

*Technical Bulletin*

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# **Assistance Options to New Applicants and Sponsors in connection with Internal Controls over Financial Reporting**

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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**

**ASSISTANCE OPTIONS TO NEW APPLICANTS AND SPONSORS  
IN CONNECTION WITH  
INTERNAL CONTROLS OVER FINANCIAL REPORTING**

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## EXECUTIVE SUMMARY

1. This Technical Bulletin is intended as a guide for members in public practice providing assistance to new applicants and sponsors in connection with new applicants' internal controls over financial reporting.<sup>1</sup>
2. Such assistance will typically take the form of either a long form report or agreed-upon procedures engagement as described in sections I and J respectively of this Technical Bulletin. Another form of assistance could be an engagement to express assurance on internal controls over financial reporting. It is not currently a common market practice in Hong Kong for reporting accountants to undertake separate assurance engagements in respect of new applicants' internal controls over financial reporting in view of the relative immaturity of many new applicants' system of internal controls over financial reporting for reasons described in paragraph 6. It is also noted that assurance in respect of new applicants' internal controls over financial reporting is not typically required or sought by sponsors (or equivalent) and new applicants in other jurisdictions prior to listing. Engagements to express assurance on internal controls over financial reporting are discussed in Appendix 2.
3. These three types of engagements should not be viewed as alternatives that are available in every instance. The reporting accountants<sup>2</sup> will need to work closely with the new applicant and the sponsors to agree the most appropriate approach given the new applicant's circumstances and the requirements of the new applicant and the sponsors.
4. In the case of long form report and agreed-upon procedures engagements, it would be for the benefit of all parties that the work of the reporting accountants be started as soon as the new applicant has the positive intention to seek a listing. This allows for sufficient time to implement in an orderly manner any recommendations that come out of the reporting accountants' work.

### A. Introduction

5. In preparing for listing the directors of a new applicant should ensure that the new applicant has the capability to meet the demands of a listed company, including the demands of public shareholders for reliable and timely financial information. This typically means that management performs some form of assessment of the sufficiency of the new applicant's internal controls over financial reporting in the run up to listing.
6. In practice, although they may have a positive intention to seek listing, new applicants may not yet have designed and implemented internal controls over financial reporting sufficient for a listed company. Reasons for this include:
  - a. the group may only have been formed following a recent reorganisation in anticipation of listing creating a new control environment; and

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<sup>1</sup> The scope of internal controls over financial reporting is indicated by "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission in 1992. For the purposes of this Technical Bulletin internal controls over financial reporting are taken also to include certain relevant supplementary areas of financial control including over key business processes, forecasting and budgeting and management reporting. See Appendix 1.

<sup>2</sup> Please refer to paragraph 10.

- b. whilst lower-level operational controls might be in place there is less in the way of the higher-level corporate and management controls required to enable management to plan the business and monitor its progress.
7. It has been indicated by the sponsor community that they consider that it will normally be necessary for sponsors to engage third party professionals to assist them to undertake tasks related to their due diligence enquiries in respect of the new applicant's internal controls over financial reporting.
8. In the context of paragraph 15 of Practice Note 21 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited "Due Diligence by Sponsors in respect of Initial Listing Applications" ("Practice Note 21")<sup>3</sup>, it has further been indicated by the sponsor community that reporting accountants have valuable expertise in the area of procedures, systems and controls over the financial reporting process.
9. In practice, accounting firms in Hong Kong are commonly engaged by new applicants or jointly engaged by new applicants and sponsors to perform work to assist new applicants in connection with the readiness of their internal controls over financial reporting and to provide information to sponsors to assist sponsors in connection with the declaration that they are required to make under Listing Rule 3A.15(5).
10. It may or may not be the case that the accounting firm engaged to provide assistance to the new applicant and the sponsors is the same firm that is acting as reporting accountants for the new applicant's planned listing. Nevertheless, in the interests of simplicity, for the purposes of this Technical Bulletin the accounting firm engaged to provide assistance to the new applicant and the sponsors is referred to as the reporting accountants.
11. Assurance engagements fall within the Hong Kong Framework for Assurance Engagements for which independence is required in accordance with the Code of Ethics for Professional Accountants issued by the HKICPA. Although long form report engagements as described herein and agreed-upon procedures engagements do not fall within the Hong Kong Framework for Assurance Engagements, the reporting accountants should ensure that such non-assurance services do not impair their independence. In this context, consideration should be given to whether long form report engagements and agreed-upon procedures engagements should be performed in whole or in part by personnel not involved in the financial statement audit and accountants' report engagements and with different reporting lines within the firm. Irrespective of whether their work on internal controls over financial reporting takes the form of a long form report, agreed-upon procedures or assurance engagement, the reporting accountants should apply safeguards by ensuring that:
- (a) the new applicant acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls over financial reporting;
  - (b) the new applicant designates a competent employee, preferably within senior management, to be responsible for internal controls over financial reporting and all management decisions made in connection therewith; and

