

PN 810.2 (Revised)  
Issued February 2015; revised February 2016, October 2016

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Effective for audits of financial statements  
for periods ending on or after 15 December 2016~~upon issue~~

*Practice Note 810.2 (Revised)*

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# **The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance**

~~\* There are specific transition arrangements for reporting under Parts 8 and 9 of the Third Schedule to the Insurance Companies Ordinance (Examples 4(a) to (d) of Appendix 2 in this Practice Note), please refer to Appendix 5 of this Practice Note.~~



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

**PRACTICE NOTE  
810.2 (REVISED)  
THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED UNDER  
THE INSURANCE COMPANIES ORDINANCE**

*(Issued February 2015; revised February 2016, October 2016  
Effective for audits of financial statements for periods ending on or after 15 December 2016 upon issue)*

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Practice Note (PN) 810.2 (Revised), *"The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance"* should be read in the context of the *"Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements"* which sets out the application and authority of PNs.

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*The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.*

*Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.*

**PART I - GENERAL**

**Introduction**

1. In this Practice Note ("PN") all the sections mentioned below are in respect of the Hong Kong Insurance Companies Ordinance (Cap.41) ("the Ordinance") unless otherwise stated.
2. This PN is intended to give guidance to members on the duties of the auditor of an insurer appointed under section 15 (see paragraphs 21 and 22) or paragraph 4(1A) of Part 1 of the Third Schedule to the Ordinance ("the Third Schedule"). In addition, guidance on the duties of the auditor of an insurance broker appointed under section 72 is also included (see paragraphs 55 to 57). This guidance is set out in Part II of this PN below.

This PN also provides guidance to members when reporting on levies paid to the insolvency schemes for Motor and Employee Compensation, and to the Terrorism scheme for Employee Compensation. This guidance is set out in Part III of this PN below.

It is not intended to provide detailed guidance on the general audit procedures to be adopted in respect of insurance companies and brokers.

3. The PN has been prepared following discussions with the Insurance Authority ("IA").
4. This is a guide to the provisions in the Ordinance which were effective as at 2 May 1997 (i.e. including the amendments introduced by the Insurance Companies (Amendment) Ordinance 1997), prepared for reference only. Every care has been taken in its preparation. However, the legislation itself is the sole authority of the law and the PN should be used in conjunction with the legislation.

**PART II – THE DUTIES OF THE AUDITOR UNDER THE INSURANCE COMPANIES  
ORDINANCE**

**Scope of the Ordinance**

5. The Ordinance is applicable to all persons (companies or individuals) carrying on insurance business in Hong Kong (including insurance brokers) other than those persons noted in paragraph 7 and those specifically exempted by section 51 (see paragraph 8). Insurers which are deemed to carry on insurance business in or from Hong Kong will also fall within the scope of the Ordinance. Section 2(3) provides that a person shall be deemed to carry on insurance business in or from Hong Kong if he opens or maintains an office or agency in Hong Kong for the purpose of carrying on insurance business, or he holds himself out as carrying on insurance business, in or from Hong Kong. Insurers will fall within this scope if they are incorporated in Hong Kong, have a place of business here, are represented here by an agent or are holding themselves out as

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carrying on insurance business in or from Hong Kong. The following would therefore be included within the scope of and required to be authorized under the Ordinance:

- a. a Hong Kong incorporated company carrying on insurance business in Hong Kong;
  - b. a Hong Kong incorporated company carrying on insurance business through an overseas branch or agency, whether or not it is operating as an insurer in Hong Kong;
  - c. an overseas incorporated company carrying on insurance business through a Hong Kong branch;
  - d. an overseas company carrying on insurance business in Hong Kong by means of an agency;
  - e. a captive insurer, as defined in section 2(7);
  - f. reinsurance companies carrying on reinsurance business in or from Hong Kong (but see paragraph 8(b)); and
  - g. any other person holding himself out as carrying on insurance business in or from Hong Kong.
6. The location of the risks is not relevant in determining whether a particular entity falls within the scope of the Ordinance. Thus, for example, an insurer or a reinsurer who is incorporated overseas and who has not established a place of business in Hong Kong, is not represented by an agent in Hong Kong, and does not hold himself out as carrying on insurance business in or from Hong Kong, can accept insurance or reinsurance premiums relating to Hong Kong risks, without having to be authorized under the Ordinance.
7. Under section 6(1), Lloyd's and an association of underwriters approved by the IA are allowed to carry on insurance business in or from Hong Kong without having to be authorized under the Ordinance. Also, the following persons, although involved in insurance business, do not have to be authorized under the Ordinance:
- a. a Hong Kong incorporated company with an overseas incorporated subsidiary that carries on insurance business outside Hong Kong, provided that the Hong Kong holding company is not itself an insurer;
  - b. an insurance agent (being a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or subagent of one or more insurers). However, an insurer is required to register its appointed insurance agents in accordance with section 66 and the IA has the power, also under section 66, to direct the insurer to de-register its appointed insurance agents under certain conditions.
8. Section 51 specifically exempts the following persons from the provisions of the Ordinance:
- a. any body of persons carrying on insurance business in Hong Kong whose gross premiums do not exceed HK\$500,000 in any financial year and who are bound together for certain specified purposes but not for the purpose of gain;
  - b. persons carrying on only reinsurance business in Hong Kong (unless incorporated in Hong Kong or, if incorporated elsewhere, who have a place of business in Hong Kong or are represented in Hong Kong by an agent or any other person or partnership having a place of business in Hong Kong);
  - c. registered trade unions (subject to certain limitations);
  - d. registered co-operative societies;

- e. the Hong Kong Export Credit Insurance Corporation;
  - f. banks, restricted licence banks and deposit-taking companies carrying on insurance business, limited to certain long term or general insurance business carried on solely for the purposes of their banking or deposit-taking business;
  - g. the Credit Union League of Hong Kong;
  - h. a recognized clearing house (as defined in section 51(h));
  - i. a person who is authorized under Part III of the Securities and Futures Ordinance (as defined in section 51(i)).
9. Under section 53 the Chief Executive in Council has power to exempt any insurer from any of the provisions of the Ordinance or to modify or vary any of its provisions in respect of any insurer.

### **Financial information to be submitted by insurers**

10. Section 20 requires two copies of the audited financial information required by the Third Schedule (as detailed in paragraph 11 and summarised in Appendix 1) to be submitted to the IA within six months of the end of the financial period to which they relate. At the same time, where an insurer is a company, section 21 requires that a copy of each document, except those required by Parts 8 and 9 of the Third Schedule (i.e. the returns on Hong Kong long term and/ or general businesses and statement of assets and liabilities), should be deposited with the Registrar of Companies.

11. Requirements for submitting financial information to the IA include:

- a. Statutory requirements

The Third Schedule requires, amongst other things, the following to be submitted annually to the IA:

- i. a report by the directors with respect to the profit or loss of the insurer for the financial year and the state of the insurer's affairs as at the end thereof (the detailed disclosure requirements of which are set out in Part 2 of the Third Schedule);
- ii. a balance sheet;
- iii. a revenue account;
- iv. a profit and loss account.

Where an insurer carrying on long term business only, or a captive insurer, is a holding company, whether or not it is itself a subsidiary of another body corporate, the statements in (ii) to (iv) above must in addition contain the equivalent consolidated information relating to the insurer and its subsidiaries.

Where an insurer is authorized to carry on general business:

- v. a return on Hong Kong business;
- vi. a statement of assets and liabilities (not applicable to reinsurers or captive insurers).

Where an insurer is authorized to carry on long term business:

- vii. a return on Hong Kong long term business.

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The detailed disclosure requirements for the statements in (ii) to (iv) above are outlined in Parts 3 to 5 of the Third Schedule while those relating to the returns referred to in (v) and (vii) above and the statement referred to in (vi) above are covered in Parts 8 and 9 of the Third Schedule respectively.

An auditor's report is required in respect of each of the statements referred to in (ii) to (iv) above (see paragraph 27), the returns referred to in (v) and (vii) above (see paragraphs 28 and 29) and the statement referred to in (vi) above (see paragraph 30).

b. Other requirements

Although it is not a statutory requirement, the IA requires an insurer to submit annually an audited cash flow statement in addition to the statutory requirements in (i) and (iv) above based on its previous circular.

12. The requirements for the submission of these statements to the IA do not override the requirements of the Companies Ordinance. Insurance companies which are incorporated in Hong Kong are also required to produce financial statements to lay before the shareholders in general meeting and these financial statements have to comply with the disclosure provisions of the Companies Ordinance.

**Holding company**

13. It should be noted that the additional provisions relating to an insurer which is a holding company (Part 3 (paragraphs 10 to 13) of the Third Schedule) may result in consolidated financial statements being prepared where none are required under the Companies Ordinance. Paragraph 10 of the Third Schedule provides that Part 3 of the Third Schedule shall apply to an insurer carrying on long term business only, or a captive insurer that is a holding company, whether or not it is itself a subsidiary of another body corporate. This means that such an insurer authorized in Hong Kong must prepare its own consolidated financial statements even if it is the wholly-owned subsidiary of a parent company, whether or not that parent company is an insurer. Where a group is structured vertically with each subsidiary or sub-subsiidiary being an insurer in its own right, each holding company in the group will have to submit group financial statements in respect of its own subgroup. Depending on the merits of individual insurer, it may be possible for the insurer to obtain a modification of the Third Schedule requirements by making an application under section 17(2).
14. Apart from the requirements under Parts 8 and 9, which are in respect of Hong Kong Insurance Business and Hong Kong Long Term Insurance Business (as defined in paragraph 1(1) of the Third Schedule) only, the information to be submitted under the Third Schedule shall be in respect of the total business of the insurer.

**Hong Kong branch**

15. Where an overseas company carries on insurance business in Hong Kong through a branch, the information required by the IA apart from the requirements under Parts 8 and 9 must relate to the company's worldwide position. In this respect it should be noted that section 17(2) permits the IA to modify or vary any of the requirements of the Third Schedule in relation to an insurer, provided that the insurer requests such a modification in writing. The IA has indicated that it may be prepared to modify or vary the requirements of the Third Schedule in respect of an overseas company incorporated in a country where the insurer is subject to an acceptable standard of prudential supervision depending on the merits of individual insurer. The auditor who audits a Hong Kong branch of such company is therefore recommended to suggest to the client that the insurer discusses with the IA.
16. According to the IA, submission of audited branch financial statements is one of the standard requirements for the giving or renewal of an accounting concession under section 17(2).
- a. Unless specifically required by the IA, the audited branch financial statements need not comply with the requirements of the Insurance Companies (General Business) (Valuation)

Regulation. They shall, however, comply so far as applicable with the requirements of the Third Schedule.

- b. The audited branch financial statements would normally include a revenue account, and/or a profit and loss account, a balance sheet, a cash flow statement and notes thereto.

The auditor of the branch is required to ascertain whether the financial statements have been prepared in accordance with the IA's conditions on accounting concession granted to the branch. The IA would normally require the branch to submit financial statements prepared in accordance with the Hong Kong Financial Reporting Standards (HKFRSs) and audited by certified public accountants who are qualified under the Professional Accountants Ordinance (Cap.50) (and not disqualified under section 393(2) of the Companies Ordinance) for appointment as auditors of a company. Financial statements prepared in accordance with the HKFRSs will be needed in order for the auditor to issue a report for Part 8 for the financial year ending on or after 31 December 2015. When the branch prepares the financial statements in accordance with the HKFRSs for the first time the requirements in HKFRS 1 "First-time Adoption of Hong Kong Financial Reporting Standards" apply in full. The auditor of the branch is also required to ascertain the extent the requirements of HKFRS 1 may have been exceptionally amended by the IA's accounting concession when certain facts and circumstances apply (for example the omission of comparative financial information for which the example audit opinion is included in Appendix 65). ~~The relevant transition arrangement is set out in Appendix 5.~~

### Requirement for assets in Hong Kong

17. General and composite insurers, other than captive insurers or persons authorized to carry on reinsurance business only, are required by section 25A to maintain assets in Hong Kong at all times in respect of their liabilities as of the end of the last preceding year, arising from Hong Kong Insurance Business, and to file a statement of assets and liabilities with the IA annually to ensure compliance. The Eighth Schedule to the Ordinance sets out a list of assets which qualify as assets in Hong Kong. The auditor's requirements to report on this statement are set out in paragraph 30. Where the insurer has entered into contracts of reinsurance for which the premiums payable exceeded 50% of the gross premiums received, such assets shall be at least equal to the greater of:
  - a. the aggregate of:
    - i. 80%<sup>1</sup> of its liabilities after deducting the amount in respect of which contracts of reinsurance have been entered into; and
    - ii. the relevant amount (see paragraph 18); and
  - b. the aggregate of:
    - i. 40% of its liabilities before deducting the amount in respect of which contracts of reinsurance have been entered into; and
    - ii. the relevant amount (see paragraph 18).

Where the insurer has not entered into contracts of reinsurance for which the premiums payable exceeded 50% of the gross premiums received, then such assets shall be at least equal to the amount determined in (a) above.

18. "Relevant amount" means the relevant amount determined in accordance with section 10 (see paragraph 38) except that:
  - a. the reference to gross premium income in that section shall, for the purposes of section 25A, be deemed to be the gross premium income arising from the insurer's Hong Kong Insurance Business only; and
  - b. the references to claims outstanding, additional amount for unexpired risks and fund in section 10 shall, for the purposes of section 25A, be deemed to be the claims outstanding, additional amount for unexpired risks and fund respectively arising from the insurer's Hong Kong Insurance Business only.

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<sup>1</sup> The IA may increase the percentage on individual case basis.



19. The value of assets and the amounts of liabilities shall be determined in accordance with any applicable valuation regulations made under section 59(1)(a). Existing valuation regulations at the time of issue of this PN are covered in paragraphs 41 to 51.
20. Pursuant to section 25A(8), if an insurer is required by law to, and does, maintain assets in a place outside Hong Kong for the sole purpose of making preferential payments to policyholders in respect of claims payable relating to Hong Kong insurance business where the insurer is in liquidation, then the assets to be maintained in Hong Kong by section 25A shall be reduced by the amount of these assets.

### **Appointment of the auditor**

21. Under section 15, the insurer must appoint an auditor ("the Appointed auditor") who is:
  - a. qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance); or
  - b. qualified as an auditor in the country of incorporation, if the insurer is incorporated outside Hong Kong and who holds such qualification as the IA accepts as being of a comparable standard to that of a person referred to in (a) above.

Financial information and statements to be submitted by an insurer under Parts 3, 4 and 5 of the Third Schedule, as appropriate, must be audited by the Appointed auditor.

22. The forms and statements to be submitted by an insurer under Parts 8 and 9 of the Third Schedule must be audited by an auditor who is qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance). This auditor may or may not be the Appointed auditor of the insurer referred to in paragraph 21.
23. The insurer must notify the IA in writing of any appointment of, or change in, its Appointed auditor within one month. The first auditor must be appointed within one month of the insurer beginning to carry on insurance business. It is recommended that before beginning the audit the auditor ensures that he/ she has been formally appointed under the Ordinance and that the IA has been notified of the appointment. The IA keeps a record of all the Appointed auditors of insurers for its own use.
24. Section 15A(1) requires that the insurer immediately notifies the IA in writing if for any reason a person appointed under section 15 ceases to be the Appointed auditor or a Hong Kong incorporated insurer proposes to give notice to its shareholders of a resolution removing/replacing the Appointed auditor.
25. Section 15A(2) requires the Appointed auditor to notify the IA in writing immediately if the auditor resigns, decides not to seek reappointment, or decides to qualify any of the auditor's reports required in respect of the information to be submitted under the Third Schedule. Further guidance on this obligation may be found in PN 620.2 "*Communications between the auditor and the Insurance Authority*" issued by the HKICPA.

### **The auditor's reports**

26. Separate requirements apply in respect of auditor's reports on the financial information, forms and statements required by the Third Schedule for different categories of insurers. These are set out below and in Appendix 1. Suggested forms of wording for each report are included in Appendix 2. For the IA's easy identification of all the forms and statements submitted which are reported on by the auditor, the auditor should stamp the identification chop on each page of the forms and statements. The page numbers set in the auditor's report on the statement to be submitted to the IA under Part 9 of the Third Schedule should refer to the statements and the accompanying supplementary information, where applicable.
27. Paragraph 4 of Part 1 of the Third Schedule requires the auditor to audit the financial information prepared in accordance with Parts 3, 4 and 5 of that Schedule (being a balance sheet, revenue account, profit and loss account and, where applicable, consolidated financial statements) and to state in the auditor's report the items set out below. Definitions of "relevant premium income" and

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"relevant claims outstanding" are contained in paragraphs 32 to 37. Solvency requirements are set out in paragraph 38.

The auditor is required to state:

*In the case of a general insurer other than a captive insurer,*

- a. the relevant premium income and relevant claims outstanding of, and the relevant amount as defined in section 10 (see paragraph 38) in the case of, the insurer;
- b. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by that relevant amount;
- c. whether in the auditor's opinion proper records have been maintained in accordance with section 16; and
- d. whether in the auditor's opinion the balance sheet, revenue account and profit and loss account have been properly prepared in accordance with the provisions of the Ordinance.

*In the case of an insurer carrying on long term business only,*

- a. the greater of:
  - i. the relevant amount as defined in section 10 (see paragraph 38) in the case of the insurer, and
  - ii. the required margin of solvency, as determined by the insurer's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation;
- b. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by the amount under (a) above;
- c. whether in the auditor's opinion proper records have been maintained in accordance with section 16;
- d. whether in the auditor's opinion the balance sheet, revenue account, profit and loss account and (if it is a holding company submitting group financial statements) the group financial statements have been properly prepared in accordance with the provisions of the Ordinance; and
- e. whether in the auditor's opinion the financial statements give a true and fair view of:
  - i. the state of the insurer's affairs;
  - ii. the insurer's profit or loss for the financial year (if the financial statements are unconsolidated); and
  - iii. the state of the group's affairs and of its profit or loss for the financial year (in the case of group financial statements).

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*In the case of a captive insurer,*

- a. the net premium income and net claims outstanding of, and the relevant amount as defined in section 10 (see paragraph 38) in the case of, the insurer;
- b. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by that relevant amount;
- c. whether in the auditor's opinion proper records have been maintained in accordance with section 16;
- d. whether in the auditor's opinion the balance sheet, revenue account, profit and loss account and (if it is a holding company submitting group financial statements) the group financial statements have been properly prepared in accordance with the provisions of the Ordinance; and
- e. whether in the auditor's opinion the financial statements give a true and fair view of:
  - i. the state of the insurer's affairs;
  - ii. the insurer's profit or loss for the financial year (if the financial statements are unconsolidated); and
  - iii. the state of the group's affairs and of its profit or loss for the financial year (in the case of group financial statements).

*In the case of a composite insurer,*

- a. the relevant premium income and relevant claims outstanding of, and the relevant amount as defined in section 10 (see paragraph 38) in the case of, the insurer's general business;
  - b. the greater of:
    - i. the relevant amount as defined in section 10 (see paragraph 38), and
    - ii. the required margin of solvency, as determined by the insurer's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation in the case of the insurer's long term business;
  - c. whether in the auditor's opinion the value of the assets of the insurer exceeds its liabilities by the aggregate of the relevant amount under (a) and the amount under (b) above;
  - d. whether in the auditor's opinion proper records have been maintained in accordance with section 16;
  - e. whether in the auditor's opinion the balance sheet, revenue account and profit and loss account have been properly prepared in accordance with the provisions of the Ordinance; and
  - f. whether in the auditor's opinion the financial statements give a true and fair view of the financial position of the insurer's long term business.
28. For insurers carrying on general insurance business, paragraph 4(1A)(a) of Part 1 of the Third Schedule requires the auditor to audit the forms (except Form HKL1) prepared in accordance with Part 8 of the Third Schedule (often referred to as the general business returns). The auditor is required to state:

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- a. whether in the auditor's opinion proper records have been maintained in accordance with section 16 for the purposes of preparing the forms;
  - b. whether the forms have been properly prepared in accordance with those records; and
  - c. whether the information supplied in the forms is prepared, in all material respects, in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance and, on that basis, the forms, when read in conjunction with the insurer's audited financial information for the year then ended prepared in accordance with Hong Kong Financial Reporting Standards and the provisions of the Ordinance, gives a true and fair view of the insurer's underwriting results pertaining to the Hong Kong Insurance Business for the year then ended.
29. For insurers carrying on long-term insurance business, paragraph 4(1A)(aa) of Part 1 of the Third Schedule requires the auditor to report on Form HKL1 prepared in accordance with Part 8 of the Third Schedule (revenue account), and to state:
- a. whether in the auditor's opinion proper records have been maintained in accordance with section 16 for the purposes of preparing the form; and
  - b. whether the form has been properly prepared in accordance with those records.
30. For insurers carrying on general insurance business, paragraph 4(1A)(b) of Part 1 of the Third Schedule requires the auditor to audit the statement of assets and liabilities ("the statement") prepared in accordance with Part 9 of the Third Schedule, and to state:
- a. whether in the auditor's opinion proper records have been maintained in accordance with section 16 for the purposes of preparing the statement;
  - b. whether the statement has been properly prepared in accordance with those records;
  - c. whether the values of the assets and liabilities have been determined in accordance with any applicable valuation regulations;
  - d. whether the relevant amount as defined in section 10 has been determined in accordance with section 25A(1) (see paragraph 18); and
  - e. where the statement is submitted pursuant to:
    - i. section 25A(9), the assets held by the insurer, as shown in the statement, enable it to comply with the requirement stipulated in section 25A as at the last day of the financial year and two such other dates in the financial year as the auditor may elect, provided that the intervening period between those two dates shall not be shorter than three months; or
    - ii. section 25B(3)(b), the assets held by the insurer, as shown in the statement, enable it to comply with the requirement stipulated in section 25B as at the date specified in the notice issued under that section.

Notwithstanding section 25A(3) which states that an insurer shall, at all times, maintain assets in Hong Kong in respect of its liabilities, as of the end of the last *preceding* financial year, it has been agreed with the IA that for the purposes of checking compliance with section 25A, the auditor compares the assets with liabilities on the last day of the *current* financial year as well as the assets at two dates during the year, as elected by the auditor, with the liabilities at the *preceding* financial year end date.

The auditor may add qualifications, amplifications or explanations to the auditor's reports as necessary.

31. The auditor's report required in respect of the financial information prepared in accordance with Parts 3, 4 and 5 of the Third Schedule relates to the financial information, which has to be submitted to the IA and the Registrar of Companies. Where the insurer is incorporated in Hong Kong, financial statements will also have to be prepared for the members in accordance with the applicable requirements of the Companies Ordinance. The auditor will be required to issue two separate audit reports, one for the members on the Companies Ordinance financial statements, and one addressed to the directors who will have the responsibility for submitting the financial information required by the Third Schedule to the IA. The report addressed to the directors will refer to the financial information prepared in accordance with the provisions of the Ordinance (see Appendix 2 for report format). The audit report addressed to members and relating only to the Companies Ordinance financial statements will also have to be submitted to the IA under section 20(5) (see Appendix – Illustrations 1 or 3 of HKSA 700 (Revised), "*Forming an Opinion and Reporting on Financial Statements*" for report format).

### **Definitions of "relevant premium income" and "relevant claims outstanding"**

32. "Relevant premium income" is defined as the greater of:
- a. 50% of the annual gross premium income of the company; and
  - b. gross premium income less premiums payable by the company in respect of reinsurance.

Gross premium income is defined in section 10(4)(c) as the premiums receivable in that financial year in respect of all insurance business other than long term business. Premiums receivable are defined as the premiums paid or payable to an insurer in respect of contracts written or renewed in that financial year before deducting commissions of agents or brokers but after deducting any discounts specified in policies or refunds of premiums made in respect of any termination or reduction of risks. Discounts specified in policies are generally discounts that relate to the reduction of risks which are being underwritten and should not contain an element of rebate as regards the premiums paid by the insured. Gross premium income as defined above will normally be the amount disclosed in the revenue account under the requirements of paragraph 24(1)(a) of the Third Schedule, provided that the amounts recorded are consistent with the amounts written in the year. It should be noted however that this will not be the same as the earned premiums accounted for on an accruals basis since the former is based on all contracts written in the financial year.

33. "Relevant claims outstanding" is defined as:
- a. where no class of the general business of the insurer is accounted for on a fund accounting basis, the aggregate of the following:
    - i. an amount equal to 50% of the claims outstanding (see paragraph 35) before deducting any amount recoverable from reinsurers thereon, or the amount of claims outstanding after deducting any amount recoverable from reinsurers thereon, whichever is the greater; and
    - ii. the additional amount for unexpired risks (see paragraph 36);
  - b. where all classes of the general business are accounted for on a fund accounting basis, the fund (see paragraph 37);
  - c. where part of the general business is accounted for on a fund accounting basis, the aggregate of the following:
    - i. in respect of *that* part, the fund (see paragraph 37); and
    - ii. in respect of *the other* part of that business:

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- an amount equal to 50% of the claims outstanding (see paragraph 35) before deducting any amount recoverable from reinsurers thereon, or the amount of claims outstanding after deducting any amount recoverable from reinsurers thereon, whichever is the greater; and
  - the additional amount for unexpired risks (see paragraph 36).
34. "Claims outstanding", "additional amount for unexpired risks" and "fund" are defined in paragraph 1(1) of Part 1 of the Third Schedule.
35. "Claims outstanding" is defined as, the amount set aside by an insurer as at the beginning or end of its financial year as being an amount likely to be sufficient to meet:
- a. claims in respect of incidents occurring:
    - i. in the case of an amount set aside as at the beginning of the financial year, before the beginning of that year; and
    - ii. in the case of an amount set aside at the end of the financial year, before the end of that year,being claims which have not been treated as claims paid and including claims relating to business accounted for over a longer period than a financial year, claims the amount of which have not been determined and claims arising out of incidents that have not been notified to the insurer; and
  - b. expenses (such as legal, medical, surveying and engineering costs) which have been incurred but not yet recorded as paid or which are likely to be incurred by the insurer, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual claims which relate to incidents occurring before the beginning or the end of the financial year (as the case may be), whether or not the individual claims in question are those mentioned above.
36. "Additional amount for unexpired risks" (otherwise known as premium deficiency) means the amount set aside by an insurer at the end of its financial year, in addition to any unearned premiums, which is considered necessary to meet the cost of claims and expenses of settlement arising from risks to be borne by the insurer after the end of the financial year under contracts of insurance entered into before the end of that year.
37. "Fund", in relation to general business recorded as commencing in any financial year of an insurer but accounted for over a period longer than that financial year, means, during such period, an amount not less than the aggregate amount of the premiums receivable during that period (net of reinsurance premiums payable) reduced by the aggregate amount of the claims paid (net of reinsurance recoveries), expenses for settling claims, commission (net of reinsurance commission receivable) and premium taxes in respect of that business and any management expenses attributable to the management of the fund, and after the end of such period, means such amount as is considered necessary to discharge the remaining obligations (net of reinsurance) in respect of that business.

### **Solvency requirements**

38. a. Each company authorized to conduct general business in or from Hong Kong (except a captive insurer) must maintain an excess of assets over liabilities by a relevant amount (often referred to as solvency margin) equivalent to 20% of relevant premium income or relevant claims outstanding, whichever is higher, up to HK\$200 million plus 10% of relevant premium income or relevant claims outstanding in excess of HK\$200 million. The minimum relevant amount required is HK\$10 million (HK\$20 million if authorized for statutory business).

- b. Each company authorized to conduct long term business in or from Hong Kong must maintain an excess of assets over liabilities by an amount equivalent to the greater of the relevant amount of HK\$2 million and the margin of solvency calculated in accordance with the Insurance Companies (Margin of Solvency) Regulation. At least the greater of HK\$2 million and one-sixth of the margin of solvency must be held in funds maintained in respect of its long term business (other than class G or H business specified in Part 2 of the First Schedule to the Ordinance).
- c. Each company authorized to conduct composite business in or from Hong Kong must maintain an excess of assets over liabilities by an amount equivalent to the aggregate of the amounts determined in accordance with (a) and (b) above.
- d. Each company authorized to conduct business as a captive insurer in or from Hong Kong must maintain an excess of assets over liabilities by a relevant amount equivalent to 5% of net premium income or net claims outstanding, whichever is higher. The minimum relevant amount is HK\$2 million.

