

Circular on Reporting on the Audit of Schools

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. There are different types of schools in Hong Kong, such as aided schools, Direct Subsidy Scheme (DSS) schools, government schools and private schools. The schools may be managed by an Incorporated Management Committee (IMC), established under section 40BN or 40BX of the Education Ordinance in respect of the school, or a non-incorporated management committee (referred to as non-IMC hereafter). There are different accounting and reporting requirements for different types of schools.
2. The purpose of this Circular is to provide guidance to auditors in relation to audits of financial statements of aided and DSS schools (irrespective of whether they are IMC or non-IMC schools), which are required to comply with the accounting requirements of the Education Bureau (EDB). This guidance is not applicable to the audit of aided and DSS schools with management committees incorporated under the Hong Kong Companies Ordinance, or who themselves are incorporated under the Hong Kong Companies Ordinance, as their financial statements are required to comply with the Hong Kong Companies Ordinance and they should be prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs).

Requirements applicable to IMC schools

3. In accordance with subsection (1) of section 40BB of the Education Ordinance (EO), an IMC shall:
 - (a) maintain proper books of account and other financial and accounting records as stipulated in –
 - (i) the code of aid for primary schools, the code of aid for secondary schools or the code of aid for special schools (as may be applicable)¹; or
 - (ii) such instructions as may be given by the Permanent Secretary for Education for the purposes of this paragraph from time to time;

¹ The code of aid specifically applicable to an aided IMC school is Code of Aid for Aided Schools.

- (b) cause to be prepared for each accounting year of the committee statements of the accounts of the committee; and
 - (c) submit the statement of accounts to the Permanent Secretary for Education at such time and in such manner as the Permanent Secretary for Education may specify.
4. In accordance with subsection (4) of section 40BB of the EO, the auditor appointed by the IMC under subsection (3) of section 40BB of the EO shall:
- (a) audit the accounts prepared under subsection (1) of section 40BB of the EO;
 - (b) report as to -
 - (i) whether such account and balance sheet present fairly the financial transactions of the IMC during the accounting year to which the account and balance sheet relate; and
 - (ii) the financial position of the IMC at the end of that year, subject to such qualification (if any) as he thinks fit;
 - (c) submit the report to the Permanent Secretary for Education at such time as the Permanent Secretary for Education may specify;
 - (d) be entitled to require such information and explanations as he considers necessary for discharging his duties; and
 - (e) comply with such directions as may be given by the Permanent Secretary for Education for the purposes of this paragraph from time to time.

Additional EDB reporting requirements applicable to both IMC and non-IMC schools

5. In addition to the above requirements in the EO, the EDB issues circular memoranda and reference notes for auditors for both IMC and non-IMC schools (both aided and DSS schools) regarding the auditor's reporting requirements, which also require auditors to state in their reports whether in their opinion the school financial statements give a true and fair view of (or present fairly) the state of the school's affairs as at the accounting year end date and of its results for the accounting year then ended. The EDB issues reporting requirements from time to time and the auditor should obtain a complete list of relevant reporting requirements from the School.

B. Compliance with the accounting requirements of the EDB

6. It has been identified by the Institute's Auditing and Assurance Standards Committee (AASC), in consultation with the EDB, that financial statements of aided and DSS schools 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 schools' financial statements.
7. 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.
8. The accounting requirements of the EDB, 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 government subventions by schools. 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.
9. As explained in paragraph A13 of HKSA 200, where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the HKSA is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework.
10. In accordance with the requirements of the EO and EDB as stated in paragraphs 4 and 5 above respectively, the auditors of schools are to provide a "present fairly" opinion or a "true and fair view" opinion. However, as explained in paragraph 8 above, because the financial reporting framework used by schools is a compliance framework, the auditor is unable to state whether the school's financial statements "present fairly" or provide a "true and fair view".
11. In this regard, the AASC, together with the EDB, have developed a two-part report to address the relevant reporting requirements, within the constraints of HKSA. The first part of the report would address whether the financial statements "present fairly" in accordance with HKFRSs or give a "true and fair view" in accordance with HKFRSs. The second part of the report would state whether the financial statements "are prepared, in all material respects, in accordance with" the requirements set by the EDB.