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<sup>3</sup> The corresponding rules in the Rules Governing the Listing of Securities on the Growth Enterprise Market (GEM) of The Stock Exchange of Hong Kong Limited is Practice Note 2. For the purpose of this Technical Bulletin, the requirement under the Main Board Listing Rules is discussed. The same discussion is relevant to engagements in connection with listings on the GEM.

- (c) the new applicant is responsible for evaluating the adequacy and determining which recommendations of the reporting accountants should be implemented.
12. The Code of Ethics for Professional Accountants issued by the HKICPA refers to the provision of services to an audit client:
- (a) which involve either the design or implementation of financial information technology systems that are used to generate information forming part of a client's financial statements and which may create a self-review threat; and
  - (b) in connection with the assessment, design and implementation of internal accounting controls and risk management controls which are not considered to create a threat to independence provided the auditors do not perform management functions.

In this context, the provision of services in connection with the design and implementation of financial information technology systems and internal accounting controls and risk management controls would be the subject of an engagement separate from the reporting accountants' engagement to assist in connection with internal controls over financial reporting.

13. The work to be undertaken by the reporting accountants is normally done either under a joint engagement with both the new applicant and the sponsors or under an engagement with the new applicant only with the sponsors as a third party. It is assumed for the purposes of this Technical Bulletin that the reporting accountants will be engaged jointly by both the new applicant and the sponsors who will together determine the type of assistance to be given by the reporting accountants. The new applicant and the sponsors will also agree with the reporting accountants the detailed scope of work to be performed, including that work which the sponsors require to be performed by the reporting accountants in connection with the sponsors' declaration under the Listing Rules (See section C. below).
14. It should be understood that any engagement by the reporting accountants to assist the new applicant and the sponsors in connection with internal controls over financial reporting will be a private reporting engagement as distinct from a public reporting engagement.
15. An engagement for the reporting accountants to assist the new applicant and the sponsors in connection with internal controls over financial reporting will be a separate engagement from that described in Hong Kong Standard on Investment Circular Reporting Engagements 400 "Comfort Letters and Due Diligence Meetings on Financial and Non-financial Information", the purpose of which is to provide comfort in respect of the integrity of certain information disclosed in the investment circular, or to comment on changes in selected financial statement items subsequent to the latest period reported on in the accountants' report.
16. Against this background, this Technical Bulletin discusses the responsibilities of the directors of new applicants and the sponsors in respect of internal controls over financial reporting and the different ways in which the reporting accountants can assist new applicants and sponsors in assessing the new applicants' internal controls over financial reporting.

## **Part 1 – SUMMARY OF RESPECTIVE RESPONSIBILITIES OF DIRECTORS OF NEW APPLICANTS AND SPONSORS IN RESPECT OF INTERNAL CONTROLS OVER FINANCIAL REPORTING**

### **B. The responsibility of directors of new applicants**

17. Listing Rule 3A.15(5) makes it clear that it is the responsibility of the new applicants to establish procedures, systems and controls (including accounting and management systems) which are sufficient to enable the new applicants' directors to make a proper assessment of the financial position and prospects of the new applicant and its subsidiaries, both before and after listing.

### **C. The sponsors' declaration under Listing Rule 3A.15(5)**

18. Listing Rule 3A.15 states: "Having made reasonable due diligence inquiries, each sponsor must confirm that it has reasonable grounds to believe and does believe that: ... (5) the new applicant has established procedures, systems and controls (including accounting and management systems) which are adequate having regard to the obligations of the new applicant and its directors to comply with the Exchange Listing Rules and other relevant legal and regulatory requirements (in particular rules 13.09, 13.10, 13.46, 13.48 and 13.49, Chapters 14 and 14A and Appendix 16) and which are sufficient to enable the new applicant's directors to make a proper assessment of the financial position and prospects of the new applicant and its subsidiaries, both before and after listing..."<sup>4</sup>.

### **D. The Exchange's expectations on sponsors under Practice Note 21**

19. Practice Note 21 sets out the Exchange's expectations of the due diligence that sponsors will typically perform.
20. Paragraph 15 of Practice Note 21 states: "Typical due diligence enquiries in relation to the new applicant's accounting and management systems .....include a) assessing the new applicant's accounting and management systems that are relevant ..... to the directors' ability to make a proper assessment of the financial position and prospects of the new applicant and its subsidiaries, both before and after listing. Such assessment should cover ..... any letters given by the reporting accountants to the new applicant that comment on the new applicant's accounting and management systems or other internal controls...".
21. The focus of the guidance contained in this Technical Bulletin is on how reporting accountants can provide assistance to new applicants and sponsors in connection with internal controls over financial reporting. In the context of Listing Rule 3A.15 and Practice Note 21, this means that the focus is on the sufficiency of the new applicant's accounting and management systems for the purposes of enabling the directors to make a proper assessment of the financial position and prospects of the new applicant. Such assistance typically takes the form of either a long form report or agreed-upon procedures engagement as described in sections I and J respectively. Another form of assistance could be an engagement to express assurance on internal controls over financial reporting. It is not currently a common market practice in Hong Kong for reporting accountants to undertake separate assurance engagements in respect of new applicants' internal controls over financial reporting in view of the relative

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<sup>4</sup> The same requirement for GEM issuers is set out in the GEM Listing Rule 6A.15(5). It should be noted that the full scope of Listing Rule 3A.15(5) and GEM Listing Rules 6A.15(5) is wider than internal controls over financial reporting, extending to compliance with the Exchange Listing Rules generally.

immaturity of many new applicants' systems of internal controls over financial reporting for reasons described in paragraph 6. As a result, in many cases, it may not be possible for reporting accountants to give an unqualified opinion. It is also noted that assurance in respect of a new applicant's internal controls over financial reporting is not typically required or sought by sponsors (or equivalent) and new applicants in other jurisdictions prior to listing. Engagements to express assurance on internal controls over financial reporting are discussed in Appendix 2.

22. Practice Note 21 makes it clear that sponsors are required to take responsibility for:
- (a) making their own due diligence enquiries;
  - (b) making their own assessment; and
  - (c) reaching their own conclusion for the purposes of their declaration under Listing Rule 3A.15(5).

Whilst a long form report, agreed-upon procedures or an assurance report from the reporting accountants can provide one of a number of sources of information to sponsors to assist them in making their declaration, it should be understood that it is not possible for the reporting accountants to stand in the place of the sponsors as concerns their responsibilities under the Listing Rules.

## **Part 2 – INTERNAL CONTROLS OVER FINANCIAL REPORTING**

### **E. The internal control process over financial reporting**

23. It is not possible nor is it necessary to describe in detail in this Technical Bulletin the concept and scope of internal control. Such a detailed description may be found in "Internal Control and Risk Management - A Basic Framework".<sup>5</sup> It is, however, worthwhile to characterise briefly the internal control process over financial reporting.
24. The internal control process over financial reporting begins with management setting financial reporting objectives relevant to the new applicant's particular business activities and circumstances. Once set, management identifies and assesses a variety of risks impacting those objectives, determines which risks could result in a material misstatement in financial reporting and determines how the risks should be managed through a range of control activities. Management implements policies and procedures to capture, process and communicate information needed for financial reporting and other components of the internal control system. All this is done in the context of the new applicant's control environment, which is shaped and refined as necessary to provide the appropriate tone at the top of the organisation and related attributes. These components all are monitored to help ensure that controls continue to operate properly over time.<sup>6</sup>

### **F. Effective internal controls over financial reporting**

25. Listing Rule 3A.15(5) refers to the ability of the directors to "...make a proper assessment of the financial position and prospects of the new applicant...". Accordingly, as part of their readiness deliberations both new applicants and sponsors

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<sup>5</sup> "Internal Control and Risk Management – A Basic Framework" issued by the HKICPA in June 2005.

<sup>6</sup> The content of this paragraph is based on "Internal Control over Financial Reporting - Guidance for Small Public Companies Volume 1: Executive Summary" published by the Committee of Sponsoring Organizations of the Treadway Commission in 2006.



are concerned with the reliability of the new applicant's internal controls over financial reporting.

26. Relevant principles in achieving the objective of reliability of financial reporting are set out in Appendix 1. These principles are used to assist the new applicant and sponsors and the reporting accountants in determining the financial control objectives to be addressed by the reporting accountants' work. While the financial control objectives vary among different companies depending on the industry, size, organisational structure, culture, and management philosophy, these principles remain fundamental to all companies.

#### **G. Scoping**

27. Scoping typically involves the new applicant, the sponsors and the reporting accountants working closely together to identify the key risks that the new applicant faces and the corresponding financial control objectives and control activities that are significant to mitigate those risks. Since each new applicant is unique and faces different risks, the internal controls to be considered are different among applicants. A further complexity arises for new applicants that carry on business in multiple locations with different control environments and internal control systems. There is no "one-size-fits-all" set of control objectives and control activities applicable to all new applicants.
28. The declaration of the sponsors under Listing Rule 3A.15(5) will be based on their own due diligence enquiries and assessment of the areas of internal control that are of concern to them. The sponsors will need to work closely with the reporting accountants to ensure that the work of the reporting accountants is focused on these identified areas of concern. It is for the sponsors to satisfy themselves that the scope of work to be carried out by the reporting accountants will, together with the sponsors' own enquiries, be sufficient for the purposes of the sponsors' declaration under Listing Rule 3A.15(5).

#### **H. Considering design, implementation and operating effectiveness**

29. Engagements in connection with the readiness of a new applicant's internal controls over financial reporting typically involve consideration of the design, implementation and/or operating effectiveness of control activities.
30. Control activities can be said to be properly designed when, individually or in conjunction with other control activities, they contribute to the meeting of control objectives. So far as design effectiveness is concerned, it is irrelevant whether the control procedures have or have not been implemented. Instead, reporting accountants gain an understanding of the design of the control procedures through inquiry and review of documentation in order to determine whether relevant control objectives are properly addressed by those procedures if they are to be implemented.
31. Implementation concerns whether control activities are implemented as designed. When considering implementation effectiveness, the reporting accountants perform walkthrough procedures and inquiries which are corroborated with observation, review of documentation, or re-performance, so as to determine whether the control activities are implemented as designed. An assessment of implementation effectiveness should not be carried out where the design of the control procedures fails to meet the control objectives.

32. Operating effectiveness is concerned with whether control activities are operated as designed for a period of time. Operating effectiveness is assessed through detailed testing covering an elapsed period of time. This contrasts with the testing of implementation which is performed as at a point in time.