A summary of solvency requirements is set out in Appendix 3 for easy reference.

### **Value of assets and liabilities**

39. The calculation of relevant premium income, relevant claims outstanding and the relevant amount applicable (see paragraph 38), and the required margin of solvency as determined by the insurer's appointed actuary are required in order to enable the auditor to state in the auditor's report, whether in the auditor's opinion the value of the assets of the insurer exceed its liabilities by the required amount applicable according to the Ordinance. The required amount is determined as being the relevant amount applicable in relation to an insurer's general and captive insurance business and the greater of the relevant amount and the required margin of solvency in relation to an insurer's long term business. An insurer is under an obligation to ensure that the value of the assets exceed its liabilities by the required amount at all times but it is recommended that the auditor only verifies the position at the balance sheet date and two such other dates in the financial year as the auditor may elect, provided that the intervening period between those two dates shall not be shorter than three months. If the value of the assets does not exceed its liabilities by the relevant amount applicable, the insurer is deemed to be unable to pay its debts under section 42 and can be wound up.
40. Subject to any relevant valuation regulations issued under section 59(1)(a) (see paragraphs 41 to 51), it is necessary to base the calculation on the provisions laid down in section 8. This section requires assets to be valued having regard to their market value and the cost of realising such assets. In computing the amount of liabilities, all contingent and prospective liabilities shall be taken into account but not liabilities in respect of the insurer's share capital. In determining the amount of these liabilities, regard shall be made to cost of settlement of such liabilities and, where the amount of any such liabilities is assessed or estimated, to the experience of the insurer in carrying on any relevant insurance business or of other persons carrying on the same or similar insurance business.

### **Valuation Regulation for companies carrying on general business**

41. In accordance with section 8(4)(b), the valuation of assets and liabilities of an insurer whose business includes or will include general business, other than a captive insurer, should be determined in accordance with the Insurance Companies (General Business) (Valuation) Regulation ("Valuation Regulation") issued in December 1995.
42. Different requirements are made in the Valuation Regulation in respect of different categories of assets. The major categories of assets in respect of which more detailed provisions are made, and the relevant sections in the Valuation Regulation, include:
  - a. land and buildings (section 3);
  - b. listed shares or securities, unit trusts or mutual funds (section 4);

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- c. shares in investment subsidiaries (section 5);
- d. shares in other insurers (section 6);
- e. other unlisted shares (section 7);
- f. unlisted securities (section 8); and
- g. premiums receivable (section 9).

Some provisions are also made in respect of:

- a. intangible assets and deferred acquisition costs (section 10);
- b. discounting of claims (section 11); and
- c. additional amount for unexpired risks (section 12).

- 43. Section 14 of the Valuation Regulation stipulates admissibility limits for the different categories of assets to ensure a prudent spread of investments. The admissibility limits are applicable to the financial information prepared in accordance with Parts 4 and 5 of the Third Schedule only. This section of the Valuation Regulation does not apply to the assets of an insurer required to be maintained in Hong Kong under section 25A or 25B and therefore does not apply to the statement of assets and liabilities prepared under Part 9 of the Third Schedule.
- 44. Notwithstanding that the value given to an asset of an insurer is permissible under the Valuation Regulation, if, in all circumstances of the case, it appears that the asset is of a lesser value than that given, such lesser value is to be the value of the asset (section 15 of the Valuation Regulation).
- 45. The Valuation Regulation reaffirms that where no provision for valuation is made under the Valuation Regulation in respect of any asset or liability, section 8(4)(c) continues to apply (section 13 of the Valuation Regulation).
- 46. In the case of a company carrying on or intending to carry on business as a captive insurer, the values of assets and liabilities may be determined in accordance with section 8.
- 47. Liabilities are defined in section 8(4) as including all contingent and prospective liabilities but excluding liabilities in respect of the insurer's share capital. Where specific valuation rules are not applicable, regard should be had to the cost of settlement of the liabilities and, where estimates are necessary, to the experience of the insurer in carrying on any relevant insurance business or of other persons carrying on the same or similar insurance business.
- 48. For the purpose of valuing the amount of liabilities, contingent liabilities will be assessed on the probability of their crystallisation. Generally it will be the auditor's responsibility to have regard to the nature of the contingency, the uncertainties which are expected to affect the ultimate outcome and a prudent estimate of the financial effect.

**Liabilities Regulation for companies carrying on long term business**

- 49. Where the liabilities of an insurer are in respect of long term business, they must be determined in accordance with the Insurance Companies (Determination of Long Term Liabilities) Regulation ("Liabilities Regulation").
- 50. The general principles and certain specific factors underlying the determination of long term liabilities are laid down in section 4 of the Liabilities Regulation. Generally, they shall be determined on actuarial principles, having due regard to the reasonable expectations of policyholders. Proper provisions shall be made for liabilities on a prudent basis including an allowance for adverse variations of relevant assumptions, and provisions shall be made for all



prospective liabilities as determined by the policy conditions for each contract, taking account of future premiums.

51. Specific requirements of the Liabilities Regulation, and the sections of that Regulation in which they are covered, are made in respect of options and guarantees (section 10), expenses (section 12), valuation of future premiums (section 14) and acquisition expenses (section 15). Section 5 of the Liabilities Regulation requires prospective calculations to be used in preference to retrospective calculations where possible.

### **Proper records**

52. The Ordinance requires the auditor to state specifically in the auditor's report whether proper records have been maintained in accordance with section 16.
53. Without prejudice to the Companies Ordinance, section 16 requires the insurer to keep proper books of account which sufficiently exhibit and explain all transactions entered into by the insurer in the course of any business carried on by him. These books can be kept either in a legible form or in a non-legible form capable of being reproduced in a legible form. The Ordinance also requires adequate precautions to be taken to guard against falsification of these records and to facilitate the discovery of any such falsification. In the case of an overseas insurer carrying on insurance business through a branch or an agency, the IA would normally require books to be kept in respect of all its branch or agency business carried on in or from Hong Kong.
54. These books of account must be kept for seven years from the end of the financial year to which the last entry made or matter recorded therein relates.

### **Insurance brokers**

55. Section 65 states that an insurer may not accept any business from an insurance broker in Hong Kong unless that broker is authorized. An authorized insurance broker may be an insurance broker directly authorized by the IA or a member of a body of insurance brokers approved by the IA. Sections 69 and 70 set out the requirements to be complied with by insurance brokers and bodies of insurance brokers in order to obtain the relevant authorization and approval.
56. Under section 72, the insurance broker must appoint an auditor who is:
  - a. qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance); or
  - b. qualified as an auditor in the country of incorporation, if the insurance broker is incorporated outside Hong Kong and who holds such qualification as the IA accepts as being of comparable to that of a person referred to in (a) above.
57. The auditor of an insurance broker is required to report on the broker's financial statements to its proprietor (in the case of an unincorporated broker) or its shareholders (in the case of an incorporated broker). The auditor is also required to report on an insurance broker's compliance with the minimum requirements. For further guidance on this area, members may refer to PN 810.1 (Revised), "*Insurance brokers - compliance with the minimum requirements specified by the Insurance Authority under sections 69(2) and 70(2) of the Insurance Companies Ordinance*" issued by the HKICPA.

## **Communications between the auditor and the IA**

58. Section 53D introduces statutory protection for an auditor from liability to the client for breach of confidentiality when he/ she communicates directly with the IA in good faith on matters relevant to any functions of the IA under the Ordinance. Sections 15A(2) (see paragraph 25) and 53E impose a statutory obligation on the auditor to report certain matters directly to the IA. Members may refer to PN 620.2 for further guidance in this area.

## **PART III – OTHER REPORTING**

### **Annual return on employees' compensation gross premium**

59. The Hong Kong Government (the "Government") has entered into an agreement with some authorized insurers for the provision of a facility covering terrorism risk in respect of employees' compensation insurance business. Under the agreement, the insurer is required to pay a monthly charge to the Government based on the gross premium in respect of the employees' compensation business written. An annual return together with a report by the auditor are required to be submitted to the IA within four months after the end of each financial year on the amounts of gross premium for the financial year and the charge payable thereon to the Government. For the IA's easy identification of the annual return which is reported on by the auditor, the auditor should bind the annual return together with the report thereon and stamp the identification chop on each page of the annual return. An auditor should conduct such an engagement in accordance with HKSAE 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*. An example auditor's report is set out in Example 1 in Appendix 4.

### **Report on levies paid to the insolvency scheme for motor compensation insurance**

60. All insurance companies in Hong Kong that are authorized by the Government to write motor vehicle insurance are required to be members of the Motor Insurers' Bureau of Hong Kong ("MIB"). Each member has entered into an agreement with the MIB to contribute such funds as may be required by the MIB to meet its objectives, and furnish particulars of motor premium income and submit such report as the MIB may from time to time deem necessary. A practitioner should conduct such an engagement in accordance with HKSRS 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information". An example report is set out in Example 2 in Appendix 4.

### **Report on levies paid to the insolvency scheme for employees' compensation insurance**

61. All insurance companies in Hong Kong who are authorized by the Government to write direct employees compensation insurance business are required to be members of the Employees Compensation Insurer Insolvency Bureau ("ECIIB"). Each member has entered into an agreement with the ECIIB to contribute such funds as may be required by the ECIIB to meet its objectives, and furnish particulars of employees' compensation premium income and submit such report as the ECIIB may from time to time deem necessary. A practitioner should conduct such an engagement in accordance with HKSRS 4400. An example report is set out in Example 3 in Appendix 4.

## Appendix 1

### What does the insurer need to submit to the IA?

The following summary lists out the references to different Parts of the Third Schedule to the Insurance Companies Ordinance and also includes the paragraph references in Part 1 of that Schedule that set out the reporting requirements.

	Parts 3 <sup>2</sup> , 4 and 5: Financial Information		Part 8 <sup>3</sup> : Return on Hong Kong business		Part 9 <sup>3</sup> : Statement on Hong Kong assets and liabilities under Hong Kong business	Notes
	Part 3	Parts 4, 5	Forms 1-9	Form HKL1		
General insurer	-	√ Para.4.(1AB)	√ Para.4.(1A)(a)	-	√ Para.4.(1A)(b)	a)
Long term insurer (including pure reinsurer)	√ Para.4.(1)*	√ Para.4.(1)*	-	√ Para.4.(1A)(aa)	-	b)
Composite insurer	-	√ Para.4.(1AC)^	√ Para.4.(1A)(a)	√ Para.4.(1A)(aa)	√ Para.4.(1A)(b)	c)
Captive insurer	√ Para.4.(1AD)*	√ Para.4.(1AD)*	√ Para.4.(1A)(a)			
Pure reinsurer (General)		√ Para.4.(1AB)	√ Para.4.(1A)(a)			
Pure reinsurer (Composite)		√ Para.4.(1AC)^	√ Para.4.(1A)(a)	√ Para.4.(1A)(aa)		
Lloyd's			√ Para.4.(1A)(a)		√ Para.4.(1A)(b)	

\* True and fair opinion required

^ True and fair opinion required in respect of the life insurance business only

<sup>2</sup> Part 3 of the Third Schedule deals with additional provisions relating to an insurer which is a holding company. It applies to an insurer carrying on long term business only or a captive insurer, which is a holding company preparing consolidated financial statements.

<sup>3</sup> Part 8 return and Part 9 statement should be prepared in respect of the insurer's Hong Kong Insurance Business and Hong Kong Long Term Insurance Business.

**Notes**

**a) General Insurer**

**i) *Financial information prepared under Parts 4 and 5 of the Third Schedule***

This financial information is submitted to the Insurance Authority by a general insurer. Part 4 deals with general provisions relating to the balance sheet. Part 5 deals with general provisions relating to the revenue account and profit and loss account.

The requirement to audit this financial information including the opinions to be given is set out in paragraph 4(1AB) of Part 1 of the Third Schedule. An example auditor's report is set out as Example 1 in Appendix 2.

**ii) *Forms prepared under Part 8 of the Third Schedule***

These forms are submitted to the Insurance Authority by a general insurer. These forms are in respect of the Hong Kong insurance business only as defined in Part 1 of the Third Schedule.

The requirement to report on these forms including the opinions to be given is set out in paragraph 4(1A)(a) of Part 1 of the Third Schedule. The general insurer prepares the standard forms to which the auditor will annex the auditor's report. Example auditor's reports are set out as Example 4(a) and 4(b) in Appendix 2.

**iii) *Statement prepared under Part 9 of the Third Schedule***

This statement is submitted to the Insurance Authority by a general insurer. This statement is in respect of the Hong Kong assets and liabilities as defined in Section 25A of the Ordinance.

The requirement to report on this statement including the opinions to be given is set out in paragraph 4(1A)(b) of Part 1 of the Third Schedule. The general insurer prepares the statement under Part 9 and auditor will annex the auditor's report. Example auditor's reports are set out as Example 4(c) and 4(d) in Appendix 2.

**b) Long term insurer**

**i) *Financial information prepared under Parts 3, 4 and 5 of the Third Schedule***

This financial information is submitted to the Insurance Authority by a long term insurer. Part 3 deals with additional provisions relating to a long term insurer which is a holding company. Part 4 deals with general provisions relating to the balance sheet. Part 5 deals with general provisions relating to the revenue account and profit and loss account.

The requirement to audit this financial information including the opinions to be given is set out in paragraphs 4(1) and (1AA) of Part 1 of the Third Schedule. An example auditor's report is set out as Example 2 in Appendix 2.

**ii) *Form HKL1 prepared under Part 8 of the Third Schedule***

This form is submitted to the Insurance Authority by a long term insurer. This form is in respect of the Hong Kong long term insurance business only as defined in Part 1 of the Third Schedule.

The requirement to report on this form including the opinions to be given is set out in paragraph 4(1A)(aa) of Part 1 of the Third Schedule. The long term insurer prepares the standard form to which the auditor will annex the auditor's report. An example auditor's report is set out as Example 5 in Appendix 2.

**c) Composite insurer**

**i) *Financial information prepared under Parts 4 and 5 of the Third Schedule***

This financial information is submitted to the Insurance Authority by a composite insurer. Part 4 deals with general provisions relating to the balance sheet. Part 5 deals with general provisions relating to the revenue account and profit and loss account.

The requirement to audit this financial information including the opinions to be given is set out in paragraph 4(1AC) of Part 1 of the Third Schedule. An example auditor's report is set out as Example 3 in Appendix 2.

**ii) *Forms prepared under Part 8 of the Third Schedule***

These forms are submitted to the Insurance Authority by a composite insurer. They relate only to the general business written in Hong Kong by a composite insurer.

The requirement to report on these forms including the opinions to be given is set out in paragraph 4(1A)(a) of Part 1 of the Third Schedule. The composite insurer prepares the standard forms to which auditor will annex the auditor's report. Example auditor's reports are set out as Example 4(a) and 4(b) in Appendix 2.

**iii) *Statement prepared under Part 9 of the Third Schedule***

This statement is submitted to the Insurance Authority by a composite insurer. The statement reports the Hong Kong assets and liabilities relating to the general business only.

The requirement to report on this statement including the opinions to be given is set out in paragraph 4(1A)(b) of Part 1 of the Third Schedule. The composite insurer prepares the statement under Part 9 and auditor will annex the auditor's report. Example auditor's reports are set out as Example 4(c) and 4(d) in Appendix 2.

**iv) *Form HKL1 prepared under Part 8 of the Third Schedule***

This form is submitted to the Insurance Authority by a composite insurer. The form is in respect of the Hong Kong long term insurance business only as defined in Part 1 of the Third Schedule.

The requirement to report on this form including the opinions to be given is set out in paragraph 4(1A)(aa) of Part 1 of the Third Schedule. The composite insurer prepares the standard form to which the auditor will annex the auditor's report. An example auditor's report is set out as Example 5 in Appendix 2.

## Appendix 2

### Example unmodified auditor's reports under the Third Schedule to the Insurance Companies Ordinance

- Example 1 – **General insurer:** an auditor's report on financial information to be submitted to the Insurance Authority in accordance with Parts 4 and 5 of the Third Schedule
- Example 2 – **Long term insurer:** an auditor's report on financial information to be submitted to the Insurance Authority in accordance with Parts 4 and 5 of the Third Schedule
- Example 3 – **Composite insurer:** an auditor's report on financial information to be submitted to the Insurance Authority in accordance with Parts 4 and 5 of the Third Schedule
- Example 4 – **General insurer/ Composite insurer:**
- (a) an auditor's report on forms (except Form HKL1) to be submitted to the Insurance Authority under Part 8 of the Third Schedule
  - (b) an auditor's report for Hong Kong branch of an overseas insurance company which has obtained an Accounting Concession under Section 17(2) of the Insurance Companies Ordinance on forms (except Form HKL1) to be submitted to the Insurance Authority under Part 8 of the Third Schedule
  - (c) an auditor's report on statement to be submitted to the Insurance Authority under Part 9 of the Third Schedule
  - (d) an auditor's report for Hong Kong branch of an overseas insurance company which has obtained an Accounting Concession under Section 17(2) of the Insurance Companies Ordinance on statement to be submitted to the Insurance Authority under Part 9 of the Third Schedule
- Example 5 – **Long term insurer/ Composite insurer:** an auditor's report on Form HKL1 to be submitted to the Insurance Authority under Part 8 of the Third Schedule

**Example 1 - General insurer: an auditor's report on financial information  
to be submitted to the Insurance Authority  
in accordance with Parts 4 and 5 of the Third Schedule**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of financial information of an entity other than a listed entity<sup>4</sup>, that have been prepared by the directors of the entity in accordance with the provisions of the Hong Kong Insurance Companies Ordinance (that is, a special purpose framework) to meet the requirements of the Insurance Authority. The directors do 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 the directors' responsibility for the financial statements in HKSA 210.<sup>5</sup>
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>6</sup>
- Use of the auditor's report is restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>7</sup>
- The auditor has obtained all of the other information<sup>8</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial information differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial information, the auditor has other reporting responsibilities required under paragraph 4(1AB) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance.

**INDEPENDENT AUDITOR'S REPORT**

To the Directors of XYZ Insurance Company Limited ~~THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED~~

**Report on the Audit of the Financial Information**

**Opinion**

We have audited the financial information of XYZ Insurance Company Limited ("the Company") set out on pages ..... to ....., which comprises the [balance sheet][statement of financial position] as at 31 December 20X1, and the [income statement][statement of profit or loss and other comprehensive income], [statement of changes in equity], [cash flow statement][statement of cash flows] and the revenue

<sup>4</sup> See HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* for illustrations of auditor's reports for listed entities.

<sup>5</sup> HKSA 210, *Agreeing the Terms of Audit Engagements*.

<sup>6</sup> HKSA 570 (Revised), *Going Concern*.

<sup>7</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>8</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c).

account for the year then ended, and notes to the financial information, including a summary of significant accounting policies and other explanatory information.

In our opinion, the financial information of the Company for the year ended 31 December 20X1 is prepared, in all material respects, in accordance with the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance").

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Information* section of our report. We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Emphasis of Matter - Basis of Accounting and Restriction on Use**

Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company in complying with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report. Our opinion is not modified in respect of this matter.<sup>9</sup>

### **Other Information [or another title if appropriate such as "Information Other than the Financial Information and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).*]

### **Responsibilities of Directors' Responsibility and Those Charged with Governance for the Financial Information**<sup>10</sup>

The directors are responsible for the preparation of the financial information in accordance with the provisions of the ~~Hong Kong Insurance Companies Ordinance~~ ("the Ordinance"), and for such internal control as the directors determine is necessary to enable the preparation of financial information that is free from material misstatement, whether due to fraud or error.

In preparing the financial information, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain the relevant amount applicable as defined in section 10 of the Ordinance.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

<sup>9</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

<sup>10</sup> Throughout the illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.



~~In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain the relevant amount applicable as defined in section 10 of the Ordinance.~~

### **Auditor's Responsibilities for the Audit of the Financial Information**

~~Our objectives are to obtain reasonable assurance about whether the financial information as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our responsibility is to express an opinion on this financial information based on our audit. We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the relevant amount applicable as at year end. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial information. In addition, ~~we~~ we ~~also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the relevant amount applicable as at year end.~~ Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.~~

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSA's expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or~~

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~~error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial information 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 directors, as well as evaluating the overall presentation of the financial information.~~

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

~~*Opinion*~~

~~In our opinion, the financial information of the Company for the year ended 31 December 20X1 is prepared, in all material respects, in accordance with the provisions of the Ordinance.~~

**Report on matters under paragraph 4(1AB) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance**

The relevant premium income, the relevant claims outstanding and the relevant amount applicable, as defined in section 10 of the Ordinance and reported in note x to the financial information, amounted to HK\$ \_\_\_\_\_, HK\$ \_\_\_\_\_ and HK\$ \_\_\_\_\_ respectively as at 31 December 20X1.

In our opinion:

- (i) proper records have been maintained in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1; and
- (ii) the value of the assets of the Company as determined under the Ordinance and reported in note x to the financial information exceeds its liabilities by not less than the relevant amount applicable as at 31 December 20X1.

**~~Basis of Accounting and Restriction on Use~~**

~~Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to comply with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>44</sup>.~~

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date]

<sup>44</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 2 - Long term insurer: an auditor's report on financial information  
to be submitted to the Insurance Authority  
in accordance with Parts 4 and 5 of the Third Schedule**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of financial information of an entity other than a listed entity<sup>12</sup>, that have been prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards (a general purpose framework) and the provisions of the Hong Kong Insurance Companies Ordinance to meet the requirements of the Insurance Authority. The directors do not have a choice of financial reporting frameworks.<sup>13</sup>
- The applicable financial reporting framework is a fair presentation framework.
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.<sup>14</sup>
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' Code of Ethics for Professional Accountants.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>15</sup>
- Use of the auditor's report is restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>16</sup>
- The auditor has obtained all of the other information<sup>17</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial information differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial information, the auditor has other reporting responsibilities required under paragraphs 4(1) and (1AA) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance.

**INDEPENDENT AUDITOR'S REPORT**

To the Directors of XYZ Insurance Company Limited ~~TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED~~

**Report on the Audit of the Financial Information**

**Opinion**

We have audited the financial information of XYZ Insurance Company Limited ("the Company") set out on pages ..... to ....., which comprises the [balance sheet][statement of financial position] as at 31 December 20X1, and the [income statement][statement of profit or loss and other comprehensive

<sup>12</sup> See HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* for illustrations of auditor's reports for listed entities.

<sup>13</sup> According to paragraph A14 of HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, the financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs.

<sup>14</sup> HKSA 210, *Agreeing the Terms of Audit Engagements*.

<sup>15</sup> HKSA 570 (Revised), *Going Concern*.

<sup>16</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>17</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c).

income], [statement of changes in equity], [cash flow statement][statement of cash flows] and the revenue account for the year then ended, and notes to the financial information, including a summary of significant accounting policies and other explanatory information.

In our opinion, the financial information gives a true and fair view of the state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") and is prepared, in all material respects, in accordance with the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance").#

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Information* section of our report. We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Emphasis of Matter - Basis of Accounting and Restriction on Use**

Without modifying our opinion, wWe draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to in complying with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report. Our opinion is not modified in respect of this matter.<sup>18</sup>

### **Other Information [or another title if appropriate such as "Information Other than the Financial Information and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).*]

### **Responsibilities of Directors' Responsibilities and Those Charged with Governance for the Financial Information**<sup>19</sup>

The directors are responsible for the preparation of the financial information that gives a true and fair view in accordance with Hong Kong Financial Reporting StandardsHKFRSs issued by the Hong Kong Institute of Certified Public AccountantsHKICPA and the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance"), and for such internal control as the directors determine is necessary to enable the preparation of financial information that is free from material misstatement, whether due to fraud or error.

In preparing the financial information, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

In addition, the directors are required to maintain proper records in accordance with section 16 of the

<sup>18</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

<sup>19</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

Ordinance and to maintain the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable as defined in the Ordinance (the "minimum solvency requirements").

Those charged with governance are responsible for overseeing the Company's financial reporting process.

~~In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable as defined in the Ordinance (the "minimum solvency requirements").~~

### **Auditor's Responsibilities for the Audit of the Financial Information**

Our objectives are to obtain reasonable assurance about whether the financial information as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our responsibility is to express an opinion on this financial information based on our audit. We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the minimum solvency requirements applicable as at year end. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial information. In addition, ~~We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the minimum solvency requirements applicable as at year end.~~ Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSA's expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's

report to the related disclosures in the financial information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial information, including the disclosures, and whether the financial information represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial information that gives 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial information.~~

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

#### ~~Opinion~~

~~In our opinion, the financial information gives a true and fair view of the state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and is prepared, in all material respects, in accordance with the provisions of the Ordinance.#~~

#### **Report on matters under paragraphs 4(1) and (1AA) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance**

The [relevant amount applicable, as defined in section 10 of the Ordinance]/[required margin of solvency, as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]\*, being greater than the [required margin of solvency, as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]/[relevant amount applicable, as defined in section 10 of the Ordinance]\*, amounted to HK\$ \_\_\_\_\_\*\* as at 31 December 20X1.

In our opinion:

- proper records have been maintained in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1; and
- the value of the assets of the Company as stated in the financial information exceeds its liabilities by not less than HK\$ \_\_\_\_\_\*\* as at 31 December 20X1.

#### **~~Basis of Accounting and Restriction on Use~~**

~~Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to comply with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority~~

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~~and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>20</sup>.~~

ABC & Co.

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

[*Auditor's Address*]

[*Date*]

\* Delete where appropriate.

\*\* The amount stated should be the same.

# May be qualified where the valuation of any asset or liability is in accordance with any statutory provision which does not give a true and fair view, indicating the items affected by such valuation and the statutory provisions in question.

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<sup>20</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 3 - Composite insurer: an auditor's report on financial information  
to be submitted to the Insurance Authority  
in accordance with Parts 4 and 5 of the Third Schedule**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of financial information of an entity other than a listed entity<sup>21</sup>, that have been prepared by the directors of the entity in accordance with the provisions of the Hong Kong Insurance Companies Ordinance to meet the requirements of the Insurance Authority. For the long term business, the statement of financial position is also prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs"). The directors do not have a choice of financial reporting frameworks.<sup>22</sup>
- The applicable financial reporting framework is a fair presentation framework.
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.<sup>23</sup>
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' Code of Ethics for Professional Accountants.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>24</sup>
- Use of the auditor's report is restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>25</sup>
- The auditor has obtained all of the other information<sup>26</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial information differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial information, the auditor has other reporting responsibilities required under paragraph 4 (1AC) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance.

**INDEPENDENT AUDITOR'S REPORT**

To the Directors of XYZ Insurance Company Limited ~~TO THE DIRECTORS OF XYZ INSURANCE COMPANY LIMITED~~

**Report on the Audit of the Financial Information**

**Opinion**

We have audited the financial information of XYZ Insurance Company Limited ("the Company") set out

<sup>21</sup> See HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* for illustrations of auditor's reports for listed entities.

<sup>22</sup> According to paragraph A14 of HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, the financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs.

<sup>23</sup> HKSA 210, *Agreeing the Terms of Audit Engagements*.

<sup>24</sup> HKSA 570 (Revised), *Going Concern*.

<sup>25</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>26</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c).



on pages ..... to ....., which comprises the [balance sheet][statement of financial position] as at 31 December 20X1, and the [income statement][statement of profit or loss and other comprehensive income], [statement of changes in equity], [cash flow statement][statement of cash flows] and the revenue account for the year then ended, and notes to the financial information, including a summary of significant accounting policies and other explanatory information, and the supplementary schedules set out on pages ..... to .....