12. The Appendix to this Circular contains an example Independent Auditor's Report ("audit report") that is based on HKSA 800 (which is effective for audits of financial statements for periods beginning on or after 15 December 2009). In general, the financial year end of schools is 31 August, thus the revised reporting requirements are effective for audits of financial statements for years beginning on or after 1 September 2010 and ending on or after 31 August 2011.
13. The example audit report in the Appendix illustrates a "disclaimer" of opinion with respect to whether the financial statements "present fairly" or "give a true and fair view of" the financial transactions in accordance with HKFRSs and an unqualified opinion with respect to the EDB's requirements. The "disclaimer" of opinion is based on the premise that auditors cannot express an opinion on the financial statements as to whether they present fairly or give a true and fair view of the financial transactions of the school as the financial statements of the school have not been prepared in accordance with HKFRSs and the IMC or non-IMC has not quantified the departures of the financial statements from HKFRSs and it is not practical for the auditor to quantify these departures.
14. If the auditor is of the opinion that proper books of accounts have not been kept by the school, or if the balance sheet and income and expenditure account are not in agreement with the books of accounts, or if the auditor fails to obtain all the information and explanations which, to the best of their knowledge and belief, are necessary for the purpose of their audit, they should make appropriate qualifications in their reports. An example of the potential qualification wording is included in the example audit report in the Appendix.
15. 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, other than non-compliance with HKFRSs, that may 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. Conclusion

16. The Institute and the AASC may issue further guidance where appropriate as a result of any developments arising from discussions with the EDB.
17. The AASC welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk, for the attention of Steve Ong, Director, Standard Setting.

Date of Circular: 20 October 2011

APPENDIX

Example Independent Auditor's Report

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

It should be noted that below is an example audit report which should be considered in instances where it is not practicable for the auditor to quantify the departures of the financial statements from Hong Kong Financial Reporting Standards. Consideration should be given to other types of opinion (e.g. adverse, except for or unqualified opinion) in other instances depending on the circumstances.

The Basis for Disclaimer of Opinion and Opinion wordings may need to be aligned with the requirements of the EDB issued from time to time. If there are new reporting requirements issued by the EDB, the auditor needs to consider the implications to the audit report and include additional audit procedures as appropriate.

INDEPENDENT AUDITOR'S REPORT

TO THE [INCORPORATED][SCHOOL]¹ MANAGEMENT COMMITTEE OF ABC SCHOOL

We have audited the financial statements of ABC School ("the School") set out on pages to....., which comprise the [balance sheet][statement of financial position]² as at [year end date of the financial statements] and the [income statement][statement of comprehensive income]² for the year then ended, and a summary of significant accounting policies and other explanatory information. The financial statements have been prepared by the [Incorporated Management Committee ("IMC")][School Management Committee ("SMC")] based on the accounting requirements of the Education Bureau ("EDB") as described in Note 1 to the financial statements.

[Incorporated][School] Management Committee's Responsibility for the financial statements

The [IMC][SMC] of the School is responsible for the preparation of these financial statements in accordance with the accounting requirements of the EDB, which require the financial statements to be prepared in accordance with its [Code of Aid and other]³ related accounting instructions, and for such internal control as the [IMC][SMC] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In addition, the [IMC][SMC] is responsible to ensure the School has used the government [subventions][subsidies]⁴ in accordance with the applicable rules issued by the EDB and the correctness of the balances of individual grant accounts.

¹ Use "Incorporated Management Committee" for management committee incorporated under the Education Ordinance or "School Management Committee" for non-incorporated management committee.

² Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

³ Applicable to aided schools only.