**Part 3 – DISCUSSION OF TYPICAL TYPES OF ASSISTANCE**

**I. Long form report**

33. There is no professional standard in Hong Kong covering long form report engagements. Accordingly, the scope of work to be performed and the form of the report to be issued is a matter to be agreed between the new applicant, the sponsors and the reporting accountants.
34. The reporting accountants would normally expect to gather a description of the new applicant's existing internal controls over financial reporting and to include in their report a commentary thereon. The commentary might reflect a description of any detailed procedures performed on the design and implementation of internal controls over financial reporting and details of the findings. The agreed scope of work might also involve the reporting accountants in carrying out tests on the operating effectiveness of internal controls over financial reporting. The purpose of such testing is to report the findings for the information of the new applicant and the sponsors and not to report any conclusion about control activities as a whole or to express any form of assurance.
35. The reporting accountants would set out in their report a description of internal control deficiencies which have come to their attention during the course of their work and provide recommendations for measures to be taken to address such deficiencies.

KEY POINTS
<p><b>Scope</b></p> <ul style="list-style-type: none"> <li>● Scoping may be performed at a high-level in terms of general areas of internal controls over financial reporting to be considered by the reporting accountants.</li> <li>● Can combine review and commentary with detailed testing.</li> </ul> <p><b>Report</b></p> <ul style="list-style-type: none"> <li>● Narrative report format.</li> <li>● Commentary on internal control and processes and identification of control deficiencies.</li> <li>● Recommendations for improvement (to the extent that they came to the attention of the reporting accountants within the scope of their work).</li> <li>● Findings of any detailed testing performed.</li> <li>● No assurance as to the effectiveness of the new applicant's internal control activities.</li> </ul> <p><b>Follow-up</b></p> <ul style="list-style-type: none"> <li>● If applicable, a follow-up visit to determine and report on whether recommendations have been implemented.</li> </ul>

**J. Agreed-upon procedures**

36. Agreed-upon procedures engagements are carried out with reference to the principles outlined in Hong Kong Standard on Related Services 4400 "Engagements to Perform Agreed-upon Procedures Regarding Financial Information" issued by the HKICPA and in accordance with the terms of engagement.
37. In an agreed-upon procedures engagement, procedures of an audit nature are performed, the scope of which should be agreed between the reporting accountants, the new applicant and the sponsors. This requirement to scope the procedures to be performed at a detailed level distinguishes an agreed-upon procedures engagement from a long form report engagement where scoping is typically done at a high-level in terms of the general areas of internal controls over financial reporting to be considered by the reporting accountants.
38. The reporting accountants provide a report of the factual findings resulting from the agreed-upon procedures and no assurance is expressed. Instead, it is for the new applicants and the sponsors to assess for themselves the procedures and findings reported on by the reporting accountants and to draw their own conclusions. The report will be restricted to the new applicants and the sponsors that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the results.

KEY POINTS	
<b>Scope</b>	<ul style="list-style-type: none"> <li>● Specific procedures of an audit nature agreed-upon between the new applicant, the sponsors and the reporting accountants.</li> </ul>
<b>Report</b>	<ul style="list-style-type: none"> <li>● Report of factual findings based on the specific procedures performed which may encompass providing commentary and identification of control deficiencies.</li> <li>● No assurance as to the effectiveness of the new applicant's internal control activities.</li> <li>● Recommendations for improvement (to the extent that they came to the attention of the reporting accountants within the scope of their work), may also be included.</li> </ul>
<b>Follow-up</b>	<ul style="list-style-type: none"> <li>● If applicable, a follow-up visit to determine and report on whether recommendations have been implemented.</li> </ul>

**Part 4 – OTHER MATTERS**

**K. Meetings with sponsors**

39. It is normal practice for the sponsors to discuss the content of any report on internal controls over financial reporting with the reporting accountants. Where the reporting accountants provide oral comments, the comments are not intended to have any greater significance than explanations of matters contained in the report. Reliance may be placed on information set out in the report and on matters dealt with in oral comments only on the basis of the terms and conditions on which it is agreed in the letter of instruction that such information or comments are provided. Should the directors of the new applicant or the sponsors wish to rely upon any oral comments,

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the reporting accountants should be asked to amend their report to include the matters in question or otherwise confirm them in writing, or the instructions to the reporting accountants should be framed accordingly.

## Appendix 1

### Internal controls over financial reporting

Reproduced below are twenty basic principles in achieving effective internal controls over financial reporting set out in "Internal Control over Financial Reporting – Guidance for Smaller Public Companies"<sup>7</sup> representing the fundamental concepts associated with, and drawn directly from, the five components of the COSO Framework<sup>8</sup>. Relevant supplementary principles are shown in shaded textboxes.

#### Control Environment

1. **Integrity and Ethical Values** – Sound integrity and ethical values, particularly of top management, are developed and understood and set the standard of conduct for financial reporting.
2. **Board of Directors** – The board of directors understands and exercises oversight responsibility related to financial reporting and related internal control.

**Audit Committee** - The audit committee understands and exercises oversight responsibility related to financial reporting and related internal control.

3. **Management's Philosophy and Operating Style** – Management's philosophy and operating style support achieving effective internal control over financial reporting.
4. **Organisational Structure** – The company's organisational structure supports effective internal control over financial reporting.
5. **Financial Reporting Competencies** – The company retains individuals competent in financial reporting and related oversight roles.
6. **Authority and Responsibility** – Management and employees are assigned appropriate levels of authority and responsibility to facilitate effective internal controls over financial reporting.
7. **Human Resources** – Human resource policies and practices are designed and implemented to facilitate effective internal control over financial reporting.

#### Risk Assessment

8. **Financial Reporting Objectives** – Management specifies financial reporting objectives with sufficient clarity and criteria to enable the identification of risks to reliable financial reporting.
9. **Financial Reporting Risks** – The company identifies and analyses risks to the achievement of financial reporting objectives as a basis for determining how the risks should be managed.

<sup>7</sup> "Internal Control over Financial Reporting – Guidance for Smaller Public Companies Volume 1: Executive Summary" published by the Committee of Sponsoring Organizations of the Treadway Commission in 2006.

<sup>8</sup> "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission in 1992.

10. **Fraud Risk** – The potential for material misstatement due to fraud is explicitly considered in assessing risks to the achievement of financial reporting objectives.
11. **Integration with Risk Assessment** – Actions are taken to address risks to the achievement of financial reporting objectives.
12. **Selection and Development of Control Activities** – Control activities are selected and developed considering their cost and their potential effectiveness in mitigating risks to the achievement of financial reporting objectives.
13. **Policies and Procedures** – Policies related to reliable financial reporting are established and communicated throughout the company, with corresponding procedures resulting in management directives being carried out.

**Key Business Processes** – Policies related to reliable financial reporting are established and communicated in respect of key business processes including.

- Revenue
- Expenditure
- Inventory
- Human resource and payroll
- Fixed assets
- Cash management and treasury

14. **Information Technology** – Information technology controls, where applicable, are designed and implemented to support the achievement of financial reporting objectives.

#### Information and Communication

15. **Financial Reporting Information** – Pertinent information is identified, captured, used at all levels of the company, and distributed in a form and timeframe that supports the achievement of financial reporting objectives.

**Forecasting and Budgeting** – Forecasting and budgeting procedures are implemented to meet the present and future needs of the business.

**Management Reporting Framework** – Management reporting procedures are implemented to enable management (including the board of directors) to understand the financial position and prospects of the company.

16. **Internal Control Information** – Information used to execute other control components is identified, captured, and distributed in a form and timeframe that enables personnel to carry out their internal control responsibilities.
17. **Internal Communication** – Communications enable and support understanding and execution of internal control objectives, processes, and individual responsibilities at all levels of the organization.
18. **External Communication** – Matters affecting the achievement of financial reporting objectives are communicated with outside parties.