In our opinion, the financial information set out on pages ..... to ..... is prepared, in all material respects, in accordance with the provisions of the Ordinance and, on that basis, the long term business [balance sheet][statement of financial position] on page ....., when read in conjunction with the notes on pages ..... to ..... and the supplementary schedules on pages ..... to ....., gives a true and fair view of the financial position of the Company's long term business as at 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") and the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance").<sup>#</sup>

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Information* section of our report. We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Emphasis of Matter - Basis of Accounting and Restriction on Use**

~~Without modifying our opinion, w~~We draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company ~~in complying with the provisions of the Ordinance.~~ As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report. Our opinion is not modified in respect of this matter.<sup>27</sup>

### **Other Information [or another title if appropriate such as "Information Other than the Financial Information and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).*]

### **Responsibilities of Directors' Responsibilities and Those Charged with Governance for the Financial Information<sup>28</sup>**

The directors are responsible for the preparation of the financial information that is in accordance with the provisions of the Hong Kong Insurance Companies Ordinance ("the Ordinance"). This responsibility includes the preparation of a long term business [balance sheet][statement of financial position] which, when read in conjunction with the notes and supplementary schedules to the financial information, gives a true and fair view of the financial position of the Company's long term business, in accordance with the provisions of the Ordinance and ~~Hong Kong Financial Reporting Standards~~HKFRSs issued by the ~~Hong Kong Institute of Certified Public Accountants~~HKICPA, and for such internal control as the directors determine is necessary to enable the preparation of financial information that is free from material misstatement, whether due to fraud or error.

<sup>27</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

<sup>28</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

In preparing the financial information, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain an excess of assets over liabilities by the aggregate of the relevant amount applicable and attributable to its general business as defined in section 10 of the Ordinance and the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable and attributable to its long term business as defined in the Ordinance.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

~~In addition, the directors are required to maintain proper records in accordance with section 16 of the Ordinance and to maintain an excess of assets over liabilities by the aggregate of the relevant amount applicable and attributable to its general business as defined in section 10 of the Ordinance and the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable and attributable to its long term business as defined in the Ordinance.~~

#### **Auditor's Responsibilities for the Audit of the Financial Information**

Our objectives are to obtain reasonable assurance about whether the financial information as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our responsibility is to express an opinion on this financial information based on our audit. We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the relevant amount applicable and attributable to general business and the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable and attributable to its long term business as defined in the Ordinance as at year end. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial information. In addition, ~~We also express opinion on whether proper records have been maintained in accordance with section 16 of the Ordinance and as to whether the value of the assets of the Company as determined under the Ordinance exceeds its liabilities by not less than the relevant amount applicable and attributable to general business and the greater of the required margin of solvency attributable to its long term business as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation and the relevant amount applicable and attributable to its long term business as defined in the Ordinance as at year end.~~ Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial information is free from material misstatement.

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit

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evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial information or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial information, including the disclosures, and whether the financial information represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

~~Opinion~~

~~In our opinion, the financial information set out on pages ..... to ..... is prepared, in all material respects, in accordance with the provisions of the Ordinance and, on that basis, the long term business [balance sheet][statement of financial position] on page ....., when read in conjunction with the notes on pages ..... to ..... and the supplementary schedules on pages ..... to ....., gives a true and fair view of the financial position of the Company's long term business as at 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards and the provisions of the Ordinance.#~~

**Report on matters under paragraph 4 (1AC) of Part 1 of the Third Schedule to the Hong Kong Insurance Companies Ordinance**

In respect of the Company's general business, the relevant premium income, the relevant claims outstanding and the relevant amount applicable, as defined in section 10 of the Ordinance and reported in note x to the financial information, amounted to HK\$\_\_\_\_\_, HK\$\_\_\_\_\_ and HK\$\_\_\_\_\_ respectively as at 31 December 20X1.

In respect of the Company's long term business, the [relevant amount applicable, as defined in Section

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10 of the Ordinance]/[required margin of solvency, as determined by the Company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]\*\*, being greater than the [required margin of solvency, as determined by the company's appointed actuary in accordance with the Insurance Companies (Margin of Solvency) Regulation]/[relevant amount applicable, as defined in Section 10 of the Ordinance]\*\*, amounted to HK\$\_\_\_\_\_ as at 31 December 20X1.

In our opinion:

- (i) proper records have been maintained in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1; and
- (ii) the value of the assets of the Company as stated in the financial information exceeds its liabilities by not less than HK\$\_\_\_\_\_ , being the aggregate of the [relevant amount applicable attributable to its general business and the required margin of solvency attributable to its long term business]/[relevant amounts applicable]\*\* as at 31 December 20X1.

**~~Basis of Accounting and Restriction on Use~~**

~~Without modifying our opinion, we draw attention to note X to the financial information, which describes the basis of accounting. The financial information is prepared to assist the Company to comply with the provisions of the Ordinance. As a result, the financial information may not be suitable for another purpose. Our report is intended solely for the submissions by the Company to the Hong Kong Insurance Authority and the Registrar of Companies and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>29</sup>.~~

ABC & Co.

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

[Auditor's Address]

[Date]

\*\* Delete where appropriate.

# May be qualified where the valuation of any asset or liability is in accordance with any statutory provision which does not give a true and fair view, indicating the items affected by such valuation and the statutory provisions in question.

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<sup>29</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 4(a) - General insurer/ Composite insurer: an auditor's report  
on forms (except Form HKL1)  
to be submitted to the Insurance Authority  
under Part 8 of the Third Schedule**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Directors of XYZ Insurance Company Limited

Pursuant to paragraph 4(1A)(a) of Part 1 of the Third Schedule to the Insurance Companies Ordinance ("the Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited ("the Company") to the Insurance Authority ("the IA").

*Directors' Responsibilities*

The directors are responsible for the preparation of forms in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance ("the Forms") set out on pages ..... to ..... This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Forms and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>30</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the matters referred to in paragraph 4(1A)(a) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our opinion.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

Our engagement includes examining, on a test basis, evidence supporting that proper records have been maintained by the Company in accordance with section 16 of the Ordinance for the purpose of preparing the Forms, and that the Forms have been properly compiled from those records.

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

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<sup>30</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

*Opinion*

Based on the foregoing, in our opinion:

- (i) the Company has maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1 for the purpose of preparing the Forms;
- (ii) the Forms have been properly prepared in accordance with those records; and
- (iii) the information supplied in the Forms is prepared, in all material respects, in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance and, on that basis, the Forms, when read in conjunction with the Company's audited financial information for the year ended 31 December 20X1 prepared in accordance with Hong Kong Financial Reporting Standards and the provisions of the Ordinance dated [ ], gives a true and fair view of the Company's underwriting results pertaining to the Hong Kong Insurance Business for the year then ended.\*

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>31</sup>.

ABC & Co.

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

[Auditor's Address]

Date

\* To facilitate compliance with various reporting requirements, the Insurance Authority expects an insurer to prepare a combined set of financial statements in accordance with the Hong Kong Companies Ordinance (Cap.622) and financial information in accordance with the Insurance Companies Ordinance (Cap.41) in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule to the Insurance Companies Ordinance. The effective date for this combined set of financial statements and information is for the financial year ending on or after 31 December 2015 with early adoption permitted. When preparing the combined set of financial statements and information, the insurer should refer to the guidance set out in Accounting Bulletin 6 "Guidance on the Requirements of Section 436 of the Hong Kong Companies Ordinance Cap. 622".

~~As a transition arrangement for reporting under Part 8 of the Third Schedule to the Insurance Companies Ordinance, the auditor should continue to use the report template in the superseded Auditing Bulletin 2 "Insurance Companies Ordinance — Auditors' Reports issued pursuant to the Third Schedule" if there is no early adoption.~~

<sup>31</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

**Example 4(b) - General insurer/ Composite insurer (Hong Kong Branch of an overseas insurance company which has obtained an Accounting Concession under Section 17(2) of the Insurance Companies Ordinance): an auditor's report on forms (except Form HKL1) to be submitted to the Insurance Authority under Part 8 of the Third Schedule**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Directors of XYZ Insurance Company Limited

Pursuant to paragraph 4(1A)(a) of Part 1 of the Third Schedule to the Insurance Companies Ordinance ("the Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited ("the Company") to the Insurance Authority ("the IA").

*Directors' Responsibilities*

The directors are responsible for the preparation of forms in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance ("the Forms") set out on pages ..... to ..... This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Forms and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>32</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the matters referred to in paragraph 4(1A)(a) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our opinion.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

Our engagement includes examining, on a test basis, evidence supporting that proper records have been maintained by the Company in accordance with section 16 of the Ordinance for the purpose of preparing the Forms, and that the Forms have been properly compiled from those records.

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

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<sup>32</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

*Opinion*

Based on the foregoing, in our opinion:

- (i) the Company has maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1 for the purpose of preparing the Forms;
- (ii) the Forms have been properly prepared in accordance with those records; and
- (iii) the information supplied in the Forms is prepared, in all material respects, in accordance with the provisions of Part 8 of the Third Schedule to the Ordinance and, on that basis, the Forms, when read in conjunction with the Company's Hong Kong Branch audited financial statements for the year ended 31 December 20X1 prepared in accordance with Hong Kong Financial Reporting Standards dated [ ], gives a true and fair view of the Company's underwriting results pertaining to the Hong Kong Insurance Business for the year then ended.

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>33</sup>.

ABC & Co.

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

[Auditor's Address]

Date

- \* Branch financial statements prepared in accordance with the HKFRSs will normally be required in order for the auditor to issue a report for Part 8 for the financial year ~~ending~~ ended on or after 31 December 2015. ~~For details of the transition arrangements for branch reporting, please refer to Appendix 5.~~

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<sup>33</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.



**Example 4(c) - General insurer/ Composite insurer: an auditor's report  
on statement to be submitted to the Insurance Authority  
under Part 9 of the Third Schedule**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Directors of XYZ Insurance Company Limited

Pursuant to paragraph 4(1A)(b) of Part 1 of the Third Schedule to the Insurance Companies Ordinance ("the Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited ("the Company") to the Insurance Authority ("the IA").

*Directors' Responsibilities*

The directors are responsible for the preparation of a statement in accordance with the provisions of Part 9 of the Third Schedule to the Ordinance ("the Statement") set out on pages ..... to .....<sup>34</sup> and to maintain at all times assets in Hong Kong which enable the Company to comply with the requirement of section 25A of the Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Statement and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>35</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the matters referred to in paragraph 4(1A)(b) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our opinion.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

We have performed such procedures as we consider are necessary for the purpose of our report, which include:

- (i) on the basis of the work we performed in connection with the audit of the Company's financial information prepared under Parts 4 and 5 of the Third Schedule for the year ended 31 December 20X1, assessing whether records have been properly maintained in accordance with section 16 of the Ordinance for the purpose of preparing the Statement;

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<sup>34</sup> The page numbers here should refer to the Statement and the accompanying supplementary information.

<sup>35</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

- (ii) comparing the Statement with the Company's records, and assessing whether the Statement has been properly prepared in accordance with those records and the requirements of Part 9 of the Third Schedule and whether the assets held by the Company, as shown in the Statement, enable it to comply with the requirement of Section 25A of the Ordinance as at 31 December 20X1; and
- (iii) comparing the assets held by the Company at two other dates during the year ended 31 December 20X1, as reflected in the Company's records, with the liabilities at the preceding financial year end date for the purpose of determining whether such assets enable it to comply with the requirement of section 25A of the Ordinance.

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

*Opinion*

Based on the foregoing, in our opinion:

- (i) the Company maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1 for the purpose of preparing the Statement;
- (ii) the Statement has been properly prepared in accordance with those records;
- (iii) the value of assets and amount of liabilities, as shown in the Statement, have been determined in accordance with the Insurance Companies (General Business) (Valuation) Regulation;
- (iv) the relevant amount, as shown in the Statement, has been determined in accordance with Section 25A(1) of the Ordinance; and
- (v) the assets held by the Company, as shown in the Statement, enable it to comply with the requirement of section 25A of the Ordinance as at 31 December 20X1 and, based on the records of the Company, the assets held by the Company as at [date 2\*] and [date 3 \*] enable it to comply with the requirement of section 25A of the Ordinance as at those dates#.

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>36</sup>.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
Date

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<sup>36</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

- \* The two dates selected must be not less than three months apart.
- \*\* Branch financial statements prepared in accordance with the HKFRSs will normally be required for the financial year ~~ending~~ ended on or after 31 December 2015. ~~For details of transition arrangements for branch reporting, please refer to Appendix 5.~~
- # Where the Company has received a notice under section 25B of the Ordinance then the opinion "(v)" will need to be amended accordingly as follows:
  - (v) the assets held by the Company, as shown in the Statement, enable it to comply with the requirement stipulated in section 25B of the Ordinance as at [date##].
- ## The date specified in the notice issued under section 25B of the Ordinance.

**Example 4(d) - General insurer / Composite insurer (Hong Kong Branch of an overseas insurance company which has obtained an Accounting Concession under Section 17(2) of the Insurance Companies Ordinance): an auditor's report on statement to be submitted to the Insurance Authority under Part 9 of the Third Schedule**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Directors of XYZ Insurance Company Limited

Pursuant to paragraph 4(1A)(b) of Part 1 of the Third Schedule to the Insurance Companies Ordinance ("the Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited ("the Company") to the Insurance Authority ("the IA").

*Directors' Responsibilities*

The directors are responsible for the preparation of a statement in accordance with the provisions of Part 9 of the Third Schedule to the Ordinance ("the Statement") set out on pages ..... to .....<sup>37</sup> and to maintain at all times assets in Hong Kong which enable the Company to comply with the requirement of section 25A of the Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of the Statement and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>38</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the matters referred to in paragraph 4(1A)(b) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our opinion.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

We have performed such procedures as we consider are necessary for the purpose of our report, which include:

- (i) on the basis of the work we performed in connection with the audit of the Company's Hong Kong Branch financial statements prepared under Hong Kong Financial Reporting Standards\*\* for the year ended 31 December 20X1, assessing whether records have been properly maintained in accordance with section 16 of the Ordinance for the purpose of preparing the Statement;

<sup>37</sup> The page numbers here should refer to the Statement and the accompanying supplementary information.

<sup>38</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

- (ii) comparing the Statement with the Company's records, and assessing whether the Statement has been properly prepared in accordance with those records and the requirements of Part 9 of the Third Schedule and whether the assets held by the Company, as shown in the Statement, enable it to comply with the requirement of Section 25A of the Ordinance as at 31 December 20X1; and
- (iii) comparing the assets held by the Company at two other dates during the year ended 31 December 20X1, as reflected in the Company's records, with the liabilities at the preceding financial year end date for the purpose of determining whether such assets enable it to comply with the requirement of section 25A of the Ordinance.

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

*Opinion*

Based on the foregoing, in our opinion:

- (i) the Company maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended 31 December 20X1 for the purpose of preparing the Statement;
- (ii) the Statement has been properly prepared in accordance with those records;
- (iii) the value of assets and amount of liabilities, as shown in the Statement, have been determined in accordance with the Insurance Companies (General Business) (Valuation) Regulation;
- (iv) the relevant amount, as shown in the Statement, has been determined in accordance with Section 25A(1) of the Ordinance; and
- (v) the assets held by the Company, as shown in the Statement, enable it to comply with the requirement of section 25A of the Ordinance as at 31 December 20X1 and, based on the records of the Company, the assets held by the Company as at [date 2\*] and [date 3 \*] enable it to comply with the requirement of section 25A of the Ordinance as at those dates#.

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>39</sup>.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
Date

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<sup>39</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

- \* The two dates selected must be not less than three months apart.
- \*\* Branch financial statements prepared in accordance with the HKFRSs will normally be required for the financial year ~~ending~~ended on or after 31 December 2015. ~~For details of transition arrangements for branch reporting, please refer to Appendix 5.~~
- # Where the Branch has received a notice under section 25B of the Ordinance then the opinion "(v)" will need to be amended accordingly as follows:
  - (v) the assets held by the Company, as shown in the Statement, enable it to comply with the requirement stipulated in section 25B of the Ordinance as at [date##].
- ## The date specified in the notice issued under section 25B of the Ordinance.

**Example 5 - Long term insurer/ Composite insurer: an auditor's report  
on Form HKL1 to be submitted to the Insurance Authority  
under Part 8 of the Third Schedule**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Directors of XYZ Insurance Company Limited

Pursuant to paragraph 4(1A)(aa) of Part 1 of the Third Schedule to the Insurance Companies Ordinance (the "Ordinance"), we have been requested to issue this report for submission by XYZ Insurance Company Limited (the "Company") to the Insurance Authority ("the IA").

*Directors' Responsibilities*

Pursuant to the provisions of Part 8 of the Third Schedule to the Ordinance, the directors have a responsibility for ensuring that Form HKL1 set out on pages ..... to .....has been properly compiled from the records of the Company in accordance with the Guide to Forms HKL1, HKL2 and HKL3 issued by the IA on 26 February 2004, as further updated on 7 April 2004. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of Form HKL1 and applying appropriate accounting policies; and making estimates that are reasonable in the circumstances. In addition, the directors are also responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Ordinance.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>40</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the matters referred to in paragraph 4(1A)(aa) of Part 1 of the Third Schedule to the Ordinance, based on our work performed and to report our opinion.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised) *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

Our engagement includes examining, on a test basis, evidence supporting that proper records have been maintained by the Company in accordance with section 16 of the Ordinance for the purpose of preparing the attached Form HKL1, and that the attached Form HKL1 has been properly compiled from the records of the Company in accordance with the Guide to Forms HKL1, HKL2 and HKL3 issued by the IA on 26 February 2004, as further updated on 7 April 2004.

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

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<sup>40</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

*Opinion*

Based on the foregoing, in our opinion:

- a. the Company has maintained proper records in accordance with section 16 of the Ordinance in respect of the year ended [*year end date*] for the purposes of preparing the attached Form HKL1; and
- b. the attached Form HKL1 has been properly prepared in accordance with those records.

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the IA and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>41</sup>.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[*Auditor's Address*]  
Date

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<sup>41</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.



**Appendix 3**  
**Solvency requirements**

Business	Solvency requirements	Relevant amount	Maximum relevant amount	Minimum relevant amount
General	An excess of assets over liabilities by the relevant amount	20% of relevant premium income or relevant claims outstanding, whichever is higher	HK\$40 million plus 10% of relevant premium income or relevant claims outstanding in excess of HK\$200 million	HK\$10 million (HK\$20 million if authorized for statutory business)
Long term	An excess of assets over liabilities by the greater of the relevant amount and the required margin of solvency calculated in accordance with the Insurance Companies (Margin of Solvency) Regulation*	Other than classes G & H: HK\$2 million  Classes G & H: HK\$ nil	-	-
Composite	An excess of assets over liabilities by the aggregate of the amounts for general and long term business	-	-	-
Captive	An excess of assets over liabilities by the relevant amount	5% of net premium income or net claims outstanding, whichever is higher	-	HK\$2 million

\* At least the greater of HK\$2 million and one-sixth of the margin of solvency must be held in funds maintained in respect of its long term business (other than classes G & H business specified in Part 2 of the First Schedule to the Ordinance).

## **Appendix 4**

### **Example reports for other reporting**

- Example 1 – Report by the auditor on annual return on employees' compensation gross premium
- Example 2 – Report on levies paid to the insolvency scheme for motor compensation insurance
- Example 3 – Report on levies paid to the insolvency scheme for employees' compensation insurance

## Example 1 – Report by the auditor on annual return on employees' compensation gross premium

### INDEPENDENT AUDITOR'S ASSURANCE REPORT ON ANNUAL RETURN ON EMPLOYEES' COMPENSATION GROSS PREMIUM

To the Directors of XYZ Insurance Company Limited

Pursuant to the Agreement for Provision of Facility covering Terrorism Risks in respect of Employees' Compensation Insurance Business entered into between XYZ Insurance Company Limited ("the Company") and the Government of the Hong Kong Special Administrative Region ("HKSAR") dated [date] ("Agreement"), we have been requested to report on the attached Annual Return on Employees' Compensation Gross Premium for the [\*year ended [date]/period from [date] to [date]] ("Annual Return").

#### *Directors' Responsibilities*

Pursuant to the Agreement, the directors are responsible for preparing the Annual Return. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation of the Annual Return. In addition, the directors are responsible for ensuring that the Company maintains proper records at all times in accordance with section 16 of the Insurance Companies Ordinance ("the Ordinance").

#### *Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>42</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on the Annual Return, based on our work performed and to report our opinion.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Companies Ordinance* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

Our engagement includes examining evidence supporting that proper records have been maintained in accordance with section 16 of the Ordinance and the amounts in the Annual Return, and performing such other procedures as we considered necessary in the circumstances.

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

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<sup>42</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

THE DUTIES OF THE AUDITOR OF AN INSURER AUTHORIZED  
UNDER THE INSURANCE COMPANIES ORDINANCE

*Opinion*

Based on the foregoing, in our opinion:

- (a) the Company has maintained proper records in accordance with section 16 of the Ordinance for the purpose of preparing the Annual Return; and
- (b) the Annual Return has been properly prepared, in all material respects, from the books and records of the Company.

*Intended Users and Purpose*

This report is intended for filing with the Government of the HKSAR pursuant to the Agreement and is not intended to be, and should not be, distributed to or used by, anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>43</sup>.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
Date

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<sup>43</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

## Example 2 – Report on levies paid to the insolvency scheme for motor compensation insurance

### REPORT OF FACTUAL FINDINGS

To the Directors of XYZ Insurance Company Limited ~~TO THE DIRECTORS OF XYZ INSURANCE  
COMPANY LIMITED~~

We have performed the procedures agreed with you and enumerated below with respect to the premium surcharges ("the Surcharges") for motor insurance business of XYZ Insurance Company Limited ("the Company") for the year ended 31 December 20X1 as set forth in the accompanying schedules. The procedures were performed solely to assist you in connection with the requirements of the Motor Insurers' Bureau of Hong Kong as to annual reporting of the Surcharges payable according to the books and records of the Company.

Our engagement was undertaken in accordance with 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 performed are summarised as follows:

1. We obtained and checked the summation of the 20X1 quarterly returns prepared by the Company regarding the determination of Surcharges due in respect of the First Fund and the Insolvency Fund Scheme ("the Quarterly Returns").
2. We compared the Surcharges as stated in the Quarterly Returns to the books and records of the Company.

We report our findings below:

- (a) With respect to item 1, we found the summation of the Surcharges payable for motor insurance business of the Company for the year ended 31 December 20X1 to be correct.
- (b) With respect to item 2, we found the amounts to be in agreement.

Because the above procedures do not constitute an assurance engagement made in accordance with Hong Kong Standards on Auditing ("HKSAAs"), Hong Kong Standards on Review Engagements ("HKSREs") or Hong Kong Standards on Assurance Engagements ("HKSAEs"), we do not express any assurance on the figures as set forth in the accompanying schedules.

Had we performed additional procedures or had we performed an assurance engagement on the information provided in accordance with HKSAAs, HKSREs or HKSAEs issued by the HKICPA, other matters might have come to our attention that would have been reported to you.

Our report is prepared solely for the purpose set forth in the first paragraph of this report and for your information and use of the Company for submission to the Motor Insurers' Bureau of Hong Kong and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to items specified above and does not extend to any financial statements of the Company, taken as a whole.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
Date

### Example 3 – Report on levies paid to the insolvency scheme for employees' compensation insurance

#### REPORT OF FACTUAL FINDINGS

To the Directors of XYZ Insurance Company Limited ~~TO THE DIRECTORS OF XYZ INSURANCE  
COMPANY LIMITED~~

We have performed the procedures agreed with you and enumerated below with respect to the Gross Premium Income as defined under Clause 1.01 of the Insolvency Fund Agreement and the amount of contributions payable ("the Contributions") for employees' compensation business of XYZ Insurance Company Limited ("the Company") for the year ended 31 December 20X1 as set forth in the accompanying schedules. The procedures were performed solely to assist you in connection with the requirements of the Employees Compensation Insurer Insolvency Bureau as to annual reporting of the Gross Premium Income and the Contributions according to the books and records of the Company.

Our engagement was undertaken in accordance with 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 performed are summarised as follows:

1. We obtained and checked the summation of the 20X1 quarterly returns prepared by the Company regarding the Gross Premium Income and the determination of Contributions due in respect of the Insolvency Fund Scheme ("the Quarterly Returns").
2. We compared the Gross Premium Income and the Contributions as stated in the Quarterly Returns to the books and records of the Company.

We report our findings below:

- (c) With respect to item 1, we found the summation of the Gross Premium Income and the amount of the Contributions payable for employees' compensation business of the Company for the year ended 31 December 20X1 to be correct.
- (d) With respect to item 2, we found the amounts to be in agreement.

Because the above procedures do not constitute an assurance engagement made in accordance with Hong Kong Standards on Auditing ("HKSA"), Hong Kong Standards on Review Engagements ("HKSREs") or Hong Kong Standards on Assurance Engagements ("HKSAEs"), we do not express any assurance on the figures as set forth in the accompanying schedules.

Had we performed additional procedures or had we performed an assurance engagement on the information provided in accordance with HKSA, HKSREs or HKSAEs issued by the HKICPA, other matters might have come to our attention that would have been reported to you.

Our report is prepared solely for the purpose set forth in the first paragraph of this report and for your information and use of the Company for the submission to the Employees Compensation Insurer Insolvency Bureau and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to items specified above and does not extend to any financial statements of the Company, taken as a whole.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
Date

## **Appendix 5**

### **Transition arrangements**

For General Insurer/ Composite Insurer:

~~1. Reporting under Part 8 of the Third Schedule (Example 4(a) and 4(b) in Appendix 2)~~

- ~~a. To facilitate compliance with various reporting requirements, the Insurance Authority expects an insurer to prepare a combined set of financial statements in accordance with the Hong Kong Companies Ordinance (Cap.622) and financial information in accordance with the Insurance Companies Ordinance (Cap.41) ("the Ordinance") in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule to the Ordinance. The effective date for this combined set of financial statements and information is for the financial year ending on or after 31 December 2015 with early adoption permitted.~~

~~As a transition arrangement, the auditor should continue to use the report template in the superseded Auditing Bulletin 2 "Insurance Companies Ordinance – Auditors' Reports issued pursuant to the Third Schedule" if there is no early adoption.~~

- ~~b. When the reporting entity is a Hong Kong branch of an overseas insurance company which has been granted accounting concession under section 17(2) of the Ordinance, the branch is normally required to prepare financial statements in accordance with the HKFRSs and audited by certified public accountants who are qualified under the Professional Accountants Ordinance (and not disqualified under section 393(2) of the Companies Ordinance) for appointment as auditors of a company in order for an auditor to give a true and fair view opinion for reporting under Part 8 of the Third Schedule to the Ordinance. The effective date is for the financial year ending on or after 31 December 2015 with early adoption permitted.~~

~~As a transition arrangement, the auditor should continue to use the report template in the superseded Auditing Bulletin 2 "Insurance Companies Ordinance – Auditors' Reports issued pursuant to the Third Schedule" if there is no early adoption.~~

~~2. Reporting under Part 9 of the Third Schedule (Example 4(c) and 4(d) in Appendix 2)~~

~~The same transition arrangement as set out in 1.b. above applies.~~

## **Appendix 56**

### **Example auditor's reports on Hong Kong Branch of an overseas insurance company**

- Example 1 – modified auditor's report on financial statements prepared in accordance with Hong Kong Financial Reporting Standards for the first time and where comparative information has not been presented and disclosed as required under Hong Kong Financial Reporting Standards
- Example 2 – unmodified auditor's report on financial statements prepared in accordance with Hong Kong Financial Reporting Standards pursuant to the conditions of accounting concession



**Example 1 - modified auditor's report on financial statements prepared in accordance with Hong Kong Financial Reporting Standards for the first time and where comparative information has not been presented and disclosed as required under Hong Kong Financial Reporting Standards**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a branch that have been prepared by the chief executive of the branch in accordance with Hong Kong Financial Reporting Standards (a general purpose framework) to assist the branch in complying with the conditions of the accounting concession. The directors do not have a choice of financial reporting frameworks.<sup>44</sup>
- The applicable financial reporting framework is a fair presentation framework.
- The terms of the audit engagement reflect the description of the chief executive's responsibility for the financial statements in HKSA 210.<sup>45</sup>
- The comparative information has not been presented as required by Hong Kong Accounting Standard 1 (Revised), *Presentation of Financial Statements*. The misstatement is deemed to be material but not pervasive to the financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>46</sup>
- Use of the auditor's report is restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>47</sup>
- The auditor has obtained all of the other information<sup>48</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law or regulation.

## INDEPENDENT AUDITOR'S REPORT

To the Chief Executive of the Hong Kong Branch of XYZ Insurance Company Limited ~~TO THE CHIEF EXECUTIVE OF THE HONG KONG BRANCH OF XYZ INSURANCE COMPANY LIMITED~~

### Qualified Opinion

We have audited the financial statements of XYZ Insurance Company Limited's Hong Kong Branch ("the Branch") set out on pages ..... to ....., which comprise the statement of financial position as at 31 December 20X1, and the [statement of profit or loss and] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then

<sup>44</sup> According to paragraph A14 of HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, the financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs.

<sup>45</sup> HKSA 210, *Agreeing the Terms of Audit Engagements*.

<sup>46</sup> HKSA 570 (Revised), *Going Concern*.

<sup>47</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>48</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c).

ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* paragraph section of our report, the financial statements give a true and fair view of the financial position of the Branch as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

### **Basis for Qualified Opinion**

As explained in [note X] to the financial statements, the comparative information for the year ended 31 December 20X1 has not been presented as required by Hong Kong Accounting Standard 1 (Revised) "Presentation of Financial Statements" which requires an entity to present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Branch in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

### **Emphasis of Matter - Basis of Accounting and Restriction on Use**

~~Without modifying our opinion, w~~We draw attention to note [X] to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Branch ~~to~~in complying with the conditions of the accounting concession. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the submissions by the Branch to the Hong Kong Insurance Authority and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report. Our opinion is not modified in respect of this matter.<sup>49</sup>

### **Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).]

### **Responsibilities of Chief Executive's Responsibility and Those Charged with Governance for the Financial Statements<sup>50</sup>**

Pursuant to the conditions of the accounting concession under section 17(2) of the Hong Kong Insurance Companies Ordinance granted by the Hong Kong Insurance Authority, the Chief Executive is responsible for the preparation of the financial statements that give a true and fair view in accordance with ~~Hong Kong Financial Reporting Standards~~HKFRSs issued by the ~~Hong Kong Institute of Certified Public Accountants~~("HKICPA"), and for such internal control as the Chief Executive determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Executive is responsible for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the

<sup>49</sup> The above wording has been agreed with the Insurance Authority. However, 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".

<sup>50</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

going concern basis of accounting unless the Chief Executive either intends to liquidate the Branch or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Branch's financial reporting process.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. 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 HKICPA. These 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.

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSA's expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to audit 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 Branch's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Chief Executive.
- Conclude on the appropriateness of the Chief Executive's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Branch's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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 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 entity's internal control. An audit also includes evaluating the appropriateness of

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UNDER THE INSURANCE COMPANIES ORDINANCE

~~accounting policies used and the reasonableness of accounting estimates made by the Chief Executive, 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 qualified audit opinion.~~

~~*Basis for Qualified Opinion*~~

~~As explained in [note X] to the financial statements, the comparative information for the year ended 31 December 20X1 has not been presented as required by Hong Kong Accounting Standard 1 (Revised) "Presentation of Financial Statements" which requires an entity to present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements.~~

~~*Qualified Opinion*~~

~~In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Branch as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.~~

~~*Basis of Accounting and Restriction on Use*~~

~~Without modifying our opinion, we draw attention to note [X] to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Branch to comply with the conditions of the accounting concession. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the submissions by the Branch to the Hong Kong Insurance Authority and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>54</sup>.~~

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date]

<sup>54</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.

## Example 2 - unmodified auditor's report on financial statements prepared in accordance with Hong Kong Financial Reporting Standards pursuant to the conditions of accounting concession

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a branch that have been prepared by the chief executive of the branch in accordance with Hong Kong Financial Reporting Standards (a general purpose framework) to assist the branch in complying with the conditions of the accounting concession. The directors do not have a choice of financial reporting frameworks.<sup>52</sup>
- The applicable financial reporting framework is a fair presentation framework.
- The terms of the audit engagement reflect the description of the chief executive's responsibility for the financial statements in HKSA 210.<sup>53</sup>
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' Code of Ethics for Professional Accountants.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>54</sup>
- Use of the auditor's report is restricted.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>55</sup>
- The auditor has obtained all of the other information<sup>56</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law or regulation.

### INDEPENDENT AUDITOR'S REPORT

To the Chief Executive of the Hong Kong Branch of XYZ Insurance Company Limited ~~TO THE CHIEF EXECUTIVE OF THE HONG KONG BRANCH OF XYZ INSURANCE COMPANY LIMITED~~

#### Opinion

We have audited the financial statements of XYZ Insurance Company Limited's Hong Kong Branch ("the Branch") set out on pages ..... to ....., which comprise the statement of financial position as at [Date], and the [statement of profit or loss and] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the financial statements give a true and fair view of the financial position of the Branch as at [Date], and of its financial performance and cash flows for the year then ended in accordance with

<sup>52</sup> According to paragraph A14 of HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, the financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs.

<sup>53</sup> HKSA 210, *Agreeing the Terms of Audit Engagements*.

<sup>54</sup> HKSA 570 (Revised), *Going Concern*.

<sup>55</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>56</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c).

Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Branch in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Emphasis of Matter - Basis of Accounting and Restriction on Use**

~~Without modifying our opinion, w~~We draw attention to note [X] to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Branch ~~to~~in complying with the conditions of the accounting concession. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the submissions by the Branch to the Hong Kong Insurance Authority and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report. Our opinion is not modified in respect of this matter.<sup>57</sup>

### **Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).*]

### **Responsibilities of Chief Executive's Responsibility and Those Charged with Governance for the Financial Statements<sup>58</sup>**

Pursuant to the conditions of the accounting concession under section 17(2) of the Hong Kong Insurance Companies Ordinance granted by the Hong Kong Insurance Authority, the Chief Executive is responsible for the preparation of the financial statements that give a true and fair view in accordance with ~~Hong Kong Financial Reporting Standards~~HKFRSs issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and for such internal control as the Chief Executive determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Executive is responsible for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Chief Executive either intends to liquidate the Branch or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Branch's financial reporting process.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate,

<sup>57</sup> The above wording has been agreed with the Insurance Authority. However, 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".

<sup>58</sup> Any deviation from the above wording may not be acceptable to the Insurance Authority. Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

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UNDER THE INSURANCE COMPANIES ORDINANCE

~~they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. 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 HKICPA. 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.~~

~~Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.~~

~~As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:~~

- ~~• Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.~~
- ~~• Obtain an understanding of internal control relevant to audit 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 Branch's internal control.~~
- ~~• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Chief Executive.~~
- ~~• Conclude on the appropriateness of the Chief Executive's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Branch's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.~~
- ~~• Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.~~

~~We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.~~

~~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 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Chief Executive, 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.~~

~~Opinion~~

~~In our opinion, the financial statements give a true and fair view of the financial position of the Branch as at [Date], and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.~~

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UNDER THE INSURANCE COMPANIES ORDINANCE

~~*Basis of Accounting and Restriction on Use*~~

~~Without modifying our opinion, we draw attention to note [X] to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist the Branch to comply with the conditions of the accounting concession. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the submissions by the Branch to the Hong Kong Insurance Authority and is not intended to be, and should not be, distributed to or used by anyone for any other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of our report<sup>59</sup>.~~

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date]

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<sup>59</sup> The above wording has been agreed with the Insurance Authority. However, 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". Any deviation from the above wording may not be acceptable to the Insurance Authority.



PN 820 (Revised)  
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Effective for audits of financial statements  
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~~upon issuance~~

*Practice Note 820 (Revised)*

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# **The Audit of Licensed Corporations and Associated Entities of Intermediaries**



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

**PRACTICE NOTE  
820 (REVISED)  
THE AUDIT OF LICENSED CORPORATIONS AND  
ASSOCIATED ENTITIES OF INTERMEDIARIES**

*(Issued December 2014; Revised March 2016, October 2016  
Effective for audits of financial statements for periods ending on or after 15 December 2016 upon  
issuance)*

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**PRACTICE NOTE  
820 (REVISED)  
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ASSOCIATED ENTITIES OF INTERMEDIARIES**

*The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.*

*Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.*

**PART I - GENERAL**

**Introduction**

1. The purpose of this Practice Note is to assist the auditor to develop an approach to the audit of the financial statements of licensed corporations and associated entities of intermediaries. This is dealt with in Part II.
2. This Practice Note also provides guidance on the auditor's other reporting responsibilities under the Securities and Futures Ordinance (SFO) which are set out in the Securities and Futures (Accounts and Audit) Rules. This is dealt with in Part III.
3. Guidance on the completion of the Securities and Futures Commission's (SFC's) Audit Questionnaire by the auditor is set out in Part IV.
4. The auditor is entitled under the SFO to report directly to the SFC in exceptional circumstances and, in some cases, has a duty to do so. Guidance on such ad hoc reporting is set out in Part V.
5. This Practice Note has been prepared in consultation with the SFC.
6. This Practice Note is based on the SFO in effect as at 1 December 2014, and the subsidiary legislation, codes and guidelines issued by the SFC up to 1 December 2014. Every care has been taken in its preparation. However, the legislation itself is the sole authority of the law and this Practice Note should be used in conjunction with the legislation.
7. It should be borne in mind that certain expressions used in the SFO may be matters for legal interpretation. There may, therefore, be circumstances in which, notwithstanding the guidance given in this Practice Note, the auditor will wish to seek legal advice.

## Definitions

8. The definitions used in this Practice Note are:

a. *Associated entity*

A company that is in a controlling entity relationship with an intermediary and receives or holds in Hong Kong client assets of the intermediary.

b. *Client assets*

As defined in section 1 in Schedule 1 of the SFO.

c. *Client asset rules*

Securities and Futures (Client Money) Rules and Securities and Futures (Client Securities) Rules.

d. *Codes and guidelines*

Codes and guidelines issued by the SFC under the SFO.

e. *FRR*

Securities and Futures (Financial Resources) Rules.

f. *Intermediary*

A licensed corporation or a registered institution.

g. *Internal Control Guidelines*

"Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission" issued by the SFC.

h. *Licensed corporation*

A corporation which is granted a licence by the SFC under Part V of the SFO for a regulated activity.

i. *Liquid assets*

Such assets as are prescribed in Division 3 of Part 4 of the FRR.

j. *Liquid capital*

The amount by which liquid assets exceeds ranking liabilities.

k. *Ranking liabilities*

The amounts required under Division 4 of Part 4 of the FRR.

l. *Registered institution*

An authorized financial institution registered under Part V of the SFO.

m. *Regulated activities*

As prescribed in Schedule 5 of the SFO.

n. *Regulated entity*

A licensed corporation or an associated entity of an intermediary.

o. *Reportable matter*

A matter that in the opinion of the person acting as an auditor within the meaning of section 157(1)(a) of the SFO –

(a) in the case of a licensed corporation –

- (i) constitutes on the part of the licensed corporation or any of its associated entities a failure to comply with any prescribed requirement;
- (ii) adversely affects to a material extent the financial position of the licensed corporation or any of its associated entities; or
- (iii) constitutes on the part of the licensed corporation a failure to comply with section 146 or with all or any of the requirements of the financial resources rules that apply to it; or

(b) in the case of an associated entity of an intermediary –

- (i) constitutes on the part of the associated entity a failure to comply with any prescribed requirement; or
- (ii) where the associated entity is not an authorized financial institution, adversely affects to a material extent the financial position of the associated entity.

p. *Segregated account*

A segregated account established and maintained under section 4(1) and (2) of the Securities and Futures (Client Money) Rules or under section 5(1) and (2) of the Securities and Futures (Client Securities) Rules.

q. *SFC*

Securities and Futures Commission.

r. *SFO*

Securities and Futures Ordinance.

s. *Suggested Control Techniques*

"Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules" issued by the SFC.

t. *Systems of control*

The internal controls over trading, accounting, settlement and stock holding systems that a licensed corporation or an associated entity has implemented to ensure its compliance with the SFO and any rules made under the SFO.

## Legislation and regulatory requirements

### The SFO

9. Under the licensing and registration regime of the SFO, any business entity which carries on or holds itself out as carrying on a business in a regulated activity in Hong Kong is required to be licensed by or registered with the SFC. It is a serious offence to act as an intermediary in Hong Kong without the appropriate licence or registration.
10. The SFC administers the regulation of the regulated activities and assumes the duties of front-line regulator of licensed corporations. It also applies certain requirements to associated entities of intermediaries in relation to their receipt and holding of client assets. The SFC is also responsible for all investigations and disciplinary matters under the SFO, subsidiary legislation, codes and guidelines.
11. Regulated entities must observe at all times all the provisions of the SFO, subsidiary legislation, codes and guidelines. In association with these requirements, regulated entities must file audited annual financial statements within four months of the financial year end to the SFC.
12. The SFO is designed to protect investors and, therefore, is concerned with ensuring that regulated activities in Hong Kong are conducted in accordance with the relevant regulations and rules by persons who are fit and proper and are licensed or registered to conduct such business.
13. The regulatory powers of the SFC are primarily vested in the SFO.
14. Section 5 of the SFO details the functions of the SFC. The functions pertinent to this Practice Note are as follows:
  - a. to take steps to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
  - b. to supervise, monitor and regulate activities carried on by regulated entities;
  - c. to promote, encourage and enforce the proper conduct, competence and integrity of persons carrying on regulated activities;
  - d. to promote and develop an appropriate degree of self-regulation;
  - e. to take steps it considers appropriate to ensure relevant provisions are complied with;
  - f. to secure an appropriate degree of protection for members of the investing public investing in or holding financial products;
  - g. to promote, encourage and enforce the adoption of appropriate internal controls and risk management systems; and
  - h. to suppress illegal, dishonourable and improper practices in the industry.

### *Regulated activities*

15. The SFO covers different types of regulated activities as prescribed in Schedule 5 of the SFO.

### *Auditor's statutory rights and duties*

16. Guidance on the auditor's statutory rights and duties under the SFO is given in Parts III and V below.

## **Regulatory requirements**

17. The SFO provides a framework for the regulation of regulated entities in Hong Kong and the detailed requirements are set out in subsidiary legislation, codes or guidelines issued by the SFC. Each regulated entity is bound by all these requirements, where applicable, to remain fit and proper. The main provisions of the SFO, subsidiary legislation, codes or guidelines are set out in the following paragraphs but they are not a substitute for the legislation and rules themselves. In addition, the SFC has posted a series of "Frequently Asked Questions" on its website which provide a useful source of reference on how to interpret specific circumstances which may arise.

### *Licensing and registration*

18. Persons carrying on business in a regulated activity in Hong Kong are required to have successfully applied for a licence, or a registration in the case of an authorized financial institution. In addition, they must remain fit and proper at all times.

### *Business conduct*

19. This is the ongoing requirement expected of regulated entities in conducting their business and is designed to ensure that adequate standards are maintained in dealings with clients.
20. The requirements for business conduct are set out either in subsidiary legislation or in non-statutory codes of conduct. Breach of legislation is subject to criminal sanctions and breach of any codes of conduct may be taken into account in determining fitness and properness. The auditor has no requirement to express an opinion on the business conduct of a regulated entity but should be aware of the requirements.
21. The nine basic principles for business conduct cover the following areas:
- a. honesty and fairness;
  - b. diligence;
  - c. capabilities;
  - d. information about clients;
  - e. information for clients;
  - f. conflicts of interests;
  - g. compliance;
  - h. client assets; and
  - i. responsibility of senior management.

### *Client assets*

22. The client asset rules apply to regulated entities that control or are otherwise responsible for client assets and they cover the proper protection of these assets. There are two sets of rules:
- a. one dealing with client securities; and
  - b. the other dealing with client money (not applicable to an associated entity of a registered institution or an associated entity of a licensed corporation where the associated entity is an authorized financial institution).



23. The Securities and Futures (Client Securities) Rules require client securities and securities collateral received or held in Hong Kong to be treated by regulated entities in a prescribed manner.
24. The Securities and Futures (Client Money) Rules require segregation of client money received or held in Hong Kong by licensed corporations and their associated entities (unless they are authorized financial institutions) in a prescribed manner.

*Record keeping*

25. The Securities and Futures (Keeping of Records) Rules are rules for the keeping of accounts and records by regulated entities. Such records are required to contain sufficient details to explain business activities and operations and account for their client assets, and to be retained for a specified period of time.

*Financial resources requirements*

26. The FRR are made to ensure that licensed corporations are financially sound and have the resources to provide adequate services to investors.
27. Subject to exceptions, licensed corporations are subject to minimum paid-up capital and liquid capital requirements. The requirements are different for different regulated activities. However, where a corporation is licensed for more than one regulated activity, the highest of the paid-up share capital and liquid capital requirements which are applicable to the different regulated activities will apply.

## PART II - THE AUDIT OF FINANCIAL STATEMENTS

### Introduction

28. Hong Kong Standards on Auditing (HKSA) apply to the audit of the financial statements of any entity, irrespective of the size of the entity, its legal form, or the nature of its activities. The commentary which follows identifies the special considerations arising from the application of certain individual HKSA to the audit of the financial statements of regulated entities, and suggests ways in which these can be addressed. Where no special considerations arise in relation to a particular HKSA, no material is included. For the specific requirements of a HKSA, auditor would refer to the HKSA concerned.

### HKSA 210: AGREEING THE TERMS OF AUDIT ENGAGEMENTS

#### Background note

*The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. (HKSA 210 paragraph 9)*

29. In addition to those principal contents set out in HKSA 210, the auditor's engagement letter would also cover reporting requirements under the Securities and Futures (Accounts and Audit) Rules and in particular, the auditor's rights and duties to report directly to the SFC. The engagement letter makes it clear that the statutory duty to report places an obligation on the auditor to report matters if found and does not involve undertaking additional work to identify them. It also clarifies that the auditor may sometimes consider it necessary to report directly to the SFC without the client's prior knowledge or consent.

### HKSA 240: THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

#### Background note

*In accordance with HKSA 315 (Revised), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. (HKSA 240 paragraph 25)*

30. In addition to the conditions or events specified in HKSA 240 as increasing the risk of fraud, the following factors may be especially relevant for regulated entities (this list is not exhaustive):
- a. backlogs in key reconciliations, particularly those with brokers and exchanges and for bank accounts and safe custody accounts - both the regulated entity's own and those relating to its clients;
  - b. inadequate segregation of duties between the front, middle and back office staff (i.e. "incompatible functions");
  - c. complex products and transactions inadequately understood by management;
  - d. inadequate definition of management responsibilities and supervision of staff;
  - e. elements of the remuneration package (particularly bonuses) for certain staff which are highly geared in relation to reported profits or revenues;
  - f. existence of hold mail arrangements, operation of discretionary accounts, and issuance and acceptance of third party or cash cheques;
  - g. volatility in the market place;

- h. no established compliance culture or inadequate internal controls; and
- i. risk of management override of controls.

Additional factors relevant for regulated entities can be found in the SFC's website which contain press releases and circulars providing examples of malpractices and advisory circulars of compliance areas.

- 31. Regulated entities are specifically required by the SFC to have adequate systems of internal control over client assets, which include appropriate systems to minimize the risk of losses to the business from irregularities, fraud or error. The auditor needs to bear in mind his responsibilities to report to the SFC in accordance with guidance set out in Part V below.

## HKSA 250: CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

### Background note

***The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. (HKSA 250 paragraph 13)***

- 32. The auditor needs to recognize particularly that some laws and regulations (including any licensing conditions imposed on the regulated entity, its responsible officers or licensed representatives) are central to the regulated entity's ability to conduct its business as compliance is a prerequisite of obtaining a licence to operate. Non-compliance may result in the regulated entity ceasing operations, or call into question the regulated entity's status as a going concern.
- 33. The auditor of regulated entities will normally:
  - a. discuss with the regulated entity's general counsel, compliance officer, internal auditor and other personnel responsible for compliance to obtain an understanding of the regulated entity's policies and procedures as to how it complies with the applicable laws and regulations and how it detects non-compliance; and review any work on compliance matters carried out by them;
  - b. inquire of management as to whether the regulated entity is in compliance with the applicable laws and regulations;
  - c. read the SFC's press releases and public register of licensed persons on its website for any disciplinary actions or licensing conditions imposed on the licensed corporation, its responsible officers or licensed representatives;
  - d. review correspondence between the regulated entity and the SFC; and
  - e. assess the actual or contingent consequences arising from non-compliance and consider the impact on the financial statements.

The auditor should be alert to findings of the above and other audit procedures performed that may indicate instances of non-compliance. For example, a licensed corporation which is an introducing agent may be subject to certain conditions, including but not limited to not holding client assets, imposed on its licence and any breach of which may affect the fitness and properness of the licensed corporation to remain licensed. The auditor may consider, where appropriate, carrying out additional audit procedures in response to any suspected non-compliance identified.

- 34. If the auditor becomes aware of correspondence between the regulated entity and the SFC which is subject to the secrecy provisions of section 378 of the SFO, the auditor should request the regulated entity to seek the SFC's consent for the regulated entity to disclose ~~disclosing~~ the

correspondence to the auditor. Paragraphs 165 to 167 provide additional information on the circumstances that the SFC may communicate to the auditor matters pertinent to a regulated entity for the purpose of enabling or assisting the SFC to perform its functions under any of the relevant provisions and paragraph 70b provides suggestions for additional representation to be obtained by the auditor from management in such circumstances.

### **Money Laundering and Terrorist Financing**

35. Laws and regulations relating to money laundering are integral to the legal and regulatory framework within which regulated entities operate. By the nature of their business, regulated entities may be ready targets of those engaged in money laundering and terrorist financing activities.
36. The primary bodies of law in Hong Kong concerned with the subject of money laundering and terrorist financing are the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance, the Drug Trafficking (Recovery of Proceeds) Ordinance, the Organized and Serious Crimes Ordinance and the United Nations (Anti-Terrorism Measures) Ordinance. Details on the matters are set out in the related guidance notes and circulars issued by the SFC. The HKICPA has ~~revised~~ issued in ~~April 2015~~ ~~July 2006~~ ~~an the~~ Anti-Money Laundering Bulletin (AMLB) 1 on "Requirements on Anti-money Laundering, ~~Anti~~Counter-Terrorist Financing and Related matters" and in ~~May 2012~~ ~~at the~~ supplement to AMLB 1, "Frequently Asked Questions on Suspicious Transaction Reporting".
37. The SFC expects regulated entities to establish policies and controls to combat money laundering and terrorist financing which cover the following areas:
  - a. the establishment and maintenance of policies, procedures and controls to deter and to recognize suspicious transactions;
  - b. the establishment of a procedure to report suspicious transactions;
  - c. evidence of client identification;
  - d. retention of client identification and transaction records for use as evidence in future investigations; and
  - e. education and training of staff.

### **Codes and guidelines issued by the SFC**

38. The auditor has no direct reporting responsibility in respect of the codes and guidelines issued by the SFC. Nevertheless, breaches of such codes and guidelines may:
  - a. give rise to claims by investors against the regulated entity; and
  - b. cause the regulated entity to have its business restricted or, in extreme cases, have its licence revoked so threatening its viability as a going concern.
39. The auditor will also be aware that breaches of the codes and guidelines could have consequences for other matters which are the subject of the auditor's reporting responsibilities to the SFC for example, financial resources, accounting records and the handling of client assets.
40. The auditor would ensure that members of the audit team have a general understanding of the applicable codes and guidelines, sufficient to enable them to be alert to possible non-compliances which come to their attention.
41. As part of the normal procedures undertaken for the purposes of the audit of the financial statements and reporting under the Securities and Futures (Accounts and Audit) Rules, the auditor would gain an understanding of the regulated entity's operations, including the nature of the business carried out. They would also obtain an understanding of the control environment that

exists, including the regulated entity's high level controls for complying with the applicable codes and guidelines.

42. Such an understanding will provide an indication of the extent to which the general atmosphere and controls in the regulated entities are conducive to compliance, for example through consideration of:
  - a. the adequacy of procedures and training to inform staff of the requirements of the applicable codes and guidelines to ensure that they meet those requirements;
  - b. adequacy of authority and supervision;
  - c. the review of compliance by senior management;
  - d. procedures to ensure that possible non-compliances are investigated by an appropriate person and are brought to the attention of senior management; and
  - e. the authority of, and resources available to, the compliance officer, internal auditor and those in charge of compliance functions.
43. The auditor needs to be alert to any indication that a regulated entity is conducting business outside the scope of its licence or in violation of any licensing conditions imposed on its licence as this may affect the fitness and properness of the regulated entity to remain licensed or even amount to an offence under the SFO.
44. Where an apparent non-compliance of the codes and guidelines comes to the auditor's attention, it needs to ensure that the implications for its reporting responsibilities are correctly identified.
45. The auditor would enquire of management and staff whether any non-compliances have occurred and obtain appropriate representations from management, preferably in writing, addressing any possible non-compliances which have come to their attention.
46. The auditor would also note that the codes and guidelines issued by the SFC are not exhaustive in nature and auditor would always exercise professional judgment in determining the adequacy of controls and certain behaviours/conduct.

## **HKSA 260 (REVISED): COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE**

### **HKSA 265: COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT**

#### **Background note**

*The auditor shall communicate the following matters with those charged with governance:*

- *The auditor's responsibilities in relation to the financial statement audit (HKSA 260 (Revised), paragraph 14);*
- *Planned scope and timing of the audit (HKSA 260 (Revised), paragraph 15);*
- *Significant findings from the audit (HKSA 260 (Revised), paragraph 16); and*
- *In the case of listed entities, auditor independence (HKSA 260 (Revised), paragraph 17).*

*The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. (HKSA 265 paragraph 9)*

47. The SFC may request copies of the auditor's management letters from regulated entities. Against this background, the auditor may consider to include in the management letter to directors or management a statement that:
- a. the management letter has been prepared for the sole use of the regulated entities;
  - b. it must not be disclosed to a third party (except to the SFC), or quoted or referred to, without the written consent of the auditor; and
  - c. no responsibility is assumed by the auditor to any other person.

**Breach of laws and rules issued by the SFC**

48. Unless there are reasons for supposing a report would be made directly to the SFC (see Part V below), the auditor would discuss promptly with appropriate management of the regulated entity (including the compliance officer) apparent breaches of the law, codes and guidelines, or instances where a regulated entity may be carrying on activities outside the scope of its authorization, which come to his attention in the course of the audit. This will both enable the auditor to determine the impact of the matter on its reporting obligations, and permit appropriate corrective action to be taken by management.
49. Breaches or possible breaches of the law, codes and guidelines which come to the auditor's attention and which neither require the auditor to make a report to the SFC under the statutory duty provisions of the SFO, nor require its auditor's report to be qualified, will be considered for inclusion in the auditor's management letter.

**HKSA 300: PLANNING AN AUDIT OF FINANCIAL STATEMENTS**

**HKSA 315 (REVISED): IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT**

**Background note**

*The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. (HKSA 300 paragraph 7)*

*The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. (HKSA 315 (Revised), paragraph 5)*

*Risk assessment procedures are defined as the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels. (HKSA 315 (Revised), paragraph 4.(d))*

50. Regulated entities can be complex and the auditor would seek to understand the business and the regulatory regime in which they operate. The auditor would ensure that the audit engagement is performed/overseen by staff with sufficient knowledge about the licensed corporation's operations, market practices, the products handled by the licensed corporation and the SFC regulations for regulated activities carried out by the licensed corporation. A fundamental principle embodied in the HKICPA Code of Ethics for Professional Accountants is that the auditor does not accept or perform work which it is not competent to undertake. The auditor may also consider the use of technical specialists, for example where the business is trading in complex products or is heavily reliant on e-commerce. Generally, there is a close relationship between planning and understanding the entity and an understanding of the high level control environment.

51. To avoid potential duplication of audit effort, the audit approach to a regulated entity normally addresses the audit of the financial statements and the work required for reporting under the Securities and Futures (Accounts and Audit) Rules together. The auditor plans so as to ensure that its audit work on the financial statements and the regulatory reporting is completed within timescales imposed by the SFC. The audit plan for a regulated entity typically explains the legal and regulatory background and, in order to reduce audit risk, discusses those areas where the auditor's responsibilities are different from those for other types of entity.

**Direct communication from the SFC**

52. As explained in paragraph 165 below, the SFC is able to disclose information directly to the auditor. Where such a matter has been brought to the attention of the auditor, it considers the implications for its work and may amend its approach accordingly. However, the fact that it may have been informed of such a matter by the SFC does not, of itself, require the auditor to change the scope of its work, nor does it require the auditor actively to search for evidence in relation to the matter communicated by the SFC.
53. The auditor has no obligation to seek out breaches of the law, codes and guidelines. However, the auditor would include procedures within their planning process to ensure that members of the audit team are able to recognize reportable matters which are encountered in their audit work and that such matters are reported to the audit partner without delay.

**Internal controls and risk assessment**

54. There is a wide variation between different regulated entities in terms of size, activity and organization, so that there can be no standard approach to internal controls and risk. The auditor assesses the adequacy of controls in relation to the circumstances of each entity. In addition to the factors set out in paragraphs A2447 to A484 and Appendix 1 of HKSA 315 (Revised), the following factors would be considered by the auditor in assessing whether there may be an increased level of inherent risk of material misstatement:
- a. the nature and status of the regulated entities and any changes in their status which may affect the application of protection of client assets requirements;
  - b. a change in the market environment (for example, high volatility);
  - c. the introduction of new clients or products or marketing and distribution methods;
  - d. the risk profile of business undertaken, the complexity and consistency of products, methods and operations in different departments or locations;
  - e. client profile (retail vs. institutional);
  - f. existence of claims and complaints by clients;
  - g. the legal and operational structure of the regulated entities, the number of branches or sales offices (see paragraph 57 below);
  - h. where a group structure exists, the financial and managerial support provided to and by other group companies;
  - i. management's attitude towards regulation, compliance and control and its appreciation of the importance of investor protection;
  - j. the respective roles and responsibilities attributed to the finance, internal audit and compliance functions;
  - k. the recruitment, competence, training and supervision of personnel (e.g. the use of licensed representatives); and
  - l. the integrity, competence and experience of management.

55. Regulated entities vary greatly in the complexity of their operations and hence the auditor may consider whether to take a reliance approach on the internal controls of the regulated entities. Attention should be paid in cases where the accounting system is at risk of failing to capture transactions which do not involve the immediate movement of funds - such as trading in certain derivative instruments or underwriting. A sound understanding of the process is required in order to guard against the risk of unrecorded or mis-recorded transactions.
56. Client assets is one area where detailed internal controls are particularly relevant. Client assets are an important and relevant factor to audit planning and any material deficiency in the adequacy of internal controls over client assets will need to be reported in the compliance report (see paragraphs 107 to 110). Any shortfall in client assets, whether due to misappropriation or otherwise, may have significant implications on the regulated entity's compliance with the client asset rules and the adequacy of its internal controls. Furthermore, such shortfall could also impact on the financial position of the regulated entity. Such implications and impact could affect the opinions to be given by the auditor in its audit report and compliance report and trigger the auditor's obligation to report to the SFC under section 157 of the SFO. If the auditor considers that the regulated entity's system of control over client assets or system of control to avoid receiving or holding client assets for a regulated entity which does not hold client assets are inadequate or decides that no reliance would be placed on the regulated entity's systems, the auditor would use its professional judgment to consider the use of fund tracing procedures or external circularisation as a substantive procedure to obtain evidence on some of the control objectives, e.g. paragraphs 45, 47, 68 and 69 of Appendix 2 to this Practice Note. Fund tracing means obtaining copies of sampled outward cheques issued by the regulated entity from the bank or copies of cheques deposited into the bank account of the regulated entity and verifying the identity of the payee or drawer against the regulated entity's accounting records.
57. Some regulated entities operate a network of branches. In such instances, the auditor determines the degree of head office control over the business and accounting functions at the branch office and the scope and effectiveness of the regulated entity's inspection and/or internal audit visits. Where branches maintain separate accounting records, the extent of audit visits and work on each branch is also dependent on the materiality of, and risks associated with, the operations of each branch and the extent to which controls over branches are exercised centrally. In the case of smaller branches, the degree to which exceptions to the regulated entity's normal control procedures may be caused by minimal staffing levels (the greater difficulty of ensuring adequate segregation of duties, for example) and the consequential need for an increased level of control from outside the branch are relevant to audit planning.
58. The auditor would consider how a computer information system (CIS) environment affects the audit. Computer information system (CIS) is integral to the business of a regulated entity due to the high volume of transactions and the linkages to various third party systems. Many regulated entities also use their CIS to prepare regulatory reports to the SFC. It is therefore common for the auditor to require a detailed knowledge of the regulated entity's CIS.
59. As new CIS technologies emerge, they are frequently employed by regulated entities to build increasingly complex computer systems that may include micro-to-mainframe links, distributed data bases, end user processing, and business management systems that feed information directly into the accounting systems. Such systems increase the overall sophistication of CIS and the complexity of the specific applications that they affect. As a result, they may increase risk and require further consideration.

## HKSA 320: MATERIALITY IN PLANNING AND PERFORMING AN AUDIT

### Background note

***When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. (HKSA 320 paragraph 10)***

***The auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. (HKSA 320 paragraph 11)***



***For purposes of the HKSAs, performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures. (HKSA 320 paragraph 9)***

60. The assessments of materiality and performance materiality for the financial statements of a regulated entity will require an auditor to make the same professional judgment decisions as on any audit with reference to the standard. However the auditor would remember that in respect of the compliance report there is no materiality concept outlined in the Securities and Futures (Accounts and Audit) Rules and therefore if the auditor becomes aware of any breach in the relevant rules then that breach needs to be reported in the compliance report. The Audit Questionnaire that the auditor is asked to complete for submission to the SFC does however refer to whether the auditor has found any material discrepancies between the FRR first submitted and the financial statements and therefore it is possible to have a reconciliation reported in the compliance report in respect of immaterial discrepancies between the submitted FRR and the financial statements but not to report this matter in the Audit Questionnaire if it is deemed to be immaterial.

## **HKSA 402: AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANIZATION**

### **Background note**

***The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement. (HKSA 402 paragraph 11)***

61. Some regulated entities outsource a variety of activities. Specific examples include:
- a. safe custody of client assets by a custodian;
  - b. settlement or clearing of trades (this may or may not include the third party taking on the settlement risk, maintaining accounting records, reconciling client assets, sending client statements directly);
  - c. maintenance of accounting records;
  - d. product administration (such as unit trusts or savings schemes);
  - e. investment management; and
  - f. valuation of investments.
62. A regulated entity would ensure compliance with the law, codes and guidelines whether or not activities are outsourced. In addition, a regulated entity using a service organization would comply with the following requirements in respect of the outsourced activities:
- a. ongoing assessment and monitoring of the competence and independence of the third party such as reviewing of reports issued in accordance with Hong Kong Standard on Assurance Engagements 3402 "Assurance Reports on Controls at a Service Organization" or other relevant service provider reports where available;
  - b. responsibility for keeping records; and
  - c. responsibility for acts or omissions by the third party.

## HKSA 505: EXTERNAL CONFIRMATIONS

### Background note

***The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. (HKSA 505 paragraph 16)***

63. External confirmation of client account balances can provide strong evidence regarding the existence of the account and accuracy of the regulated entity's records of client assets held at a certain date. It can also provide strong audit evidence regarding the operation of cut-off procedures.
64. For efficiency purpose, the auditor may circularize external confirmations of client account balances together with client assets held for custody so as to obtain audit evidence to support the financial statement assertions and regulatory reporting items at the same time. Given the objectives of the external confirmations as noted in paragraph 63 above, the auditor should consider to circularize external confirmations (including clients with zero account balances or assets holding if appropriate). Further details on circularisation are set out in paragraph 27 of Appendix 2 to this Practice Note.
65. In determining the auditor's assessment of risk, consideration as to whether or not to perform external circularisation would also be linked to the fraud assessment (HKSA 240) and the assessment of the quality of internal controls, particularly over client assets (HKSA 315 (Revised)). The higher the auditor's assessment of risk, the more important it is for the auditor to seek reliable and relevant audit evidence from substantive procedures. For example, if the auditor considers that the licensed corporation has inadequate systems of control over client assets, or the auditor decides not to rely on the licensed corporation's internal control systems, then external confirmations of client account balances and client assets held by the licensed corporation would be a strong substantive audit procedure.

## HKSA 560: SUBSEQUENT EVENTS

### Background note

***Subsequent events are defined as events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report. (HKSA 560 paragraph 5(e))***

***The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (HKSA 560 paragraph 6)***

***The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, if, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor 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 shall:***

- a. ***Discuss the matter with management and, where appropriate, those charged with governance.***
- b. ***Determine whether the financial statements need amendment and, if so,***
- c. ***Inquire how management intends to address the matter in the financial statements.***

***(HKSA 560 paragraph 10)***

66. In addition to the specific procedures to identify subsequent events which may require amendment to, or disclosure in, the financial statements outlined in paragraph 7 of HKSA 560, for the regulated entity, the auditor would review correspondence with the SFC since the financial year end and make enquiries of management to determine whether any breaches of the law, codes and guidelines or other regulatory concerns have come to light since the financial year end.

## **HKSA 570 (REVISED): GOING CONCERN**

### **Background note**

***The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. (HKSA 570 (Revised), paragraph 11)***

67. In reviewing going concern, the auditor of a regulated entity would consider the following areas in addition to those set out in paragraph A32 of HKSA 570 (Revised), since the possible regulatory action of the SFC on the regulated entity is particularly relevant to the going concern assumption:
- a. regulatory censure or fines;
  - b. regulatory capital shortages;
  - c. visits from the SFC;
  - d. reputation and other indicators (including client complaints);
  - e. general non-compliance with the law, codes and guidelines; and
  - f. unusual movements in the financial market.
68. If the auditor has any doubts as to the ability of a regulated entity to continue as a going concern, it may be required to make a report to the SFC under their statutory duties on which guidance is set out in Part V below.
69. If the auditor is performing a cessation audit as discussed in paragraphs 119 and 120 below, the auditor may wish to consider whether the financial statements of that entity should be prepared on a going concern or a break-up basis.

## **HKSA 580: WRITTEN REPRESENTATIONS**

### **Background note**

***The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. (HKSA 580 paragraph 9)***

70. In addition to the examples of representations given in ~~HKAS~~ HKSA 580, the auditor of a regulated entity would also consider obtaining additional confirmations. The letter could cover inter alia the following representations:
- a. acknowledging management's responsibility for establishing and maintaining accounting records and systems of control in accordance with the law, codes and guidelines;
  - b. confirming that management has made available to the auditor all correspondence and notes of meetings with the SFC (except for correspondence subject to section 378 of the SFO where no consent has been given by the SFC for the licensed corporation to disclose such correspondence to the auditor, if applicable) during and related to the relevant reporting period and up to the date of the auditor's report;

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- c. all complaints have been drawn to the attention of the auditor;
- d. where applicable, representation that no client money or client securities were administered or held by the regulated entity; and
- e. the requirements under the Securities and Futures (Keeping of Records) Rules, the client asset rules and the FRR have been complied with.

## **PART III - AUDITOR'S REPORTS UNDER THE SECURITIES AND FUTURES (ACCOUNTS AND AUDIT) RULES**

### **Introduction**

71. This part of the Practice Note is intended to provide a common approach to reporting by the auditor on regulated entities and to establish clear unequivocal wording of the auditor's reports such that a standard form of wording may be used by the auditor when reporting. One benefit of establishing a standard form of report is that it removes any ambiguity as to the assurance obtained from the auditor about compliance with the requirements of the SFO. Example auditor's reports are set out in Appendix 1 to this Practice Note.

### **Management's responsibilities**

72. The auditor's reporting responsibility under the Securities and Futures (Accounts and Audit) Rules addresses matters for which the primary responsibility lies with the management of the regulated entity. The primary responsibilities of management under the Securities and Futures (Accounts and Audit) Rules are, broadly:
- a. to prepare annual financial statements in accordance with generally accepted accounting principles;
  - b. to prepare the applicable returns as detailed in section 3(1)(b) or 3(2)(b) (as the case may be) of the Securities and Futures (Accounts and Audit) Rules;
  - c. to prepare an Account Disclosure Document which sets out additional financial information (for licensed corporations only);
  - d. to prepare Analysis of Client Assets (for associated entity only);
  - e. to ensure that the client asset rules and the Securities and Futures (Keeping of Records) Rules are observed; and
  - f. to prepare the Business and Risk Management Questionnaire.

Details are set out in section 3 of the Securities and Futures (Accounts and Audit) Rules.

73. Management should consider the above in their design and maintenance of the systems of control. They should also recognize where appropriate the cost of a particular control, as against its purpose and expected benefit.
74. For the foregoing reasons, different systems and controls may be deemed adequate in different regulated entities, if they provide reasonable assurance that certain control objectives have been achieved. In designing the systems and controls, management would address inter alia the following general control objectives:
- a. business is planned and conducted in an orderly, prudent and cost-effective manner in adherence to established and documented policies;
  - b. transactions and commitments are entered into only in accordance with management's general or specific authority;
  - c. client assets are safeguarded and are completely and accurately recorded;
  - d. assets are safeguarded and liabilities are controlled;

- e. the risk of loss from fraud, other irregularities and error is minimized, and any such losses are promptly and readily identified;
  - f. management is able to monitor on a regular and timely basis the regulated entity's business position relative to its risk exposure;
  - g. management is able to prepare complete and accurate returns for the SFC on a timely basis in accordance with the FRR; and
  - h. issues relating to compliance with the law, codes and guidelines are resolved in a timely manner to the satisfaction of the SFC.
75. In designing a control system, management needs to understand the interaction between manual and computer controls and how they contribute in aggregate to the achievement of the control objectives.

### **Auditor's responsibilities**

76. The auditor's reporting responsibility under the Securities and Futures (Accounts and Audit) Rules is primarily to provide assurance to the SFC on the financial information provided by the regulated entity and on the systems of control operated by the regulated entity during the financial year covered by the report in relation to the regulated entity's stewardship of client assets.
77. The precise matters on which the auditor is required to report vary according to the nature of the regulated entity's activities. Under section 4(1) of the Securities and Futures (Accounts and Audit) Rules, the auditor is required to report on the matters covered in paragraphs 78 and 79 below. The auditor will prepare an audit report on the regulated entity's financial statements and a compliance report, which is addressed to the board of directors of the regulated entity.
78. In the auditor's report on financial statements, the auditor should give an opinion:
- a. whether the financial statements give a true and fair view; and
  - b. whether the financial statements are in accordance with the records kept by the regulated entity under the Securities and Futures (Keeping of Records) Rules and satisfy the requirements of the Securities and Futures (Accounts and Audit) Rules.
79. In the auditor's compliance report, the auditor should cover:
- a. in the case of a licensed corporation, whether the required returns made up to the last day of the financial year as detailed in section 3(1)(b) of the Securities and Futures (Accounts and Audit) Rules have been correctly compiled from the records of the licensed corporation or, if not correctly compiled, the nature and extent of the incorrectness;
  - b. in so far as applicable, whether the regulated entity had systems of control in place that were adequate to ensure compliance with the SFC's requirements with regard to client assets during the financial year in question;
  - c. in so far as applicable, whether the regulated entity complied with the Securities and Futures (Keeping of Records) Rules and the client asset rules during the financial year in question; and
  - d. in the case of a licensed corporation, whether there appears to have been any contravention of the FRR by the licensed corporation during the financial year in question.

## General guidance for fulfilling auditor's responsibilities

80. In discharging its reporting responsibilities regarding a regulated entity, the auditor must have particular regard to any changes in the SFO and its subsidiary legislation and any other requirements of the SFC in force during the financial year to which the report relates.
81. The nature of the business undertaken by a regulated entity, its size and its particular circumstances will affect the nature and extent of the auditor's work. When planning its work, the auditor assesses the risks associated with the nature of the particular regulated entity. Certain risks will not be applicable to all regulated entities.
82. Other factors that will be considered in relation to a regulated entity are:
  - a. the scope of licensing in relation to the holding of client assets;
  - b. the extent of investment management discretion permitted;
  - c. the introduction of new and revised requirements, with reference to the up-to-date FAQs sections on the SFC website;
  - d. changes to existing requirements; and
  - e. modifications or waivers granted or special conditions imposed by the SFC.
83. In making an assessment of various risk factors, the auditor would normally meet senior management and the Compliance Officer as part of its planning process. It would also consider the following:
  - a. operational manuals;
  - b. documentation of systems and controls;
  - c. compliance monitoring programmes and results;
  - d. the records maintained by the regulated entity of any non-compliances and notifications to the SFC that may have occurred during the financial year under review;
  - e. correspondence with the SFC, relating to financial returns and any other matters;
  - f. the results of inspection visits made by the SFC;
  - g. the register of complaints received from clients during the financial year under review;
  - h. any relevant internal audit reports; and
  - i. any unresolved items from previously issued management letters on internal control weakness.

## Auditor's reporting requirements

84. The two separate reports mentioned in paragraph 77 above are required to be prepared by the auditor in respect of the year under review. They are required to be submitted by the regulated entities to the SFC within four months of their year end. The auditor should take all reasonable steps for its reports to be issued in order for the regulated entities to submit them to the SFC by the specified date.

### **The auditor's report on the financial statements**

85. For a regulated entity which is a Hong Kong incorporated company, the auditor's report contains a true and fair audit opinion pursuant to the Companies Ordinance requirements. It also states whether the financial statements are in accordance with the records kept under the Securities and Futures (Keeping of Records) Rules and satisfy the requirements of the Securities and Futures (Accounts and Audit) Rules. An example auditor's report is given in Example 1 of Appendix 1 to this Practice Note.
86. Guidance on the detailed requirements of the Securities and Futures (Keeping of Records) Rules and Securities and Futures (Accounts and Audit) Rules, which are also applicable to the auditor's report, are set out in paragraphs 90 to 101 below.

### **Compliance report by the auditor**

87. The compliance report setting out the auditor's conclusions on matters set out in paragraph 79 should be addressed to the directors of the regulated entity:
- a. For a licensed corporation, an example compliance report is given in Example 2 of Appendix 1 to this Practice Note.
  - b. For an associated entity of an intermediary, an example compliance report is given in Example 3 of Appendix 1 to this Practice Note.

#### *The assurance standards followed*

88. The auditor would state that the compliance reporting engagement has been conducted in accordance with Hong Kong Standard on Assurance Engagements (HKSAE) 3000 (Revised), *Assurance Engagements Other Audits or Reviews of Historical Financial Information* issued by the HKICPA, and with reference to this Practice Note. It also provides an informative summary of the work performed as the basis for the auditor's conclusion.

#### *The date of the report*

89. It is highly desirable that the compliance report is dated with the same date as the auditor's report on the financial statements.

## **Guidance on the reporting requirements of the Compliance Report**

### ***Internal control considerations relating to Securities and Futures (Keeping of Records) Rules and Securities and Futures (Accounts and Audit) Rules***

90. In considering the adequacy of systems of control required by the client asset rules and the Securities and Futures (Keeping of Records) Rules, the auditor must recognize the inherent limitations of such systems. These limitations mean that, despite the existence of controls, errors or irregularities may occur and may not be detected. Also, projection of any evaluation of the systems to future periods is subject to the risk that management information and control procedures may become inadequate because of changes in conditions or the risk that the degree of compliance with those procedures may deteriorate.
91. The auditor is required to report whether the regulated entity has satisfied the requirements of the Securities and Futures (Keeping of Records) Rules during the financial year under review. In order to report on whether the regulated entity has satisfied the requirements of these rules it is envisaged that consideration will be given to whether adequate systems for control of the regulated entity's accounting systems have been maintained.



92. The Securities and Futures (Keeping of Records) Rules set out the basic characteristics of adequate accounting records in general and include requirements on the contents of specialized accounting records, especially those concerned with client assets. Management, in establishing and maintaining accounting records, and the auditor, in forming a view as to whether adequate records have been kept, will need to refer to the detailed rules relevant to the particular regulated activities.
93. The Securities and Futures (Keeping of Records) Rules require that regulated entities shall in relation to the businesses which constitute any regulated activities for which they are licensed and their associated entities as regards the receipt or holding of client assets in relation to such regulated activities, to keep, where applicable, such accounting, trading and other records as are sufficient to:

*For a licensed corporation*

- a. explain, and reflect the financial position and operation of, such businesses;
- b. enable profit and loss accounts and balance sheets<sup>1</sup> that give a true and fair view of its financial affairs to be prepared from time to time;
- c. account for all client assets that it receives or holds;
- d. enable all movements of such client assets to be traced through its accounting systems and, where applicable, stock holding systems;
- e. reconcile, on a monthly basis, any differences in its balances or positions with other persons and show how such differences were resolved;
- f. demonstrate compliance with certain sections of the client asset rules and that it has systems of control in place to ensure such compliance;
- g. enable it readily to establish whether it has complied with the FRR; and
- h. keep records specified in the Schedule to and sections 5, 6, 7(2) or 8 of the Securities and Futures (Keeping of Records) Rules.

*For an associated entity*

- a. account for the client assets;
- b. enable all movements of the client assets to be traced through its accounting systems and, where applicable, stock holding systems;
- c. show separately and account for all receipts, payments, deliveries and other uses or applications of the client assets effected by it, or on its behalf, and on whose behalf such receipts, payments, deliveries or other uses or applications of the client assets have been effected;
- d. reconcile, on a monthly basis, any differences in its balances or positions with other persons and show how such differences were resolved;
- e. demonstrate compliance with certain sections of the client asset rules and that it has systems of control in place to ensure such compliance; and
- f. keep certain specific records where applicable.

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<sup>1</sup> Different terms like income statement, statement of comprehensive income, statement of financial position, etc may be used in the auditor's report as long as they are consistent with the titles of the corresponding statements.

94. These records would be kept in such a manner as will enable an audit to be conveniently and properly carried out, and make entries in these records in accordance with generally accepted accounting principles where applicable. There are also particular requirements, over and above those outlined above, for licensed corporations involved in certain regulated activities.
95. Detailed guidance on the control objectives and audit evidence in relation to the auditor's reporting requirements with regard to client assets under the Securities and Futures (Accounts and Audit) Rules are included in Appendix 2 to this Practice Note. The auditor will need to apply judgment in determining the extent and nature of its work which would be based on a good understanding of the regulated entity's systems of control.
96. Underlying any systems of control adopted by a regulated entity is the control environment. Such an environment is created by management having and showing a positive attitude towards the operation of controls and by an organizational framework which enables proper segregation and delegation of control functions and which encourages failings to be reported and corrected. Thus, where a lapse in the operation of a control is treated as a matter of concern, rather than being largely overlooked, the control environment will be stronger and will contribute to effective systems of control; whereas a weak control environment will undermine detailed controls, however well designed.
97. Within this control environment, the control procedures needed to ensure that the business is conducted to protect investors' interests would be commensurate with the regulated entity's needs and particular circumstances, and also with the inherent risks of the business undertaken. The size of the regulated entity will have an important bearing on the design and formality of the systems and controls. The operating procedures and methods of recording and processing transactions used by small regulated entities often differ significantly from those of large regulated entities. Internal controls which would be relevant to a large regulated entity, may not be practical or appropriate to a small one. Management of a small regulated entity has less need to depend on formal controls for the reliability of the records and other information, because of personal contact with, or involvement in, the operation of the business itself. Nevertheless the need for a positive attitude to the control environment is equally relevant in both small and large regulated entities.
98. Regulated entities frequently have a high degree of computerization. While the control objectives described above apply in both a manual and a computerized environment, there are nevertheless certain requirements of an internal control system peculiar to a computerized environment.
99. Clearly, the emphasis between the two forms of control will be dependent not only on the degree of computerization but also on the circumstances and particular risks of the regulated entity. The greater the degree of computerization, the greater the emphasis that will need to be placed on the general and application controls of the computerized function, as part of the overall systems of internal control. However, the routine processing of a computerized system is generally more reliable than that of a manual system.
100. Systems of control, including the assignment of responsibilities as set out in the Internal Control Guidelines, need to be clearly documented if they are to be understood, communicated and operated effectively and consistently. Regulated entities and their auditor would consider whether appropriate documentation is a prerequisite of an adequate system.
101. The effective operation of a control system may be enhanced by an internal audit department or by specific monitoring performed by a compliance department. The existence of such departments and their scope and objectives are matters for management. In assessing the effectiveness of such departments, the auditor will consider the terms of reference of the departments, their independence from operational personnel and management, the quality of staffing and to whom they report in the regulated entity.

***Securities and Futures (Financial Resources) Rules***

102. Licensed corporations are required to submit to the SFC the following financial returns as referred to in section 3(1)(b) of the Securities and Futures (Accounts and Audit) Rules made up to the last day of the financial year:
- a. Liquid capital computation (Form 1);
  - b. Required liquid capital computation (Form 2);
  - c. Summary of bank loans, advances and other credit facilities (Form 3);
  - d. Analysis of margin clients (Form 4);
  - e. Analysis of collateral received from margin clients (Form 5);
  - f. Analysis of rolling balance cash clients (Form 6);
  - g. Analysis of client assets (Form 8); and
  - h. Analysis of proprietary derivative positions (Form 10).

There is a requirement in the compliance report to state that the auditor is not aware of the licensed corporation not complying with the FRR throughout the year. If the licensed corporation has a very low excess liquid capital or is prone to material computational or classification errors this may lead to the auditor deciding to review and test a larger sample of FRR throughout the year. Those material errors may also need to be reported as a breach.

103. The auditor is required to give an opinion as to whether the financial returns referred to in paragraph 102 above which have been submitted to the SFC have been correctly compiled from the records of the licensed corporation, or if not correctly compiled, the nature and extent of the incorrectness. This involves the auditor in examining the licensed corporation's compilations by reference to the FRR, paying particular attention to those areas most susceptible to management's discretion. Particular care will be exercised in cases where the licensed corporation is operating at a level close to the minimum requirement, since any shortfall (however small) is a contravention of the FRR and results in a higher possibility of window dressing. The auditor would note that the Securities and Futures (Accounts and Audit) Rules do not provide that immaterial discrepancies or reclassifications can be disregarded. Accordingly, the auditor qualifies its opinion where discrepancies and reclassifications are identified in the financial returns regardless of materiality.
104. If the auditor qualifies its compliance report in respect of the financial returns, the auditor either provides the reconciliations or explains the differences. The reconciliations or explained differences are attached to the compliance report.
105. In particular the auditor would check that the reconciliation agrees back to supporting documentation and that the explanations given for any reconciling items are reasonable. Reconciling items commonly relate to audit adjustments made after submission of the financial return.
106. It is common for a licensed corporation to submit a revised FRR return if errors are noted following the original submission in order to avoid a qualified compliance report attaching a reconciliation. An auditor should ensure that he identifies clearly the FRR he is commenting on in his compliance report and this should be the latest FRR submitted to the SFC prior to the date of the compliance report.

***Securities and Futures (Client Securities) Rules and Securities and Futures (Client Money) Rules***

107. There are essentially two aspects to the auditor's reporting responsibilities for client assets:
- a. whether during the financial year under review, the regulated entity had systems of control in place that were adequate to enable compliance with the relevant sections of the client asset rules; and
  - b. whether during the financial year under review, the regulated entity complied with the relevant sections of the client asset rules.
108. Guidance on the control objectives and audit evidence is set out in Appendix 2 to this Practice Note. The auditor applies judgment in determining the extent and nature of its work which is based on the following general requirements:
- a. the auditor understands the business of the regulated entity and the environment in which the regulated entity operates;
  - b. the auditor reviews the regulated entity's systems and consider whether these are adequate for control and accounting purposes, and are in accordance with the requirements set out in the Suggested Control Techniques; and
  - c. the auditor tests those systems and controls to establish that they are operating effectively.
109. When planning and carrying out its work, the auditor must always keep in mind the need for audit evidence in relation to the existence of client assets and the accuracy of the regulated entity's records.
110. Certain licensed corporations do not receive or hold client money or client securities either by choice or by limitation of their licensing condition. It would therefore not normally be necessary for the auditor to make reference to the client asset rules in the compliance report. However, the auditor would ensure that such licensed corporations have procedures in place to avoid receipt or holding of client assets. If during the course of the performance of these procedures (as set out in paragraphs 68 - 70 of Appendix 2 to this Practice Note) it comes to the auditor's attention that the licensed corporation has held client assets, it would be necessary for the auditor to make reference to the licensed corporation's compliance with the client asset rules in the compliance report. In these circumstances, the auditor will need to revisit the requirements under HKSA 250 and paragraphs 41 and 42 of this Practice Note.

***Qualified Compliance Reports***

111. The auditor may qualify its compliance report on grounds other than those which arise in reporting on whether the financial statements give a true and fair view. Where the requirements of the rules upon which the auditor must report have not been met, its report includes a statement specifying the relevant requirements and the respect in which they have not been met, in sufficient detail for the breach or shortcoming to be clearly understood and evaluated. In particular, where the breach relates to a specific rule, the rule number or reference will be stated in the compliance report.
112. In considering any matter indicating a possible breach of the FRR, client asset rules and the Securities and Futures (Keeping of Records) Rules or inadequate systems of control over client assets, the auditor analyzes the circumstances in order to identify its cause, and establish the action management has taken or intends to take to correct the matter.
113. If the auditor proposes to include any qualification or adverse statement in the compliance report (or its report on the financial statements), the form and content of the report should comply with the requirements of HKSAE 3000 (Revised). Section 157(1)(b) of the SFO, requires the auditor, as soon as reasonably practicable after it first proposes the inclusion of the qualification or adverse statement, to lodge with the SFC a report. Details are set out in Part V below.

114. The Securities and Futures (Accounts and Audit) Rules do not provide that trivial breaches can be disregarded. Where small exceptions are discovered, the auditor will need to qualify its opinion, although references can be made to the extent of the breach.

## **PART IV - OTHER REPORTING CONSIDERATIONS**

### **Audit Questionnaire**

115. In order to assist the SFC to carry out its functions of supervising licensed corporations, the auditor would normally on a voluntary basis complete an Audit Questionnaire for submission to the SFC, providing information in relation to the completed audit that is not readily available from the audited financial statements.
116. Section 158 of the SFO allows the auditor to provide such information to the SFC without the breaching of any duty of confidentiality to the licensed corporations.
117. The auditor would complete the Audit Questionnaire based on information obtained during the course of its audit of the financial statements covered by the Audit Questionnaire. The SFC does not expect the auditor to extend the scope of its work in order to complete the Audit Questionnaire.

### **Account Disclosure Document**

118. The SFC has issued the Account Disclosure Document for Licensed Corporation which sets out additional financial information to be disclosed by licensed corporations. In the Audit Questionnaire the auditor is requested by the SFC to state whether the auditor is satisfied that no material inconsistency between the audited financial statements and the additional disclosure of financial information as required by the Account Disclosure Document for Licensed Corporation came to its attention. If the auditor is aware of any material inconsistencies, the auditor states details of such inconsistencies in the Audit Questionnaire.

### **Cessation of Activities**

119. Where a licensed corporation ceases to carry on all of the regulated activities for which it is licensed, or where an associated entity of an intermediary ceases to be such an associated entity, they are required to submit to the SFC certain documents, including the audited financial statements made up to the date of cessation together with the corresponding auditor reports.
120. The responsibilities of the auditor and the reporting requirements in those audits are generally the same as those discussed in "Part III – Auditor's Reports under the Securities and Futures (Accounts and Audit) Rules".

## **PART V - COMMUNICATIONS BETWEEN THE AUDITOR AND THE SECURITIES AND FUTURES COMMISSION**

### **Introduction**

121. This part of the Practice Note is concerned with communications:

- a. by the auditor to the SFC under the obligations established in section 157 of the SFO;
- b. by the auditor to the SFC under the protection of section 158 of the SFO; and
- c. by the SFC to the auditor under section 378(3)(h) of the SFO.

It is also concerned with the related issue of auditor's duty of secrecy under the SFO.

122. Because of the variety of conditions which might be encountered, the guidance in this Part of the Practice Note is necessarily set out only in general terms; the specific actions to be taken in a particular case may vary somewhat in the light of the circumstances. The auditor would be well advised to consult with its lawyers when it encounters such circumstances.

123. Under the SFO the auditor has various statutory responsibilities to report to the SFC. The auditor is automatically protected in making a report in discharge of such a statutory responsibility. Certain provisions of the SFO also provide the auditor with immunity from any liability it might otherwise incur by reason of the auditor making other reports to the SFC which it may consider to be relevant to the functions of the SFC. These responsibilities and avenues available for reporting do not require the auditor to change the scope of its audit work, nor the frequency or timing of its visits.

124. When the circumstances where reporting may be appropriate are being considered, it should be noted that investments in financial markets carry inherent risks. It is not the purpose of the SFO, nor the duty of the auditor, to protect the investors from the normal risks relating to such investment activities.

125. The auditor needs to bear in mind that its decision may have to stand up to examination at a future date on the basis of the following considerations:

- a. what it knew at the time;
- b. what it should have known in the course of its audit;
- c. what it should have concluded; and
- d. what it should have done.

The auditor should report to the SFC under section 157 of the SFO promptly and not postpone reporting the breaches until the issuance of the audit report or the compliance report. In addition, taking into account the factors raised above, the auditor should report under section 157 of the SFO in sufficient detail to enable the SFC to understand the nature and circumstances of the situation.

## The auditor to lodge report with the SFC in certain cases

### Sections 157(1)(b) and 157(2) of the SFO

126. The auditor has a statutory duty to lodge a report with the SFC in the following circumstances:
- a. if it decides to include in its audit report any qualification or adverse statement (SFO section 157(1)(b)). Such a written report is required to be lodged with the SFC as soon as reasonably practicable after the auditor first proposes the inclusion of the qualification or adverse statement; and
  - b. if it resigns before the expiration of its term of office, intends not to seek re-appointment or otherwise cease to be the auditor (SFO section 157(2)). Such a notice in writing to notify the SFC is required within one business day of the event, outlining the reasons and any connected circumstances which the auditor considers should be brought to the attention of the SFC or state the fact where there are no such circumstances.

### Section 157(1)(a) of the SFO

127. Section 157(1)(a) of the SFO provides that the auditor shall lodge a written report with the SFC, as soon as reasonably practicable after it becomes aware of any "reportable matter". A reportable matter is defined in section 157(3) of the SFO as:
- a. any matter which in the auditor's opinion adversely affects the financial position of the regulated entity to a material extent; or
  - b. a failure of the regulated entity to comply with any rules made under section 148, 149 or 151 of the SFO or a failure of the licensed corporation to comply with section 146 of the SFO or with any of the requirements of the FRR that apply to it.
128. These are statutory obligations and this Part of the Practice Note provides the auditor with procedures to follow when such circumstances arise.
129. Section 157(3) of the SFO includes a failure by the regulated entity to comply with any "prescribed requirement" as a "reportable matter". In addition to the requirements under any of the rules made under sections 148, 149 and 151 of the SFO, it also refers to the requirements under any of the rules made under section 152 of the SFO (provision of contract notes, receipts, statements of account and notifications by intermediaries and their associated entities). It should be noted that the requirements under any of the rules made under section 152 of the SFO are not included as "matters reportable by the auditor under section 157 of the SFO" in section 5 of the Securities and Futures (Accounts and Audit) Rules and therefore the auditor is not required to report to the SFC if there is a failure of the regulated entity to comply with section 152 of the SFO.

#### *Reporting criterion under section 157(1)(a) of the SFO*

130. The auditor would take the initiative and ensure that a written report on the reportable matter under section 157(1)(a) of the SFO is lodged with the SFC if the conditions specified in paragraph 127 above exist. A distinction must be drawn here between an auditor's duty as stated in paragraph 127(a) and paragraph 127(b) above. The duty under paragraph 127(b) is clear and unequivocal: if the auditor becomes aware of a contravention of the requirements which are specified, it is not given any latitude for exercising judgment. The auditor is obliged to make a report. The duty under paragraph 127(a) is different. The auditor is given the right to form an opinion based on applying criteria as to the materiality of an adverse effect on the regulated entity's financial position in deciding whether reporting would be appropriate.



131. The HKICPA has developed a criterion for use by the auditor in deciding to take the initiative in lodging a written report with the SFC under paragraph 127(a) above. The criterion is that the auditor would lodge a written report with the SFC when it considers it expedient to do so in order for the SFC to protect the interests of investors because there has been a material loss or there exists a significant risk of material loss.
132. This criterion can be more fully explained as follows:
- a. there must be a significant adverse occurrence or a change in the auditor's perception of an existing situation, that may include an adverse change in the circumstances of the business; and
  - b. the situation described in (a) above has given rise to or has indicated that a reasonable probability exists that it may give rise to:
    - i. a material financial loss to the business which would result in a material deterioration of the licensed corporation's liquid capital position under the FRR; or
    - ii. loss of control over the assets or records.
133. Examples of the circumstances encountered in which the situation set out in paragraphs 131 and 132 may be met include:
- a. the auditor discovers a failure by the regulated entity to comply with the provisions of the SFO which may have material consequences; or
  - b. there is evidence of imminent financial loss of serious proportions which might cast doubt on the continuing viability of the regulated entity.

*Reporting procedures under section 157(1)(a) of the SFO*

134. In circumstances where the auditor concludes that a written report under section 157(1)(a) of the SFO to the SFC is necessary, it would adopt the following procedures, bearing in mind that speed may be of the essence:
- a. The auditor would discuss the matter with the regulated entity (unless the matter relates to suspected or actual instance of fraud and serious misconduct by the management itself) and explain the auditor's statutory duty to lodge a written report with the SFC under section 157(1)(a) of the SFO and that it might be advisable for the regulated entity to make a report direct to the SFC immediately.
  - b. The auditor would then immediately lodge a written report with the SFC. The auditor would follow this with a written notification along with a copy of its report to the directors or management to inform them.
135. The auditor would note that lodging a written report with the SFC alone may not discharge all its responsibilities. For example, the auditor would consider the implications of the matter giving rise to the report under section 157(1)(a) of the SFO for its opinion on the financial statements, and its conclusions in the compliance report.

## Other communications by the auditor

### Statutory protection under section 158 of the SFO

136. Section 158 (1) of the SFO provides that:
- "... no duty which a person may be subject to as an auditor ... shall be regarded as contravened by reason of his communicating in good faith to the Commission ..., whether or not in response to a request made by the Commission ..., any information or opinion on a matter which (a) he becomes aware of in his capacity as such auditor (whether or not in the course of performing his functions as such auditor); and (b) is relevant to any function of the Commission ...".
137. Section 158 of the SFO only gives immunity for the auditor appointed under section 153 of the SFO. It does not cover appointments under section 159 or 160 of the SFO which give the power of appointment to the SFC. However it does extend the immunity to:
- a. an auditor who has ceased to be the auditor but became aware of a matter before his appointment ceased (SFO section 158(2)(a));
  - b. an auditor appointed by a former regulated entity (SFO section 158(2)(b)); and
  - c. an auditor who has ceased to be the auditor of a former regulated entity before his appointment ceased (SFO section 158(2)(c)).
138. Section 158 of the SFO does not lay down any rules nor specify the circumstances in which the auditor is to communicate any matter to the SFC. They provide a mechanism whereby the auditor may make matters known to the SFC with statutory protection from its duty of confidentiality.
139. This Part of the Practice Note contains guidance on the circumstances in which matters may be brought to the attention of the SFC by way of a report with statutory protection which falls outside those matters which the auditor is obliged to report (see paragraphs 126 to 135 above). In interpreting this guidance, the auditor would bear in mind the fundamental objectives of the SFO, which are to ensure that the SFC is able to fulfil its function of safeguarding the interests of investors. The auditor would have regard to any function of the SFC as summarized in section 5 of the SFO.
140. Confidentiality is an implied term of auditor's contract with its client, but in certain circumstances and under conditions specified in section 158 of the SFO it does not prevail, since the auditor of a regulated entity is entitled to communicate in good faith to the SFC information or opinion on a matter which it becomes aware of in its capacity as the auditor of the regulated entity and is relevant to any function of the SFC, without the duty of confidentiality owed to the client being regarded as having been contravened.
141. The matters which may be communicated under section 158 of the SFO depend on the functions of the SFC. Any matters relevant to any of its functions under the SFO may be communicated to the SFC.
142. Matters which may be reported under the protection of section 158 of the SFO will only arise in circumstances other than where the auditor is under a statutory duty to report under section 157 of the SFO. Considerable care needs to be taken in disclosing matters arising during any tripartite meeting with the SFC as the auditor's knowledge of these matters may have been obtained while assisting the SFC rather than in its capacity as the auditor (see paragraph 146 below).

143. Examples of circumstances in which the auditor may communicate any matter to the SFC under section 158 of the SFO include:
- a. the auditor considers investors have incurred, or are at significant risk of incurring, a material loss as a result of the regulated entity carrying on business in a manner that is not fit and proper;
  - b. there is evidence of:
    - i. fraud, dishonesty or serious incompetence; or
    - ii. serious failure to observe rules for the conduct of the regulated entity;
  - c. it has come to the attention of the auditor that the procedures, records or systems fail significantly to comply with, or to demonstrate compliance with, conduct of business requirements to which the regulated entity is subject (except in respect of client assets which are covered in section 157 of the SFO); and
  - d. the position is such that because of a significant risk which is material to the collective interests of investors, the investors' interests would be better safeguarded if the SFC were aware of the position, even if only to organize protective action.
144. Clearly the potential nature of matters which may be reported is very wide, but as explained in paragraph 147 below this does not, of itself, require the auditor to extend the scope of its work in order to discover matters and it will only be in exceptional circumstances such as those described in paragraphs 157 and 158 that it may choose to seek statutory protection.
145. Any protected communication can be made either on the auditor's initiative or in response to a request from the SFC for information. The auditor would cooperate with the SFC and respond to any requests from the SFC for information, provided it has no reason to doubt that the request is relevant to the SFC's functions. The auditor may communicate a matter to the SFC with the protection of section 158 of the SFO regardless of the source of that information, provided it became aware of the matter in its capacity as the auditor of the regulated entity and it does so in good faith.
146. Matters of which the auditor becomes aware "in its capacity as the auditor" may not be restricted to those matters identified during the course of the audit work by the auditor and members of the audit team. The auditor or members of the audit team may become aware of a matter which is relevant to the functions of the SFC during the course of its carrying out work for the regulated entity other than audit work or through private discussions on social or other occasions, in which case the information will be known to them as individuals. In circumstances which suggest that a matter would be reported to the SFC if knowledge of it had been obtained in the capacity as the auditor, it would be prudent to make enquiries in the course of the audit work in order to establish whether this is the case from information obtained in this capacity. In addition, a matter which is relevant to the functions of the SFC and which is identified during the course of work for the regulated entity by another partner (or member of staff) such as a management consultant or tax partner may be deemed to be known to the auditor (see also paragraph 147 below).
147. The auditor cannot be expected to be aware of all circumstances which, had it known of them, would have led them to exercise its right to communicate under section 158 of the SFO. This section does not require the auditor to change the scope of its audit or other work for the regulated entity, nor the frequency or timing of its visits. The auditor has no obligation to seek out grounds for making a report under section 158 of the SFO, the section does not place an obligation on the auditor to conduct its work in such a way that there is reasonable certainty that it will discover a matter upon which the SFC may need to act. It is only when the auditor does become aware in the ordinary course of this work of such a matter, or of circumstances which suggest the existence of such a matter, that it would consider using the protection of section 158 of the SFO.

148. The SFC recognizes that it would not be appropriate for the auditor to report information which it has obtained or matters which it has identified through its professional relationship with another client, even though the information obtained or the matters identified may relate to a regulated entity.
149. The auditor would need to realize that section 158 of the SFO will not provide protection where it could be held to have acted maliciously or in bad faith or if the information reported is outside the scope of the section. The SFO does not, therefore, provide complete immunity from all types of legal action by all parties affected, or subsequently affected, by their action in reporting to the SFC. The auditor would consider taking legal or other professional advice before making the decision whether or in what manner to report and in order, for example, to ensure that the form and content of its report are such as to secure the protection of section 158 of the SFO and that it only includes relevant material.
150. The auditor is protected, however, even if the information which it communicates subsequently falls short of proof, or the opinion which it communicates cannot be verified. The auditor who can demonstrate that it has acted reasonably and in good faith in informing the SFC of any information or opinion on a matter which it thinks has occurred would not be held in breach of duty to its client even if, after an investigation, it were found there was not a matter which needed to be reported. These are areas where the auditor may wish to consider taking legal advice before making a report.
151. Whilst no breach of statutory duty might arise, it should be appreciated that there is no protection given by the SFO if the auditor, after becoming aware of an occurrence, fails to report, promptly, or at all, to the SFC. Furthermore, the auditor would need to recognize that speed of reporting is likely to be important in order to enable the SFC to protect the interests of investors.

#### **Tripartite meetings**

152. As part of the SFC's system of supervision of regulated entities, meetings involving the SFC, the regulated entity and its auditor may be called by either the SFC, or the regulated entity possibly at the auditor's suggestion.
153. In such meeting, the auditor would be expected to discuss with the SFC the affairs of the regulated entity including:
- a. the presentation and content of the financial statements;
  - b. the scope, conduct and outcome of the annual audit;
  - c. the scope, conduct and outcome of any report under section 158 of the SFO;
  - d. any points raised in the management letter which relate to the SFO;
  - e. explanations for, the reason for and nature of a qualified auditor's report or of a change in a previously reported intention to qualify an auditor's report;
  - f. any step or course of action which may be necessary in the light of the reports, for example, the commissioning of a more detailed report in a particular area (under section 159 or 160 of the SFO); and
  - g. matters raised by the SFC or those which the regulated entity or the auditor have drawn to its attention since any previous meeting, including how such matters have been resolved to the satisfaction of the auditor or have been reflected or treated in the financial statements.

### **Reporting via the regulated entity**

154. Where the auditor becomes aware of a matter which, in its professional judgment, it considers is not required to be reported under section 157 of the SFO but ought to be reported to the SFC, it would consider the facts and, unless inappropriate in the circumstances (described in paragraph 157 below), discuss the matter with the management.
155. It is important for the auditor to act in a manner that will maintain its professional relationship with its client. Normally, therefore, the auditor would ask the regulated entity to draw matters about which it is concerned to the attention of the SFC.
156. Where the regulated entity will not itself inform the SFC of a matter, having been advised to do so by the auditor, or where it has not been done within the period of time specified, or where there is no adequate evidence that the client has properly reported the matter in question, the auditor would make such a report direct to the SFC.

### **Reporting direct to the SFC**

157. In exceptional circumstances, where the auditor doubts whether management is fit and proper person to carry on business as a regulated entity and it would be in the interest of protecting investors that the management of the regulated entity would not be informed in advance, the auditor would report direct to the SFC after first considering the appropriateness of taking independent legal advice. Examples of these circumstances include:
  - a. where there has been an occurrence which causes the auditor no longer to have confidence in the integrity of the directors or senior management, e.g. where it believes that a fraud or other irregularity has been committed by the directors or senior management of the regulated entity, or it has evidence of the intention of directors or senior management to commit such a fraud or other irregularity; or
  - b. where there has been an occurrence which causes the auditor no longer to have confidence that the directors or senior management will conduct the business of the regulated entity in a prudent manner so as to protect the interests of investors, e.g. where it has discovered that the directors or senior management are acting in an irresponsible or reckless manner with respect to the affairs of the business or its clients, or it has evidence of their inclination so to act.
158. The auditor would also report direct to the SFC when speed is of the essence. For example, when it becomes aware that the regulated entity may be about to cease being licensed, the auditor would consider the need to disclose to the SFC any information in its possession relevant to its functions without delay. The fact of such impending cessation of licence may bring forward the desirability of disclosing matters to the SFC, as it is easier for the SFC to take appropriate action while the entity is still licensed, particularly where such matters bear on the security of third party interests.

### **The auditor's duty of secrecy**

159. Section 378 of the SFO imposes a duty of secrecy upon any "specified person", within the meaning of that term in section 378(15). The auditor is bound by the duty of secrecy once it performs any function under or carries into effect any of the provisions of the SFO or assists another person in the performance of any function under or in carrying into effect any such provisions.
160. The precise scope of an auditor's statutory duty of secrecy is not definitive but is likely to include:
  - a. any matter which, in the auditor's opinion, adversely affects the financial position of the regulated entity to a material extent and which is the subject of a written report by the auditor to the SFC (SFO section 157(1)(a)) and the contents of that written report;

- b. any evidence of the regulated entity's failure to comply with any rules made under section 148, 149 or 151 of the SFO, or any evidence of the licensed corporation's failure to comply with section 146 of the SFO or with any of the requirements of the FRR that apply to it, which is the subject of a written report by the auditor to the SFC (SFO section 157(1)(a)) and the contents of that written report;
  - c. the auditor's decision to resign before the expiration of its term of office, the auditor's decision not to seek re-appointment, or if the auditor otherwise ceases to be the auditor, and any reason for such decision which is communicated to the SFC under section 157(2) of the SFO;
  - d. any reason for including any qualification or adverse statement in the auditor's report on the regulated entity's financial statements (SFO section 157(1)(b)) which is communicated to the SFC to the extent that such reason is not self-evident from the contents of the report itself;
  - e. any communication by the auditor to the SFC under section 158 of the SFO, which is a communication of information or opinion on a matter which is relevant to any function of the SFC of which it becomes aware in its capacity as the auditor, whether or not it is at the time of such communication still the auditor of the regulated entity concerned; and
  - f. any communication by the SFC to the auditor under section 378(3)(h) of the SFO (see paragraphs 165 - 167 below).
161. Application of section 378 of the SFO would therefore prevent the auditor from communicating any matters such as those referred to in paragraph 160 above to any parties other than the SFC except under certain circumstances as discussed in paragraphs 162 and 163 below in relation to the matters mentioned in paragraph 160(c) above. It should be emphasised that application of section 378 of the SFO would also prevent the auditor from communicating information that is subject to the duty of secrecy to the regulated entity concerned except for information which the regulated entity already knows.
162. Section 417 of the Companies Ordinance states that a person may resign from the office of auditor by giving the company a notice in writing that is accompanied by a statement required to be given under section 424. Section 424 states that a person who resigns from office must on the resignation, give the company (a) if the person considers that there are circumstances connected with the resignation that should be brought to the attention of the company's members or creditors, a statement of those circumstances; or (b) if the person considers that there are no such circumstances, a statement to that effect. Section 425(1) requires the same statement to be given where the auditor retires or is removed from office except for the conditions as stated in 425(3). Thus, the incoming auditor and members or creditors of a regulated entity may be informed by the outgoing auditor regarding its reasons to resign, not to seek re-appointment or otherwise cease to be the auditor. Disclosure of such information by the outgoing auditor of a regulated entity under the provisions of the Companies Ordinance is permitted under section 378(2)(e) of the SFO without breaching the duty of secrecy under section 378 of the SFO since the disclosure is made in accordance with a law.
163. In complying with a request by the incoming auditor to provide professional clearance which is required under HKICPA Code of Ethics for Professional Accountants, the outgoing auditor may communicate the matters referred to in paragraph 160(c) to the incoming auditor. The outgoing auditor is considered to be doing this for the purposes of carrying into effect the provisions of section 153 of the SFO in order that the incoming auditor can accept nomination as the auditor of the regulated entity under section 153 of the SFO.
164. Under this Practice Note, the auditor would prepare two auditor's reports separately in respect of reporting on the financial statements (see paragraph 85 above) and compliance reporting (see paragraph 87 above). Since the compliance report by the auditor is for filing with the SFC only and should not be made available to any other parties including the shareholders of the regulated entity, the auditor can disclose any contraventions by the regulated entity of the requirements

referred to in paragraph 160(b) in the compliance report without breaching the duty of secrecy under section 378 of the SFO.

### **Communications by the SFC to the auditor under section 378(3)(h) of the SFO**

165. Section 378(3)(h) of the SFO empowers the SFC to disclose confidential information to the auditor of regulated entities for the purpose of enabling or assisting the SFC to perform its functions under the SFO without the consent of the person from whom it is received or to whom it relates. It should be noted that disclosure by the SFC of confidential information to the auditor is to the auditor only; it is not free to pass that information to others, such as the regulated entity in question without the consent in writing of the SFC.
166. The SFC will generally take the initiative in bringing a matter to the attention of the auditor of a regulated entity under the provisions of section 378(3)(h) of the SFO if it considers disclosure is necessary to enable or assist the SFC to perform its functions under the SFO. Where the SFC discloses confidential information to the auditor under section 378(3)(h) of the SFO, it will generally inform the auditor whether it has informed the regulated entity's management of the matter and, if so, whom.
167. If the auditor is not informed by the SFC of any such matter, it is entitled to assume that the SFC has no such disclosure to make. Accordingly, there is no need for the auditor to request the SFC to confirm this.

## APPENDIX 1 - EXAMPLES OF AUDITOR'S REPORTS

### Example 1 - auditor's report on financial statements - regulated entity

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity<sup>1</sup> using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600<sup>2</sup> does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework<sup>3</sup>).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701<sup>4</sup>.
- The auditor has obtained all of the other information<sup>5</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Hong Kong Securities and Futures (Keeping of Records) Rules and Hong Kong Securities and Futures (Accounts and Audit) Rules of the Hong Kong Securities and Futures Ordinance in addition to the Hong Kong Companies Ordinance.

### INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Securities Limited ~~TO THE MEMBERS OF ABC SECURITIES LIMITED~~  
(incorporated in Hong Kong with limited liability)<sup>6</sup>

#### Report on the Audit of the Financial Statements

#### Opinion

We have audited the financial statements of ABC Securities Limited ("the Company") set out on pages ..... to....., which comprise the statement of financial position as at 31 December 20X1,<sup>7</sup>

<sup>1</sup> See HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* for illustrations of auditor's reports for listed entities.

<sup>2</sup> HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>3</sup> HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 7(b)

<sup>4</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>5</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c)

<sup>6</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>7</sup> For cessation audits (see paragraph 119), reference to the financial year end date in this example report should be changed to the cessation date of the licensed corporation's regulated activities.



and [the statement of profit or loss and] <sup>8</sup> the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information.~~

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") and with reference to Practice Note 820 (Revised), *The Audit of Licensed Corporations and Associated Entities of Intermediaries* issued by the ~~Hong Kong Institute of Certified Public Accountants~~HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ~~audit opinion.~~

### **Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).*]

### **Responsibilities of Directors' ~~Responsibility~~ and Those Charged with Governance for the Financial Statements** <sup>9</sup>

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with ~~Hong Kong Financial Reporting Standards~~HKFRSs issued by the ~~Hong Kong Institute of Certified Public Accountants~~HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

In addition, the directors are required to ensure that the financial statements are in accordance with the records kept under the Hong Kong Securities and Futures (Keeping of Records) Rules and satisfy the requirements of the Hong Kong Securities and Futures (Accounts and Audit) Rules.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

<sup>8</sup> HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

<sup>9</sup> Throughout the illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

## **Auditor's Responsibilities for the Audit of the Financial Statements**

~~Our responsibility is to express an opinion on these financial statements based on our audit. Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.<sup>10</sup> We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 820 (Revised), *The Audit of Licensed Corporations and Associated Entities of Intermediaries* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. In addition, we are required to obtain reasonable assurance about whether the financial statements are in accordance with the records kept under the Hong Kong Securities and Futures (Keeping of Records) Rules and satisfy the requirements of the Hong Kong Securities and Futures (Accounts and Audit) Rules. These 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, and whether the financial statements are in accordance with the records kept under the Hong Kong Securities and Futures (Keeping of Records) Rules and satisfy the requirements of the Hong Kong Securities and Futures (Accounts and Audit) Rules.~~

~~Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSA's expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.~~

~~As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:~~

- ~~• Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.~~
- ~~• Obtain an understanding of internal control relevant to the audit 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.~~
- ~~• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.~~
- ~~• Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.~~

<sup>10</sup> The 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".

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

~~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 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, 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.~~

### ~~Opinion~~

~~In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.~~

### **Report on matters under the Hong Kong Securities and Futures (Keeping of Records) Rules and Hong Kong Securities and Futures (Accounts and Audit) Rules of the Hong Kong Securities and Futures Ordinance<sup>11</sup>**

In our opinion, the financial statements are in accordance with the records kept under the Hong Kong Securities and Futures (Keeping of Records) Rules and satisfy the requirements of the Hong Kong Securities and Futures (Accounts and Audit) Rules.

XYZ & Co.

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

[Auditor's Address]

[Date] of the auditor's report

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<sup>11</sup> For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised), "Modifications to the Opinion in the Independent Auditor's Report", Appendix, Illustrations 3, 4 and 5.