⁴ "Subventions" is used for aided schools and "subsidies" is used for DSS schools.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. In addition, we are also engaged to report as to whether the School has used the government [subventions][subsidies]⁴ in accordance with the applicable rules issued by the EDB and whether the balances of individual grant accounts are, in all material respects, correct. Except for the inability to obtain sufficient appropriate audit evidence as explained below, 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 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 School'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 School's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the [IMC][SMC], as well as evaluating the overall presentation of the financial statements. In forming our opinion on the use of government [subventions][subsidies]⁴, our opinion thereon was based on the evidence obtained during the course of our audit of the financial statements, and when reporting on the balances of individual grant accounts, we report as to whether they are, in all material respects, correct in so far as the balances agree to the books and records made available to us.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on compliance with the accounting requirements of the EDB.

Basis for Disclaimer of Opinion on Compliance with Hong Kong Financial Reporting Standards

In accordance with the agreed terms of engagement, our responsibility is to consider whether the financial statements have been properly prepared in accordance with the EDB's [Code of Aid and its]³ related accounting instructions. The [IMC][SMC] has referred to the EDB's accounting requirements rather than Hong Kong Financial Reporting Standards when preparing the financial statements, and has not quantified the departures of these financial statements from Hong Kong Financial Reporting Standards. As it is not practicable for us to quantify the departures, we are unable to fulfil our other responsibility to opine as to whether the financial statements [present fairly][give a true and fair view of]⁵ the financial transactions of the School.

⁵ Use "present fairly" for schools managed by Incorporated Management Committee as stated in the Education Ordinance or "give a true and fair view of" for schools managed by Non-incorporated Management Committee as stated in the circulars issued by the EDB.

Opinion

Compliance with Hong Kong Financial Reporting Standards – Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on the financial statements as to whether they [present fairly][give a true and fair view of]⁵ the financial transactions of the School during the year ended [year end date of the financial statements] in accordance with Hong Kong Financial Reporting Standards.

Compliance with the accounting requirements of the EDB

In our opinion:

- (i) the financial statements are prepared, in all material respects, in accordance with the accounting requirements of the [Code of Aid,]³ relevant letters, circulars and guidelines issued by the EDB and such instructions as may be given by the Permanent Secretary for Education and reflect the financial transactions of the School during the year ended [year end date of the financial statements] and the financial position of the School as at [year end date of the financial statements];
- (ii) during the year ended [year end date of the financial statements], the School has used the government [subventions][subsidies]⁴ in accordance with the rules and ambits of the government grants as promulgated in [the Code of Aid,]³ the relevant letters, circulars and guidelines issued by the EDB; and
- (iii) the balances of individual grant accounts as at [year end date of the financial statements] are, in all material respects, correct.

Report on Other Legal and Regulatory Requirements

In respect of [describe the nature], in our opinion, [certain books of accounts have not been kept by the School,] [the balance sheet and income statement are not in agreement with the books of accounts];

In respect of [describe the nature], we have not obtained all the information and explanations that we considered necessary for the purpose of our audit.]⁶

Basis of Accounting

Without modifying our opinion on compliance with the accounting requirements of the EDB, we draw attention to Note 1 to the financial statements, which describes the basis of accounting. The basis of accounting has been designed to meet the requirements of the EDB and accordingly is not intended to [present fairly][give a true and fair view of]⁵ the financial transactions of the School in accordance with Hong Kong Financial Reporting Standards, or any other framework designed to provide fair presentation. The financial statements are prepared to assist the School to meet the

⁶ According to the circulars issued by the EDB, the auditors are also required to report by exception if they are unable to satisfy themselves regarding the above.

requirements of the EDB. As a result, the financial statements may not be suitable for another purpose⁷.

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

⁷ 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 accounting requirements of [the Code of Aid,]³ the relevant letters, circulars and guidelines issued by the EDB.
- 2 The significant accounting policies are set out below: