted by the company. The auditor would advise that the selection of accounting policies is the responsibility of management or those charged with governance, therefore the auditor responds to the question by stating that the policies comply, or do not comply, with HKFRSs with reference to the basis of preparation as stated in the notes to the financial statements. The management or those charged with governance may wish to comment on the appropriateness of the choice of accounting policies within those choices permitted by HKFRSs.

Auditor Independence

43. The auditor responds to questions about auditor independence with reference to the Hong Kong Standard on Quality Control (HKSQC)⁶, HKSA's and relevant ethical requirements⁴.

⁶ See HKSQC 1 relating to the requirements for auditor independence.

MODIFICATION TO THE INDEPENDENT AUDITOR’S REPORT

44. If the auditor has issued a modified auditor’s report, the auditor may expect to be asked questions about issues leading to that modification. The auditor addresses any such questions by reference to the auditor’s report. The auditor is reminded that HKSA 705 *Modifications to the Opinion in the Independent Auditor’s Report* requires that the auditor’s report includes all relevant information to explain matters that result in a modified auditor’s report.
45. If shareholders have questions on the content of the auditor’s report in respect of the modification, the auditor should be prepared to explain the issues leading to that modification.
46. In certain circumstances the auditor may seek legal advice or professional consultation in preparing responses to issues raised in respect of a modified auditor’s report. If further information regarding such issues is required, it may be more appropriate for the auditor to request that those charged with governance to assist in providing the response.

AUDIT FILES

47. While responses given by the auditor will be supported by sufficient appropriate audit evidence, audit files are not taken into the AGM. The level of detail relating to specific issues, as contained in audit files, is not appropriate in responses to questions at AGM.

AUDITOR’S REPRESENTATIVE AT THE AGM

48. On those occasions when the auditor is not able to attend an AGM and questions for the auditor have been identified, the auditor arranges for a representative¹ to attend the meeting on the auditor’s behalf. In this situation, the auditor ensures that the representative has sufficient knowledge of the engagement and is provided with sufficient information to provide an adequate response to the matters raised.

INABILITY TO PROVIDE A RESPONSE TO A QUESTION

49. A question may arise at the AGM in relation to the audit to which the auditor is not able to provide an immediate response. For example, the auditor may wish to seek legal advice prior to providing the response. In these circumstances, the auditor, in conjunction with the company’s management, makes alternative arrangements, as appropriate, to communicate the information to the shareholders. This may include posting the response on the company’s website as soon as practicable after the AGM.

WRITTEN QUESTIONS TO THE AUDITOR BEFORE THE AGM

50. Paragraphs 50 to 55 are relevant if a company has in place arrangements for shareholders to submit written questions to the auditor before the AGM. The auditor obtains the protocol for such arrangements when planning for the AGM.
51. The auditor and the company mutually agree on the time line by which a shareholder may submit written questions to the auditor before the AGM.
52. The company is expected to pass the question on to the auditor as soon as practicable after the question is received by the company, even if the company believes the question is not relevant to the matters specified in paragraph 5 above.
53. The auditor would normally prepare, and give to the company, a list of the questions that the company has passed on to the auditor which the auditor considers to be relevant to the matters specified in paragraph 5 above. This would normally be done as soon as practicable after the end of the time for submitting questions and a reasonable time before the AGM.

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54. The company would normally, at or before the start of the AGM, make copies of the question list available to the shareholders attending the AGM.
55. The auditor may be permitted to table a written answer to a written question submitted to the auditor and the company should make that written answer available to shareholders as soon as practicable after the AGM.

APPENDIX

Examples of Possible Questions Asked in an Annual General Meeting and Comments on the Auditor's Response

The comments on the questions cited below are more detailed than the responses that may be required, and are intended as general guidance about matters an auditor would normally consider in determining a response. The comments are not intended as illustrations of the answer that would be appropriate in every situation.

The following are a number of questions to which an auditor is usually able to respond, with comments as to the response that might be appropriate.

Question 1	Were there any limitations imposed upon the scope of your audit by management?
Response considerations	In most cases, the scope of the audit will normally enable the auditor to express an opinion without reservation on the financial statements. If there was any limitation imposed on the scope of the audit, the matter would be dealt with in the auditor's report.
Question 2	As the auditor of the company, did you consider yourself sufficiently independent of the company to perform an adequate audit?
Response considerations	The auditor would have complied with the Code of Ethics for Professional Accountants (the "Code") issued by the Hong Kong Institute of Certified Public Accountants. The auditor would advise that the auditor has performed procedures to ensure compliance with the independence requirements as set out in the Code.
Question 3	Discuss your relationship with the management. Have you had any disagreements with management that have not been resolved to your satisfaction?
Response considerations	Generally the auditor would be in a position to state that management was cooperative, and provided all of the information and explanations that the auditor required. The auditor may choose to point out that in the course of normal communications with the management, the auditor frequently meets with management to discuss emerging accounting issues, and has always been able to resolve the issues with senior management satisfactorily. The auditor may also discuss the role of the audit committee. If there are any disagreements with management that have not been resolved to the auditor's satisfaction, the auditor would have included a reservation in the auditor's report.
Question 4	Did you perform any non-audit services during the year?
Response considerations	The auditor would advise whether or not non-audit services were provided during the period. The auditor could also make reference to the disclosure note included in the annual reports as there is a requirement under paragraph 2(h) of Section M of the revised Code "Corporate governance report" to the Listing Rules to disclose an analysis of auditor's remuneration in respect of both audit and non-audit services in the corporate governance report.