## Example 2 - compliance report by the auditor - licensed corporation

### INDEPENDENT AUDITOR'S ASSURANCE REPORT ON COMPLIANCE WITH THE HONG KONG SECURITIES AND FUTURES ORDINANCE

To the Board of Directors of ABC Securities Limited ("the Company")

Pursuant to the Hong Kong Securities and Futures (Accounts and Audit) Rules and section 156 of the Hong Kong Securities and Futures Ordinance, we have been requested to issue this report for the year ended [year end date] for submission by the Company to the Hong Kong Securities and Futures Commission ("SFC").

#### *Directors' Responsibilities*

In relation to this report, the directors have a responsibility to ensure that:

- a. each of the returns as referred to in section 3(1)(b)<sup>\*</sup> of the Hong Kong Securities and Futures (Accounts and Audit) Rules made up to [year end date] is correctly compiled from the records of the Company;
- b.<sup>#</sup> the Company has systems of control in place that are adequate to ensure compliance with:
  - i. sections 4, 5, 6, 8(4), 10 and 11 of the Hong Kong Securities and Futures (Client Money) Rules; and
  - ii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules;
- c. the Company has complied with:
  - i. section 3 of the Hong Kong Securities and Futures (Keeping of Records) Rules;
  - ii.<sup>#</sup> sections 4, 5, 6, 8(4), 10 and 11 of the Hong Kong Securities and Futures (Client Money) Rules; and
  - iii.<sup>#</sup> sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules; and
- d. the Company has complied with the Hong Kong Securities and Futures (Financial Resources) Rules.

#### *Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>1</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

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<sup>1</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

### *Auditor's Responsibilities*

Our responsibility is to express an independent conclusion on the Company's compliance with the relevant sections of the Hong Kong Securities and Futures (Accounts and Audit) Rules[, the Hong Kong Securities and Futures (Client Money) Rules, the Hong Kong Securities and Futures (Client Securities) Rules]<sup>#</sup> and the Hong Kong Securities and Futures (Keeping of Records) Rules as described in the directors' responsibilities section above, based on our engagement, and to report our conclusion to you.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 820 (Revised), *The Audit of Licensed Corporations and Associated Entities of Intermediaries* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving conclusions 1(a) to (c) and obtain limited assurance for giving conclusion 2 below.

In relation to our conclusions 1(a) and 1(c) below, we have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 820 (Revised), which included examining, on a test basis, evidence obtained from the Company regarding the Company's compliance with the above sections of the Hong Kong Securities and Futures (Accounts and Audit) Rules[, the Hong Kong Securities and Futures (Client Money) Rules, the Hong Kong Securities and Futures (Client Securities) Rules]<sup>#</sup> and the Hong Kong Securities and Futures (Keeping of Records) Rules.

[In relation to our conclusion 1(b) below, our work was based upon obtaining an understanding of the relevant control procedures in operation by enquiry of management and review of documents supplied to us. Our work included tests of control procedures and policies to establish whether relevant control objectives and internal control measures were designed by management for meeting the requirements specified in the document "Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules" issued by the SFC.]<sup>#</sup>

In relation to our conclusion 2 below, we are not required to perform any procedures to search for instances of contravention of the Hong Kong Securities and Futures (Financial Resources) Rules. Our work was limited to reporting contraventions identified during the normal course of our work.

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

### *Inherent Limitations*

Systems of controls designed to address specific control objectives are subject to inherent limitations of any internal control structure, and accordingly, errors or irregularities may occur and not be detected. Such measures cannot guarantee protection against fraudulent collusion especially on the part of those holding positions of authority or trust.

### *Conclusion*<sup>2</sup>

Based on the foregoing:

1. in our opinion:

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<sup>2</sup> In the circumstances where the auditor expresses a qualified conclusion or a disclaimer of conclusion or adverse conclusion, the auditor's report is to be modified accordingly as required in paragraph 69(l)(v) of HKSAE 3000 (Revised). Further guidance is set out in paragraphs 74 to 77, A182, A188 to A191 of HKSAE 3000 (Revised).

- a. the Company has correctly compiled the attached returns as referred to in section 3(1)(b)<sup>\*</sup> of the Hong Kong Securities and Futures (Accounts and Audit) Rules made up to [year end date] from the records of the Company;
  - b.<sup>#</sup> during the year ended [year end date], the Company had systems of control in place that were adequate to ensure compliance with:
    - i. sections 4, 5, 6, 8(4), 10 and 11 of the Hong Kong Securities and Futures (Client Money) Rules; and
    - ii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules;
  - c. during the year ended [year end date], the Company has complied with:
    - i. section 3 of the Hong Kong Securities and Futures (Keeping of Records) Rules;
    - ii.<sup>#</sup> sections 4, 5, 6, 8(4), 10 and 11 of the Hong Kong Securities and Futures (Client Money) Rules; and
    - iii.<sup>#</sup> sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules; and
2. during the year ended [year end date], we are not aware of any instances where the Company has contravened the Hong Kong Securities and Futures (Financial Resources) Rules.

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the SFC and is not intended to be, and should not be, used by anyone for any other purpose.

XYZ & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date]

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<sup>#</sup>: *Not applicable where the licensed corporation does not hold client assets. The auditor should refer to paragraphs 68 to 70 of Appendix 2 for more guidance and consider carrying out the procedures set out in those paragraphs.*

Where the licensed corporation does not hold assets, the auditor is encouraged to include either one of the following paragraphs after the first paragraph of the example compliance report:

- (a) The licensed corporation is subject to the licensing condition that it shall not hold client assets. [This paragraph is applicable to licensed corporations / associated entities who are not licensed to hold client assets.]
- (b) The licensed corporation is permitted to hold client assets however no client assets were held during the year. [This paragraph is applicable to licensed corporations / associated entities who are licensed to but does not hold client assets.]

<sup>\*</sup>: *For cessation audits (see paragraph 119), reference to the financial year end date in this example report should be changed to the cessation date of the licensed corporation's regulated activities. In addition, the reference to "section 3(1)(b)" of the Hong Kong Securities and Futures (Accounts and Audit) Rules in this example report should be changed to "section 3(2)(b)" instead.*

### **Example 3 - compliance report by the auditor - associated entity of intermediary**

#### **INDEPENDENT AUDITOR'S ASSURANCE REPORT ON COMPLIANCE WITH THE HONG KONG SECURITIES AND FUTURES ORDINANCE**

To the Board of Directors of ABC Nominee Limited ("the Company")

Pursuant to the Hong Kong Securities and Futures (Accounts and Audit) Rules and section 156 of the Hong Kong Securities and Futures Ordinance, we have been requested to issue this report for the year ended [*year end date*] for submission by the Company to the Hong Kong Securities and Futures Commission ("SFC").

##### *Directors' Responsibilities*

In relation to this report, the directors have a responsibility to ensure that:

- a. the Company has systems of control in place that are adequate to ensure compliance with:
  - i.<sup>#</sup> sections 4, 5, 6, 8(4), 10, 11 of the Hong Kong Securities and Futures (Client Money) Rules; and
  - ii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules; and
- b. the Company has complied with:
  - i. section 4 of the Hong Kong Securities and Futures (Keeping of Records) Rules;
  - ii.<sup>#</sup> sections 4, 5, 6, 8(4), 10 and 11 of Hong Kong Securities and Futures (Client Money) Rules; and
  - iii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules.

##### *Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>1</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

##### *Auditor's Responsibilities*

Our responsibility is to express an independent opinion on the Company's compliance with the relevant sections of [the Hong Kong Securities and Futures (Client Money) Rules,] the Hong Kong Securities and Futures (Client Securities) Rules and the Hong Kong Securities and Futures (Keeping of Records) Rules as described in the directors' responsibilities section above, based on our engagement, and to report our opinion to you.

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<sup>1</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 820 (Revised), *The Audit of Licensed Corporations and Associated Entities of Intermediaries* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving our opinion below.

In relation to our opinion (a) below, our work was based upon obtaining an understanding of the relevant control procedures in operation by enquiry of management and review of documents supplied to us. Our work included tests of control procedures and policies to establish whether relevant control objectives and internal control measures were designed by management for meeting the requirements specified in the document "Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules" issued by the SFC.

In relation to our opinion (b) below, we have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 820 (Revised), which included examining, on a test basis, evidence obtained from the Company regarding the Company's compliance with the above sections of [the Hong Kong Securities and Futures (Client Money) Rules,<sup>#</sup> the Hong Kong Securities and Futures (Client Securities) Rules and the Hong Kong Securities and Futures (Keeping of Records) Rules.

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

#### *Inherent Limitations*

Systems of controls designed to address specific control objectives are subject to inherent limitations of any internal control structure, and accordingly, errors or irregularities may occur and not be detected. Such measures cannot guarantee protection against fraudulent collusion especially on the part of those holding positions of authority or trust.

#### *Opinion<sup>2</sup>*

Based on the foregoing, in our opinion:

- a. during the year ended [*year end date*], the Company had systems of control in place that were adequate to ensure compliance with:
  - i.<sup>#</sup> sections 4, 5, 6, 8(4), 10, 11 of the Hong Kong Securities and Futures (Client Money) Rules; and
  - ii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules; and
- b. during the year ended [*year end date*], the Company has complied with:
  - i. section 4 of the Hong Kong Securities and Futures (Keeping of Records) Rules;
  - ii.<sup>#</sup> sections 4, 5, 6, 8(4), 10 and 11 of Hong Kong Securities and Futures (Client Money) Rules; and
  - iii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules.

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<sup>2</sup> In the circumstances where the auditor expresses a qualified conclusion or a disclaimer of conclusion or adverse conclusion, the auditor's report is to be modified accordingly as required in paragraph 69(l)(v) of HKSAE 3000 (Revised). Further guidance is set out in paragraphs 74 to 77, A182, A188 to A191 of HKSAE 3000 (Revised).



*Intended Users and Purpose*

This report is intended solely for submission by the Company to the SFC and is not intended to be, and should not be, used by anyone for any other purpose.

XYZ & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date]

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#: *Not applicable in the case of an associated entity of a registered institution.*

\*: *For cessation audits (see paragraph 119), reference to the financial year end date in this example report should be changed to the date that the entity ceases to be an associated entity.*

## Example 4 – example modified auditor's assurance reports

*The following examples of modified reports are for guidance only and are not intended to be exhaustive or applicable to all situations. They are based on Examples 2 and 3 in Appendix 1.*

### (a) Qualified conclusion for Example 2 – compliance report by the auditor – licensed corporation

...

#### *Basis for Qualified Conclusion*

In respect of conclusion 1(c) below, we identified the non-compliance with [insert relevant sections of the relevant rules] as set out in the appendix to this report.

#### *Qualified Conclusion*

Based on the foregoing,

1. in our opinion:

...

- c. except for the effect of the matter described in the Basis for Qualified Conclusion section of our report, during the year ended [*year end date*], the Company has complied with:
  - i. section 3 of the Hong Kong Securities and Futures (Keeping of Records) Rules;
  - ii. sections 4, 5, 6, 8(4), 10 and 11 of Hong Kong Securities and Futures (Client Money) Rules; and
  - iii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules.

...

### (b) Qualified opinion for Example 3 – compliance report by the auditor – associated entity of intermediary

...

#### *Auditor's Responsibilities*

...

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

#### *Basis for Qualified Opinion*

In respect of opinion (b) below, we identified the non-compliance with [insert relevant sections of the relevant rules] as set out in the appendix to this report.

#### *Qualified Opinion*

Based on the foregoing, in our opinion:

...

- b. except for the effect of the matter described in the Basis for Qualified Opinion section of our report, during the year ended [*year end date*], the Company has complied with:
- i. section 4 of the Hong Kong Securities and Futures (Keeping of Records) Rules;
  - ii. sections 4, 5, 6, 8(4), 10 and 11 of Hong Kong Securities and Futures (Client Money) Rules; and
  - iii. sections 4(4), 5, 10(1) and 12 of the Hong Kong Securities and Futures (Client Securities) Rules.

...

## APPENDIX 2 - CLIENT ASSETS

### INTRODUCTION

1. This Appendix provides more detailed guidance to the auditor on the work normally carried out in order to form an opinion on client assets in the auditor's reporting under the SFO. It provides guidance on the following rules:
  - a. Securities and Futures (Client Securities) Rules (Client Securities Rules);
  - b. Securities and Futures (Client Money) Rules (Client Money Rules);
  - c. Securities and Futures (Keeping of Records) Rules (Keeping of Records Rules); and
  - d. Securities and Futures (Accounts and Audit) Rules.

For the purpose of this Appendix the term "rules" means any of the above applicable rules.

2. The main purpose of the rules in relation to client assets is to ensure that the regulated entity safeguards client assets. A further purpose is to ensure that, in the event of insolvency of the regulated entity, client assets are protected from the claims of its general creditors and, in the case of client money, from any right of set off by institutions which hold the money.
3. The rules require a regulated entity to maintain a high standard of custodianship and associated record keeping. Management of a regulated entity is responsible for establishing and maintaining adequate accounting records and systems and controls. In this regard, the SFC has issued guidance to licensed corporations in the Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules. This recognizes the position of trust under which client assets are held.
4. This Appendix is separated into three sections as follows:
  - a. client securities;
  - b. client money; and
  - c. no client assets.

The sections on client securities and client money also set out the relevant planning considerations.

5. This Appendix is to assist the auditor in determining the scope of the work for each individual audit. However it is not intended to limit or replace individual professional judgment, initiative and vigilance. Audit procedures are designed to meet the requirements of the particular situation, giving careful consideration to the size and type of regulated entity and the system of internal accounting control; this is a matter that requires the exercise of professional judgment in the light of the circumstances of each particular case.
6. Where the auditor discovers that the systems have failed or material differences have arisen, it considers the implications these may have on other areas of its work, on its reporting obligations and, in particular, on the "truth and fairness" of the financial statements.

## CLIENT SECURITIES

### Introduction

7. Client securities, for the purpose of the Client Securities Rules, are securities that are:
  - a. either
    - i. listed or traded on a recognised stock market; or
    - ii. interests in a collective investment scheme authorized by the SFC under section 104 of the SFO; and
  - b. received or held in Hong Kong by or on behalf of
    - i. a licensed corporation in the course of the conduct of any regulated activity for which the licensed corporation is licensed; or
    - ii. an associated entity of an intermediary in relation to the conduct of any regulated activity.

These securities may be held in the form of collateral.

8. The Client Securities Rules do not apply to client securities of a licensed corporation that are in an account established and maintained by a client of the licensed corporation, in that client's name, with a person other than the licensed corporation or an associated entity of the licensed corporation. The Client Securities Rules do not apply to client securities that are received or held outside Hong Kong by a licensed corporation or its associated entity.
9. For the particular regulated activity, the auditor needs to understand what may constitute client securities that are covered by the Client Securities Rules. It would consider all situations and transaction types that may be entered into by the regulated entity. Although the regulated entity may consider that a particular area is not covered by the rules relating to client securities, the auditor needs to be alert to situations where this is incorrect and the regulated entity is in breach of the Client Securities Rules as a result.

### Planning

10. The auditor's work on client securities will be planned in relation to three reporting requirements. For client securities, the main areas that need to be addressed by the auditor, to enable them to fulfill its reporting requirements, are:
  - a. whether during the financial year under review, the regulated entity had adequate systems of control in place to ensure compliance with the sections 4(4), 5, 10(1) and 12 of the Client Securities Rules;
  - b. whether during the financial year under review, the regulated entity has complied with sections 4(4), 5, 10(1) and 12 of the Client Securities Rules; and
  - c. whether during the financial year under review, the regulated entity has complied with section 3 or 4 of the Keeping of Records Rules to the extent that they relate to client securities.
11. The control objectives that a regulated entity administering or holding client securities or securities collateral will need to meet and the evidence that may be available to the auditor upon which it can base its conclusions are outlined below. They are only indicative.
12. Not every regulated entity, particularly a smaller one, will be able to meet all these objectives through the establishment of formal controls and segregation of duties. In consequence, not all the evidence indicated below will be available in every case.

13. This does not necessarily mean that the regulated entity has weak controls or that there is insufficient evidence for the auditor to give a conclusion. The regulated entity may well have adequate controls due to close supervision by the management, taking into account the low volume of client securities handled.
14. In some cases, therefore, the auditor may place greater reliance on observation and enquiry for its audit evidence than inspection of documentation. In doing so, it needs to bear in mind that undocumented systems are more prone to error and fraud, and that its presence and enquiries may influence the manner in which procedures are operated at that time.

**Adequate systems of control - Timely renewal of standing authorities (section 4(4))**

**Control objectives - Timely renewal of standing authorities**

15. The main factors that will be considered are:
  - a. satisfactory arrangements for ensuring that standing authorities that are due for renewal are identified;
  - b. satisfactory arrangements for notifying clients that their standing authorities are due to expire and informing them that unless clients object, they will be renewed upon the same terms and conditions; and
  - c. satisfactory notification to clients of the renewal of the standing authorities within the specified time frame.

**Evidence - Timely renewal of standing authorities**

16. The main factors that will be considered are:
  - a. retention of client standing authorities in a secure environment;
  - b. tracking system for timely identification of standing authorities that are approaching expiry;
  - c. management review of standing authority renewal notices prior to despatch;
  - d. client relationship personnel follow up expiring standing authorities with clients to ensure they have received notifications;
  - e. evidence of spot checks of standing authorities by the compliance or internal audit department to ensure that current standing authorities are in place; and
  - f. evidence of procedures for ensuring that standing authority renewal notices have been provided within one week after expiry.

**Adequate systems of control - Deposit or registration of client securities and securities collateral (section 5)**

**Control objectives - Deposit or registration of client securities and securities collateral**

17. The main factors that will be considered are:
  - a. whether registerable client securities are registered in a name permitted by the rules;
  - b. where client securities are deposited in the same name as that used for the intermediary's house positions, that the client securities are deposited in a designated account different from that in which its house positions are deposited;
  - c. securities held as collateral can be separately identified;

- d. arrangements for releasing documents under stock lending and borrowing arrangements are in accordance with the rules;
- e. satisfactory arrangements for ensuring that the client securities were held or securities collateral kept after receipt in a segregated account or registered in the name of the client from whom or on whose behalf the client securities have been received, or the intermediary (applicable to securities collateral only) or associated entity;
- f. satisfactory arrangements for ensuring that where client securities and securities collateral are deposited in safe custody, that the financial institutions, custodians or other intermediaries in question are appropriately authorized, approved or licensed as appropriate;
- g. satisfactory arrangements for withdrawal or disposal of client securities and securities collateral to be made to or by the client, or to or by any authorized party as specified in sections 5 and 6 of the Client Securities Rules upon the circumstances or under discretionary powers given in the client agreement;
- h. risk assessments to be carried out on all custodians to assess the risk of placing client securities and securities collateral with a third party;
- i. written arrangements between the intermediary or associated entity and the custodian covering at least the minimum requirements of the rules; and
- j. an adequate system to ensure that statements are sent to clients at required intervals, and that such statements properly reflect the regulated entity's records.

**Evidence - Deposit or registration of client securities and securities collateral**

18. The main factors that will be considered are:
- a. written instructions from clients stating the manner in which their securities are to be registered; these instructions may be set out in standard client agreements;
  - b. written procedures setting out how each security is to be identified so as to reflect the client's entitlement to that security (e.g. registered in the client's name);
  - c. where client securities are registered in the name of the intermediary or an associated entity, that an appropriate record of the interests of individual clients is maintained;
  - d. clear segregation of client securities from other securities;
  - e. separate registers maintained of securities held as collateral;
  - f. evidence of appropriate authority to engage in stock lending arrangements, given to the regulated entity by the clients concerned;
  - g. separate records of all such transactions sufficient to show the details of the stocks lent at any time and the collateral held;
  - h. proper segregation of duties which ensure each area is staffed by people independent of any other operations and password controls;
  - i. qualifications and experience of senior management;
  - j. strong boxes, fire-proof rooms and safes, restricted access via password controlled doors or limited access to keys, especially where important documents like securities certificates, were kept in the office premise;

- k. regular stock reconciliations performed for each stock segregated account against third party supporting documents;
- l. follow up actions taken by the licensed corporation on any reconciling or unusual entries in the stock records, particularly negative stock balances;
- m. evidence of spot checks of the custodian area by the compliance or internal audit department;
- n. written procedures stating how custodian staff are to process the movement of securities and what is required in the form of authorization;
- o. evidence of procedures for selection of external financial institutions, custodians or other intermediaries to ensure that they are eligible and suitable to hold client securities and securities collateral in safe custody;
- p. results of a risk assessment process including external information on credit rating, financial results etc. of the custodian and internal information on customer service received;
- q. letters of agreement with custodians stating the terms under which they are operating;
- r. file copies of statements sent to clients, which agree with the records; and
- s. procedures and controls (e.g. completed checklist) to ensure that all clients receive a statement (where required).

**Adequate systems of control - Depositing and transferring client securities and securities collateral (section 10(1))**

19. Under section 10(1) of the Client Securities Rules a regulated entity is required to take reasonable steps to ensure that client securities and securities collateral of the intermediary are not:
- i. deposited;
  - ii. transferred;
  - iii. lent;
  - iv. pledged;
  - v. repledged; or
  - vi. otherwise dealt with,

except as provided in Part 2 of the Client Securities Rules.

The relevant elements of the Client Securities Rules in Part 2 (covering sections 5, 6, 7, 8 and 9) in summary cover the following:

- a. *Section 5 - requirements for deposit or registration of client securities and securities collateral*

Unless client securities and securities collateral are registered in the name of the client, or the associated entity (or the intermediary in the case of securities collateral):



- i. client securities are:
  - deposited in safe custody in a segregated account which is designated as a trust account or client account in Hong Kong with an authorized financial institution, an approved custodian or another intermediary licensed for dealing in securities;
- ii. securities collateral is:
  - deposited in safe custody in a segregated account which is designated as a trust account or client account in Hong Kong with an authorized financial institution, an approved custodian or another intermediary licensed for dealing in securities; or
  - deposited in an account in the name of the intermediary or associated entity with authorized financial institution, an approved custodian or another intermediary licensed for dealing in securities.

*b. Section 6 - dealings with client securities and securities collateral*

A regulated entity may deal with client securities or securities collateral in accordance with:

- i. an oral or written direction to sell or to settle such a sale order;
- ii. a written direction to withdraw the client securities or securities collateral (where required under section 5);
- iii. a standing authority, except where this will result in:
  - a transfer of client securities or securities collateral to an account in Hong Kong other than an account referred to in section 5 or otherwise result in the intermediary, associated entity or a related corporation of the intermediary having the benefit or use of the client securities or securities collateral;
  - a transfer of the client securities or securities collateral to an officer or employee, unless he is the client in question; or
  - an unconscionable transaction in the sense of the Unconscionable Contracts Ordinance.

Where a licensed corporation is licensed for asset management, with the written agreement of the client, the licensed corporation may withdraw client securities from a trust account or client account, or deal with client securities that have been registered in the name of the client or an associated entity, for the purpose of selling the securities or settling a sale order on behalf of the client.

Where there is a liability owed by or on behalf of a client, with that client's written agreement, a licensed corporation may dispose, or initiate a disposal by any of its associated entities, of any of the client securities or securities collateral in settlement of that liability.

*c. Section 7 - treatment of client securities and securities collateral by intermediaries licensed for dealing in securities and their associated entities*

With a standing authority a licensed corporation licensed for dealing in securities may:

- i. apply any of the securities or securities collateral pursuant to a securities borrowing or lending agreement;

- ii. subject to the requirement of having repledged securities not exceeding 140% of aggregate margin loans, deposit any of the securities collateral in question with an authorized financial institution as collateral for financial accommodation provided; or
  - iii. deposit any of the securities collateral in question with a recognised clearing house or another intermediary licensed or registered for dealing in securities as collateral for the discharge and satisfaction of the licensed corporation's settlement obligations and liabilities.
- d. *Section 8 - treatment of securities collateral by intermediaries licensed for securities margin financing and their associated entities*

Subject to the requirement of having repledged securities not exceeding 140% of aggregate margin loans, with a standing authority a licensed corporation licensed for securities margin financing may deposit any of the securities collateral that it receives with an authorized financial institution or an intermediary licensed for dealing in securities as collateral for financial accommodation provided to the licensed corporation.

- e. *Section 8A – repledging*
- i. A regulated entity is required to ascertain the closing aggregate market value of the repledged securities collateral for each business day does not exceed 140% of its aggregate margin loan on the same date;
  - ii. If such 140% limit has been exceeded on any business day, the regulated entity is required to withdraw any excess to reduce such ratio to below the limit by the end of the next business day.
- f. *Section 9 - treatment of securities collateral by intermediaries licensed for dealing in futures contracts and their associated entities*

With a standing authority a licensed corporation licensed for dealing in futures contracts may deposit any of the securities collateral that it receives with a recognised clearing house or an intermediary licensed or registered for dealing in futures contracts as collateral for the discharge and satisfaction of the licensed corporation's settlement obligations and liabilities.

**Control objectives - Depositing and transferring client securities and securities collateral**

20. The control objectives that have been included in paragraph 17 above apply here. Additional factors that will be considered are:
- a. written procedures in place covering client dealing and transfer instructions;
  - b. controls provide assurance that client instructions are authorized prior to being actioned;
  - c. standing authorities are valid and current;
  - d. transfers of client securities and securities collateral are made to appropriate authorized accounts;
  - e. controls provide assurance that at the end of each business day repledged securities – that exceed 140% of aggregate margin loans are promptly identified and rectification action is taken within the following business day in accordance with the rules; and
  - f. where a client has failed to deliver the stock to the licensed corporation to settle his sale order, the securities of other clients are not used to settle the obligations of the client except as provided in Part 2 of the Client Securities Rules.

**Evidence - Depositing and transferring client securities and securities collateral**

21. The main factors that will be considered are:
- a. availability of up-to-date written procedures covering the handling of client instructions;
  - b. evidence that client instructions are verified as authentic and valid before being actioned;
  - c. evidence that client standing orders are checked that they are current and cover the transaction in question each time they are used;
  - d. evidence that where appropriate client securities and securities collateral are only transferred to or deposited with authorized financial institutions, approved custodians or other intermediaries licensed for dealing in securities;
  - e. where the licensed corporation has both cash clients and margin clients, the auditor should check whether separate designated accounts are maintained;
  - f. where client securities are maintained through CCASS, to determine whether securities received are allocated and transferred to the appropriate account within the timeframe as specified by the rules;
  - g. whether the licensed corporation has taken effective actions to follow up on any negative stock balance in its stock records and client ledger; and
  - h. the maximum amount of securities that the licensed corporation is permitted under section 8A of the Client Securities Rules to repledge is calculated on an ongoing basis and compared with the aggregate value of securities actually repledged, and rectification action is carried out within the statutory timeframe for any breach of the limit.

**Adequate systems of control - Reporting of non-compliance with certain provisions of the rules (section 12)**

**Control objectives - Reporting of non-compliance with certain provisions of the rules**

22. The main factors that will be considered are:
- a. system in place to identify potential incidents of non-compliance with the rules;
  - b. potential incidents of non-compliance reported to management on a timely basis; and
  - c. matters of non-compliance (a reportable matter as defined in section 157 of the SFO) are reported to the SFC in writing within one business day.

**Evidence - Reporting of non-compliance with certain provisions of the rules**

23. The main factors that will be considered are:
- a. evidence that the business has a system in place to identify potential incidents of non-compliance with the rules;
  - b. level of awareness amongst staff of the rules;
  - c. records kept in relation to potential incidents of non-compliance demonstrating that these have been reported to management on a timely basis; and
  - d. evidence that matters of non-compliance have been reported to the SFC in writing within one business day.

### **Compliance with the rules**

24. The work that the auditor will have performed as outlined above in relation to determining whether during the financial year under review, the regulated entity had adequate systems of control in place to ensure compliance with sections 4(4), 5, 10(1) and 12 of the Client Securities Rules is likely to also enable it to report on whether during the financial year under review, the regulated entity has complied with sections 4(4), 5, 10(1) and 12 of the Client Securities Rules.

Depending on the results of the work on the systems of control, some additional testing is likely to be required to enable the auditor to issue its opinion on the regulated entity's compliance with the rules during the financial year under review.