19. **Ongoing and Separate Evaluations** – Ongoing and/or separate evaluations enable management to determine whether internal control over financial reporting is present and functioning.
20. **Reporting Deficiencies** – Internal control deficiencies are identified and communicated in a timely manner to those parties responsible for taking corrective action, and to management and the board as appropriate.

## Appendix 2

### Expressing assurance on internal controls over financial reporting

1. Assurance engagements are performed in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" issued by the HKICPA and in accordance with the terms of engagement.
2. In an assurance engagement the reporting accountants express an overall conclusion (either in a positive or negative form of expression) in terms of:
  - (a) the effectiveness of the design of internal controls activities;
  - (b) the effectiveness of the design and the implementation of internal controls activities; or
  - (c) the effectiveness of the design, the implementation and operating effectiveness of internal controls activities.
3. Assurance engagements may take the form of reasonable assurance engagements or limited assurance engagements. A reasonable assurance engagement includes the expression of a positive form of opinion by the reporting accountants, based on systematic and thorough evidence-gathering procedures. The evidence-gathering procedures to be carried out within the scope of a limited assurance engagement will be less extensive and, accordingly, the reporting accountants will express a negative form of opinion.
4. In order to conclude on the effectiveness of internal controls for design, implementation or operating effectiveness, the significance of each control deficiency found during the course of assessment is evaluated individually and in the aggregate, and the likelihood that the deficiency, or a combination of deficiencies, could result in a misstatement and the magnitude of the potential misstatement are considered. In practice, considerable judgment on the part of the reporting accountants is required to determine whether the internal controls over financial reporting are effective, and therefore there is always risk of the practitioner stating that the internal controls over financial reporting are effective when in fact they are not and vice versa.
5. It is not currently market practice in Hong Kong for reporting accountants to undertake separate assurance engagements in respect of new applicants' internal controls over financial reporting for Practice Note 21 purposes. Reasons for this include the following:
  - (a) It would only be advisable to embark on an engagement to provide assurance if management of the new applicant is able to represent, as appropriate, that relevant control activities have been effectively designed and implemented and have operated effectively throughout a defined and elapsed period such that an unqualified assurance opinion can reasonably be expected to be issued on the new applicant's internal controls over financial reporting. A qualified opinion is unlikely to be viewed as valuable by users. In many cases, however, management will not be in a position to make such representation in view of the relative immaturity of the new applicant's system of internal controls over financial reporting (for the reasons described in paragraph 6 of the Technical Bulletin) such that there will be no basis for such an expectation that an unqualified opinion can be given. Where the reporting accountants have reason



to believe that a qualified opinion would be necessary were an assurance engagement to be undertaken, they should communicate this to the new applicant and the sponsors<sup>9</sup>.

- (b) Assurance in respect of new applicants' internal controls over financial reporting is not typically required or sought by sponsors (or equivalent) and new applicants in other jurisdictions prior to listing.
- (c) The extent of work (and as a result cost) involved in undertaking an assurance engagement is likely to be significantly greater than for a long form report or agreed-upon procedures engagement.

KEY POINTS	
<b>Scope</b>	<ul style="list-style-type: none"><li>● In order for the reporting accountants to issue an opinion in the report (either a positive or negative form of expression), the extent of work is at least sufficient for the reporting accountants to obtain a meaningful level of assurance as the basis for the opinion.</li><li>● While there is no specific elapsed period that is required before the assessment, the control procedures to be tested should at least be operating over the testing period and long enough so that sufficient samples could be obtained for the testing.</li></ul>
<b>Report</b>	<ul style="list-style-type: none"><li>● Assurance as to the effectiveness of the internal controls systems.</li><li>● No recommendations for improvement are provided within the scope of an assurance engagement (although this does not preclude recommendations being given separately).</li></ul>

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<sup>9</sup> An assurance engagement may be undertaken when the new applicant has implemented and operated internal controls over financial reporting for a defined and elapsed period of time (e.g. as may be the case for a spin-off of a business from an existing listed company).