

Circular on Reporting to Grantees of the Language Fund

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

A. Introduction

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

B. Audit of the project accounts

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

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

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

C. Report of Factual Findings

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

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

Conclusion

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

Date of Circular: 28 August 2015

APPENDIX 1

Example Independent Auditor's Report

Based on HKSA 800 *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

Circumstances include the following:

- The financial statements have been prepared by the Grantee in accordance with the financial reporting requirements of the LF. Grantee does not have a choice of financial reporting frameworks.
- The applicable financial reporting framework is a compliance framework.
- The terms of the audit engagement reflect the description of Grantee's responsibility for the financial statements in HKSA 210.
- Distribution and use of the auditor's report are restricted.

INDEPENDENT AUDITOR'S REPORT

TO THE [MANAGEMENT]¹ OF [NAME OF ORGANISATION]² ("Grantee")

We have audited the financial statements of ABC Project ("Project") set out on pages to....., which comprise the balance sheet as at [Completion Date] and the income and expenditure accounts for the period from [Commencement Date] to [Completion Date], and a summary of significant accounting policies and other explanatory information. The financial statements have been prepared by the [management]² of the Grantee based on the financial reporting requirements of the Language Fund ("LF") as set out in its "Language Fund Accounting Policies".

[Management's]² Responsibility for the Financial Statements

The [management]² of the Grantee is responsible for the preparation of these financial statements in accordance with the financial reporting requirements of the LF, as set out in its "Language Fund Accounting Policies", and for such internal control as the [management]² determines is necessary to enable the preparation of 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 financial statements based on our audit. 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 financial statements are free from

¹ The addressee should be the management body of the organization, e.g. Board of Directors, Trustees.

² The organization should be the one defined as the Grantee in the Agreement.

material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 the financial statements 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 [management]², as well as evaluating the overall presentation of the financial statements.

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

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

Opinion

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

Basis of Accounting and Restriction on Distribution and Use

Without modifying our opinion, we draw attention to Note 1 to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Grantee to comply with the financial reporting requirements of the LF. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the Grantee and the LF and should not be distributed to or used by parties other than the Grantee or the LF³.

XYZ & 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 "Auditors' Duty of Care To Third Parties and The Audit Report".

Example paragraph for notes to the financial statements

Basis of preparation

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

APPENDIX 2

Example Report of Factual Findings

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

REPORT OF FACTUAL FINDINGS

To THE [MANAGEMENT]⁴ OF [NAME OF ORGANISATION]⁵ ("Grantee")

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

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

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

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

⁵ The organization should be the one defined as the Grantee in the Agreement.

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

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

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

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

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

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

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

XYZ & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]*
Hong Kong
Date

* Delete as appropriate