The auditor would consider obtaining written representations from management that all incidents of non-compliance with the rules have been disclosed, or that there have been no incidents of non-compliance.

### **Adequate accounting records have been maintained**

#### **Control objectives - Adequate accounting records have been maintained**

25. The main factors that will be considered are:
- a. proper and prompt recording of the movements of documents (this includes all documents, including those relating to the regulated entity's own securities as there is a risk of teeming and lading and having client documents mixed with the regulated entity's own documents);
  - b. proper and prompt recording of all purchases and sales of securities on behalf of clients;
  - c. records in agreement with the statements sent to clients of assets held on their behalf;
  - d. reconciliations carried out in accordance with the rules; and
  - e. proper and prompt accounting for benefits, such as bonus or scrip issues accruing to clients.

#### **Evidence - Adequate accounting records have been maintained**

26. The main factors that will be considered are:
- a. evidence that documents of title are recorded immediately on receipt;
  - b. evidence that documents of title are not released from the regulated entity's control to clients, registrars, brokers, etc. without the records being amended;
  - c. records kept in respect of any document clearly setting out the date of receipt and despatch of the document, the nature of the document, the client to whom the document relates, and the nature, amount and nominal value of the securities to which the document relates;
  - d. evidence that statements are sent to clients at the required intervals, made up to the appropriate date, and properly specifying the documents held. In this context, the auditor may consider obtaining direct confirmation from clients;
  - e. evidence that correspondence from clients querying statements (including client complaints) and any other queries have been dealt with properly and promptly;
  - f. evidence that benefits such as dividends or scrip issues are collectively and correctly allocated to each client;

- g. evidence that reconciliations have been carried out in accordance with the rules (for more detailed guidance on reconciliations see paragraphs 28 to 36 below); and
  - h. circularisation of account balances in accordance with paragraph 27 below.
27. The auditor exercises its professional judgment to determine whether and how to go about the performance of a circularisation of clients' account balances. The SFC has issued a list of matters which may be taken into account by the auditor in conducting a circularisation of clients' account balances:
- a. the auditor would exercise its judgment in determining sufficient coverage of samples over the total population of clients' accounts both in terms of number of clients and the money value of clients' assets. Given the objectives of the external confirmations as noted in paragraph 63 in Part II of this Practice Note, the auditor should consider to circularize external confirmations (including clients with zero account balances or assets holding if appropriate);
  - b. a risk-based approach should be adopted for sampling client accounts for circularisation whereby greater emphasis is placed on accounts which are more susceptible to misstatement or frauds, such as accounts under an arrangement to hold mail or to direct mail to the address of management or staff of the licensed corporation, inactive and dormant accounts etc;
  - c. appropriate audit steps should be taken to ensure the completeness of the list of clients from which samples are drawn;
  - d. confirmation would be prepared in language that the clients of the regulated entity are familiar with;
  - e. confirmation would be directly sent to and received from clients. Clients would be provided with convenient means of responding to the auditor;
  - f. be aware of any client enquiries regarding any discrepancies in their account balances;
  - g. the auditor would independently select samples for circularisation;
  - h. the auditor should ensure that the client particulars (such as the name and address of the client) stated in statements of account to be sent to the clients for confirmation agree to the licensed corporation's latest client information. Furthermore, the auditor should also ensure that the account balances and securities holding in the statements of account sampled for confirmation are consistent with the licensed corporation's relevant records. For example, holdings in each stock as stated in the statements of account should be checked against the underlying accounting records and stock ledgers, which should be reconciled with custodians' statements and/or physical stock count results with discrepancies properly followed up.
  - i. to improve the number of replies it is advisable to send the confirmation out as close as possible to the date that the licensed corporation has sent out its monthly statements.
  - j. the auditor to determine appropriate procedures in assessing the reliability of the confirmation letters received such as verifying client signatures on the confirmation against client agreements and/or directly calling the clients to verify the agreed balances on a sample basis; and
  - k. adequate and timely follow-up procedures for the non-reply confirmations would be carried out such as considering sending reminders or directly calling the non-reply clients etc. and/or reviewing a sample of trade orders and withdrawals of funds and securities recorded in their accounts.

## Reconciliations

28. The requirement to carry out reconciliations is set out in the Keeping of Records Rules. Further guidance on client asset reconciliation is set out in the Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules.

*Control objectives - Reconciliation of client securities - Physically held client securities*

29. The main factors that will be considered are:
- a. physical counts and reconciliations of all securities performed with at least the frequency and in the manner required by the rules, and by staff (in so far as possible) independent of the custodian department;
  - b. procedures planned and implemented to ensure that the count of client title documents is accurate;
  - c. timely clearance of reconciling items; and
  - d. records retained of the dates and results of the physical counts.

*Evidence - Reconciliation of client securities - Physically held client securities*

30. The main factors that will be considered are:
- a. detailed instructions for the counts;
  - b. an independent function (such as compliance department or internal audit) organizing, controlling or participating in carrying out the counts and reconciliations;
  - c. sufficient time and resources devoted to the counts and reconciliations;
  - d. full and clear documentation of the counts and reconciliations;
  - e. counts carried out at the frequency and with the time limits required by the rules;
  - f. adequate explanations for reconciling items; and
  - g. completion of reconciliations (i.e. all items explained).

*Control objectives - Reconciliation of client securities - Client securities held by a custodian*

31. The main factors that will be considered are:
- a. reconciliations for all custodians performed with at least the frequency and in the manner required by the rules and the Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules;
  - b. timely clearance of reconciling items;
  - c. the reconciliations undertaken by a person who is not involved with the recording or movement of the assets, if the size of the regulated entity permits this segregation of duties; and
  - d. records retained of the dates and results of reconciliations including confirmations from external custodians.

*Evidence - Reconciliation of client securities - client securities held by a custodian*

32. The main factors that will be considered are:
  - a. an independent function carrying out the reconciliations;
  - b. sufficient time and resources devoted to reconciliations;
  - c. full and clear documentation of the reconciliations;
  - d. reconciliations carried out at the frequency required by the rules;
  - e. adequate explanations for reconciling items; and
  - f. completion of reconciliations (i.e. all items explained).
33. Where client securities are physically held by the regulated entity itself, the auditor may attend part or all of one of the physical counts of client title documents. In reaching a conclusion regarding the extent to which this is necessary, the auditor considers the strength of controls surrounding, and the independence of, the count, reconciliation, day to day processing and custody of client documents of title.
34. The auditor examines confirmations from independent custodians of documents of title held by them.
35. The auditor inspects correspondence and agreements with custodians in order to verify compliance with the rules.
36. In larger regulated entities, a rolling reconciliation basis of confirming client title documents (similar to a manufacturing company's system of perpetual stock-taking) is sometimes adopted. Care must be taken to ensure that systems and controls are in place to prevent teeming and lading.

## **CLIENT MONEY**

### **Introduction**

37. The Client Money Rules apply to client money of a licensed corporation that is received or held by or on behalf of:
  - a. the licensed corporation, in the course of the conduct of any regulated activity for which the licensed corporation is licensed; or
  - b. an associated entity of the licensed corporation where such an associated entity is not an authorized financial institution, in relation to such conduct of the regulated activity.

The Client Money Rules do not therefore apply to associated entities of registered institutions. The reference to "regulated entity" in this section below is therefore restricted to a licensed corporation or its associated entity that is not an authorized financial institution.

38. The Client Money Rules do not apply to client money of a licensed corporation that is received or held outside Hong Kong by the licensed corporation or an associated entity of the licensed corporation.
39. The Client Money Rules do not apply to client money of a licensed corporation that is in a bank account established and maintained by a client of the licensed corporation in that client's name.

40. For the particular regulated entity, the auditor needs to understand what may constitute client money that is covered by the Client Money Rules. It would consider all situations and transaction types that may be entered into by the regulated entity. Although the regulated entity may consider that a particular area is not covered by the rules relating to client money, the auditor needs to be alert to situations where this is incorrect and the regulated entity is in breach of the Client Money Rules as a result.

### **Segregated accounts**

41. When a regulated entity holds or expects to hold client money, it must open one or more segregated accounts, each of which shall be designated as a trust account or client account. These must be established and maintained with:
- a. an authorized financial institution; or
  - b. any other institution approved by the SFC for the purposes of the Client Money Rules, either generally or in a particular case.

### **Planning**

42. The auditor's work on client money will be planned in relation to the three reporting requirements. For client money, the main areas that need to be addressed by the auditor, to enable it to fulfil its reporting requirements are:
- a. whether during the financial year under review, the regulated entity had systems of control in place that were adequate to ensure compliance with sections 4, 5, 6, 8(4), 10 and 11 of the Client Money Rules;
  - b. whether during the financial year under review, the regulated entity has complied with sections 4, 5, 6, 8(4), 10 and 11 of the Client Money Rules; and
  - c. whether during the financial year under review, the regulated entity has complied with section 3 or 4 of the Keeping of Records Rules to the extent that they relate to client money.
43. The control objectives that the auditor would expect to see in a regulated entity holding client money and the evidence from which the auditor seeks to draw reasonable conclusions are outlined below. They are only indicative and will not be applicable to all regulated entities holding client money, especially smaller ones.

### **Adequate systems of controls - Payment of client money into segregated accounts (section 4)**

44. Client money held by regulated entities has to be held on trust for clients in one or more segregated bank accounts designated as a trust account or client account.

#### **Control objectives - Payment of client money into segregated account**

45. The main factors that will be considered are:
- a. all client money is paid within one business day into a segregated account;
  - b. bank accounts opened only with an authorized financial institution, or any other institution approved by the SFC for the purposes of the Client Money Rules;
  - c. bank accounts include "Client Account" or "Trust Account" in their description in accordance with section 4(1) of the Client Money Rules;
  - d. appropriate statements, confirmations and agreements sent to and received from the authorized financial institutions;



- e. systems are adequate to identify all client money;
- f. systems are adequate to ensure that all client money and only client money is paid in compliance with the rules (other than where it is specifically allowed by the rules);
- g. systems are adequate to ensure that all client money is paid in promptly; that is within one business day, unless otherwise disposed of in accordance with the rules; and
- h. client money is only applied for the purposes of the client to whom it relates.

**Evidence - Payment of client money into segregated accounts**

46. The main factors that will be considered are:
- a. clear internal instructions setting out the procedures to be followed in dealing with any potential client money;
  - b. suitable levels of staff (i.e. with the appropriate training and experience) responsible for establishing segregated accounts and identifying client money within the regulated entity;
  - c. lodgements regularly and promptly made;
  - d. lodgements to segregated accounts comprise client money only, except as otherwise permitted;
  - e. lodgements to non client accounts do not include client money;
  - f. an up to date list of all bank accounts which identifies those that are segregated accounts; and
  - g. bank statements agreeing to the regulated entity's records.

**Adequate systems of controls - Payment of client money out of segregated accounts (section 5)**

**Control objectives - Payment of client money out of segregated accounts**

47. The main factors that will be considered are:
- a. systems are adequate to ensure that all client money withdrawals in Hong Kong are made in compliance with the rules; and
  - b. all withdrawals from segregated accounts are made only for prescribed purposes and in accordance with the rules.

**Evidence - Payment of client money out of segregated accounts**

48. The main factor that will be considered is:
- a. withdrawals are properly authorized and for purposes approved by the rules.

**Adequate systems of controls - Treatment of interest on client money held in segregated accounts (section 6)**

49. The Client Money Rules require that interest derived from client money is held in a segregated account. To the extent that any amount of interest retained in a segregated account which the regulated entity is entitled to retain under an agreement with the client(s), this would be paid out of the account within one business day after the interest is credited to the account or the regulated entity becomes aware that the interest has been credited to the account.

**Control objectives - Treatment of interest on client money held in segregated accounts**

50. The main factors that will be considered are:
- a. appropriate procedures in place for identifying and withdrawing regulated entity's entitlement of interest on segregated accounts on a timely basis;
  - b. where applicable, interest paid on all money subject to interest calculations; and
  - c. interest payments correctly calculated by reference to the appropriate dates.

**Evidence - Treatment of interest on client money held in segregated accounts**

51. The main factors that will be considered are:
- a. evidence that regulated entity's interest entitlements are withdrawn on a timely basis in accordance with the rules; and
  - b. schedules showing how interest due to clients has been calculated (or equivalent computer processes).

**Adequate systems of control - Timely renewal of standing authorities (section 8(4))**

**Control objectives - Timely renewal of standing authorities**

52. The main factors that will be considered are:
- a. satisfactory arrangements for ensuring that standing authorities that are due for renewal are identified;
  - b. satisfactory arrangements for notifying clients that their standing authorities are due to expire and informing them that unless clients object, they will be renewed upon the same terms and conditions; and
  - c. satisfactory notification to clients of the renewal of the standing authorities within the specified time frame.

**Evidence - Timely renewal of standing authorities**

53. The main factors that will be considered are:
- a. retention of client standing authorities in a secure environment;
  - b. tracking system for timely identification of standing authorities that are approaching expiry;
  - c. management review of standing authority renewal notices prior to despatch;
  - d. client relationship personnel follow up expiring standing authorities with clients to ensure they have received notifications;
  - e. evidence of spot checks of standing authorities by the compliance or internal audit department to ensure that current authorities are in place; and
  - f. evidence of procedures for ensuring that standing authority renewal notices have been provided within one week after expiry.

**Adequate systems of controls - Requirement to pay money other than client money out of segregated accounts (section 10)**

54. The Client Money Rules require that a regulated entity which becomes aware that it is holding an amount of money in a segregated account that is not client money of the regulated entity shall, within one business day of becoming so aware, pay that amount of money out of the segregated account.

**Control objectives - Requirement to pay money other than client money out of segregated accounts**

55. The main factor that will be considered is appropriate procedures in place for identifying and withdrawing regulated entity's money from segregated accounts on a timely basis.

**Evidence - Requirement to pay money other than client money out of segregated accounts**

56. The main factor that will be considered is evidence that regulated entity's money is withdrawn on a timely basis in accordance with the rules.

**Adequate systems of control - Reporting of non-compliance with certain provisions of the rules (section 11)**

**Control objectives - Reporting of non-compliance with certain provisions of the rules**

57. The main factors that will be considered are:
- a. system in place to identify potential incidents of non-compliance with the rules;
  - b. potential incidents of non-compliance reported to management on a timely basis; and
  - c. matters of non-compliance (a reportable matter as defined by section 157 of the SFO) are reported to the SFC in writing within one business day.

**Evidence - Reporting of non-compliance with certain provisions of the rules**

58. The main factors that will be considered are:
- a. evidence that the regulated entity has a system in place to identify potential incidents of non-compliance with the rules;
  - b. level of awareness amongst staff of the rules;
  - c. records kept in relation to potential incidents of non-compliance demonstrating that these have been reported to management on a timely basis; and
  - d. evidence that matters of non-compliance have been reported to the SFC in writing within one business day.

**Compliance with the rules**

59. The work that the auditor will have performed as outlined above in relation to determining whether during the financial year under review, the regulated entity had adequate systems of control in place to ensure compliance with sections 4, 5, 6, 8(4), 10 and 11 of the Client Money Rules is likely to also enable them to report on whether during the financial year under review, the regulated entity has complied with sections 4, 5, 6, 8(4), 10 and 11 of the Client Money Rules.

Depending on the results of the work on the systems of control, some additional testing is likely to be required to enable the auditor to issue its conclusion on the regulated entity's compliance with the rules during the financial year under review.

The auditor would consider obtaining written representations from management that all incidents of non-compliance with the rules have been disclosed, or that there have been no incidents of non-compliance.

### **Adequate accounting records have been maintained**

#### **Control objectives - Adequate accounting records have been maintained**

60. The main factors that will be considered are:
- a. proper recording of movements of client money;
  - b. interest credited in accordance with the rules;
  - c. reconciliations carried out in accordance with the rules; and
  - d. appropriate titles are given to accounts.

#### **Evidence - Adequate accounting records have been maintained**

61. The main factors that will be considered are:
- a. adequate details of the day to day entries of money paid into and out of the segregated accounts and individual client accounts including:
    - i. dates of receipts and payments;
    - ii. name of the client;
    - iii. name of the person from whom money was received or to whom it was paid, if other than the client;
    - iv. sub-ledgers with individual client accounts; and
    - v. evidence of designation from a client;
  - b. records of the interest earned on the segregated accounts, the determination of the amount of interest payable to clients and the dates and amounts of interest paid/credited to clients;
  - c. records maintained on a timely basis;
  - d. evidence that reconciliations have been carried out as required and reconciling items have been investigated and cleared promptly (for more detailed guidance on reconciliations see paragraphs 62 to 67 below);
  - e. the records maintained comply with the guidance given by the SFC;
  - f. to provide third party evidence of client balances (except settlement balances), the auditor may consider obtaining direct confirmation from clients; in practice, this may be conveniently combined with testing the accuracy of statements of their securities sent to clients; and
  - g. circularisation of account balances in accordance with paragraph 27 of this Appendix.

#### **Reconciliations**

62. The requirement to carry out reconciliations is set out in the Keeping of Records Rules.

63. Regulated entities that hold client money are required to reconcile each month any differences during that month in its balances or positions with any of their associated entities and other parties, including:
- a. recognised exchange companies;
  - b. clearing houses;
  - c. other intermediaries;
  - d. custodians; and
  - e. banks,

and show how such differences were resolved.

*Control objectives – Reconciliation*

64. The main factors that will be considered are:
- a. client/trust money per the segregated account, as recorded by the regulated entity, is reconciled with the total of balances recorded as due to each client at least each month;
  - b. balance of each such segregated account, as recorded by the regulated entity, is reconciled with the relevant bank statements;
  - c. the reconciliations are properly prepared and adequate explanations given for reconciling items, which would be cleared without delay; and
  - d. records are retained of the dates and results of the reconciliations.

*Evidence – Reconciliation*

65. The main factors that will be considered are:
- a. an up-to-date list of the segregated accounts held that agrees with the segregated accounts being reconciled;
  - b. evidence of an independent preparation and review of these reconciliations; and
  - c. reconciliations being carried out regularly over the financial year under review.
66. The auditor carries out normal audit tests on bank reconciliations. Particular attention will be paid to reconciling items, ensuring that outstanding and uncleared items are properly identified and are duly cleared shortly after the reconciliation. As part of its substantive testing, the auditor examines and where appropriate obtain direct confirmation of bank balances from each bank concerned.
67. The regulated entity would also reconcile its segregated bank accounts as often as necessary but at least once every month. Some regulated entities need to reconcile segregated accounts daily if the volume of business is high.

## **NO CLIENT ASSETS**

68. The auditor must be alert to a situation where a licensed corporation is not permitted under its licensing condition to hold client assets or does not, as a matter of policy, hold client assets. Where this is the case, the licensed corporation would have systems in place to avoid receiving and holding client assets.

69. Although the auditor is not required to give the SFC independent assurance that the licensed corporation has not administered or held client assets, it still considers carrying out the following procedures:
- a. enquire as to what arrangements a licensed corporation has in place to ensure that relevant staff are aware of what constitutes client assets. This could be documented in a procedural manual or internal memorandum and would outline the procedures to be followed if client assets are identified;
  - b. enquire as to how settlements are effected on behalf of clients (reference will be made to client documentation and payment instructions on contract notes or statements);
  - c. review the cash book in order to confirm that receipts and payments in the cash book only relate to the licensed corporation's own money and that no client money is being received or held;
  - d. review the licensed corporation's client files to see whether they provide any indication that it has held client assets in order to undertake a particular transaction;
  - e. review client agreements for statements of how custody is to be operated; as a corollary, review the agreements with any custodians used and the counterparty files (i.e. the documentation which supports the securities transactions) for correspondence on settlement procedures to ensure that there is no evidence that the licensed corporation has offered client assets protection (i.e. held separately in accordance with the rules);
  - f. ascertain whether a system of review exists to ensure that client assets are not administered or held. This could constitute periodic review by the internal auditor or compliance officer and encompasses substantive review of the licensed corporation's bank and custodian accounts and client agreements;
  - g. enquire as to details of any client assets the licensed corporation has received and the action taken; and
  - h. review the complaints log for any indication that the licensed corporation has held client assets.

The auditor should be alert to findings from the above procedures which may indicate that the licensed corporation has held client assets. In such circumstances, the auditor should refer to the guidance in paragraph 65 in Part II of this Practice Note and consider to send confirmations to the licensed corporation's clients. In addition, the auditor should refer to the guidance in Part V of this Practice Note and consider to report to the SFC.

70. The auditor will consider obtaining written representations from management that the licensed corporation has not breached any rules relating to the client assets during the financial year under review.

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Effective for audits of financial statements  
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*Practice Note 860.1 (Revised)*

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# The Audit of Retirement Schemes



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

**PRACTICE NOTE  
860.1 (REVISED)  
THE AUDIT OF RETIREMENT SCHEMES**

*(Issued December 2014; revised December 2015, October 2016  
Effective for audits of financial statements for periods ending on or after 15 December 2016 upon  
issue)*

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**PRACTICE NOTE  
860.1 (REVISED)  
THE AUDIT OF RETIREMENT SCHEMES**

*The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.*

*Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.*

**PART I  
GENERAL**

**Introduction**

1. The purpose of this Practice Note is to assist the auditor to develop an approach to the audit of the financial statements of retirement schemes, with particular focus on those registered under the Mandatory Provident Fund Schemes Ordinance (MPFSO) and the Occupational Retirement Schemes Ordinance (ORSO).
2. This Practice Note also provides guidance relevant to the auditor's other reporting responsibilities under the MPFSO and the ORSO:
  - a. the MPFSO
    - i. the auditor's report on compliance with prescribed capital adequacy requirements pursuant to sections 18 and 115 of the Mandatory Provident Fund Schemes (General) Regulation (General Regulation);
    - ii. the auditor's report on a review of the trustee's report on control objectives and internal control measures pursuant to section 113 of the General Regulation; and
    - iii. the report by the auditor of a service provider under section 74(5)(b) of the General Regulation.
  - b. the ORSO
    - i. the report by the auditor appointed by the administrator under section 20(1)(b) and 20(3) of the ORSO; and
    - ii. work of the employer's auditor under section 20(7A) of the ORSO.

Guidance is also provided on the communications between the auditor and the Mandatory Provident Fund Schemes Authority (MPFA).

3. This Practice Note has been prepared in consultation with the MPFA.
4. This Practice Note is based on the ORSO in effect as at 23 July 1999 (i.e. the ORSO as amended by the Occupational Retirement Schemes (Amendment) Ordinance 1999), and the MPFSO and the General Regulation in effect as at 25 April 2013, and guidelines issued by the MPFA up to November 2013. Every care has been taken in its preparation. However, the legislation itself is the sole authority of the law and this Practice Note should be used in conjunction with the legislation.

5. It should be borne in mind that certain expressions used in the MPFSO, the General Regulation and the ORSO may be matters for legal interpretation. There may, therefore, be circumstances in which, notwithstanding the guidance given in this Practice Note, the auditor will wish to seek legal advice.

## Definitions

6. The definitions used in this Practice Note are:
- a. *Administrator*  
The trustee of an ORSO scheme governed by trust or the insurer of an ORSO scheme which is regulated by an insurance arrangement.
  - b. *Aggregate past service liability*  
As defined in section 2(1) of the ORSO.
  - c. *Aggregate vested liability*  
As defined in section 2(1) of the ORSO.
  - d. *Authorized financial institution*  
An institution authorized under Part IV of the Banking Ordinance.
  - e. *Authorized insurer*  
An insurer authorized under section 8 of the Insurance Companies Ordinance.
  - f. *Control objectives*  
In relation to a MPF scheme, the control objectives for the time being applicable to the scheme maintained under section 39 of the General Regulation.
  - g. *A defined benefit scheme* is one which is not a defined contribution scheme.
  - h. *A defined contribution scheme* is one which provides that amount of a benefit under the scheme is to be an amount determined solely by reference to:
    - i. the contributions to the scheme's funds by or in respect of the member concerned and any declared return in respect of such contributions (where such return may be subject to a minimum guaranteed rate but is otherwise unascertainable before it is declared); and
    - ii. where appropriate, the qualifying service and age of the member (employee).
  - i. *Encumbrance* includes a charge, pledge, lien and mortgage.
  - j. *MPFSO*  
Mandatory Provident Fund Schemes Ordinance.
  - k. *General Regulation*  
Mandatory Provident Fund Schemes (General) Regulation.
  - l. *Exemption Regulation*  
Mandatory Provident Fund Schemes (Exemption) Regulation

- m. *MPF Code*  
Code on MPF Investment Funds
- n. *MPFA*  
Mandatory Provident Fund Schemes Authority.
- o. *MPF scheme*  
A retirement scheme registered under section 21 of the MPFSO as an employer sponsored scheme or a master trust scheme, or section 21A of the MPFSO as an industry scheme.
- p. *ORSO*  
Occupational Retirement Schemes Ordinance.
- q. *ORSO scheme*  
A retirement scheme registered under the ORSO.
- r. *Pooling arrangement or agreement*  
A pooling arrangement or agreement is one where two or more schemes are administered together. Under such an arrangement, a number of individual schemes can participate either through a master trust deed or a master insurance policy depending on whether the pooling arrangement is governed by a trust or is the subject of, or regulated by an insurance agreement. Master trust schemes and industry schemes established under the MPFSO also operate within a pooling arrangement.
- s. *Relevant employer*  
An employer who provides the employment which entitles or enables the employee to be a member of a retirement scheme.
- t. *Relevant undertaking*  
Relevant undertaking is defined by section 20(4) and Schedule 2 Parts 1 and 2 paragraph 6 of the ORSO as a written undertaking by the relevant employer of the scheme to the administrator of the scheme to contribute to the scheme's fund in accordance with recommendations made by the actuary in the actuarial certificate issued as regards a particular scheme. Where more than one actuarial certificate has been issued, the undertaking referred to is the one in the most recent of those certificates which is applicable to the financial period under review.
- u. *Retirement scheme/scheme*  
Any instrument or agreement (other than contracts of life insurance) to provide a benefit, payable on termination of service, death, retirement or otherwise, to a person or his beneficiary as a result of a contract of service of employment, whether in Hong Kong or elsewhere. For the purpose of this Practice Note, this includes self-employed persons.
- v. *Rules*  
MPFSO/ ORSO Subsidiary Legislation

w. *Trustee*

Approved trustee of MPF schemes.

## Regulatory background

7. Retirement schemes are generally either constituted as trusts or insurance arrangements (policies). Retirement schemes in Hong Kong are required to be registered under the MPFSO or the ORSO, although schemes may apply to the MPFA for an exemption. The MPFA assumes the role as the Registrar of Occupational Retirement Schemes (Registrar) in administering the ORSO with effect from 10 January 2000. Exemption from the ORSO (section 7) is allowed for schemes with not more than 10% or 50 of their members, whichever is less, being Hong Kong permanent identity card holders. In exceptional cases, exemption may also be granted, at the discretion of the MPFA, for offshore schemes which are registered or approved by a recognised overseas authority.
8. The environment in which a retirement scheme operates is different from that of most commercial enterprises. The auditor would need to be familiar with the regulatory background to retirement schemes, in particular the requirements of the MPFSO, the General Regulation, the Exemption Regulation, the ORSO, the relevant Rules, guidelines and codes issued by the MPFA, as appropriate, and the accounting aspects of their operation before commencing the audit.
9. For schemes registered under the MPFSO or the ORSO, the trustee/administrator has various responsibilities imposed by the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA. The three main objectives of the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA are regulation, segregation and information.

## Administration of a retirement scheme

10. The administration of a retirement scheme involves the input and interaction of a number of different parties:
  - a. the relevant employer - has an on-going responsibility for providing adequate funding to the scheme and ensuring that his obligations under the scheme terms and the relevant legislation are properly discharged;
  - b. the trustee/administrator - is responsible for ensuring that the scheme is administered in accordance with its governing rules/trust deed, and where applicable, the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA;
  - c. the employee (or the member) - has a responsibility for providing contributions to the scheme (in the case of a contributory scheme) and as the ultimate beneficiary of the scheme has a vested interest in ensuring that the scheme is administered properly and is providing appropriate returns on the contributions made;
  - d. the administrator's/trustee's auditor - is responsible for the independent audit of the scheme;
  - e. the employer's auditor - is responsible for examining the relevant records of the employer and preparing the employer's auditor's statement for ORSO schemes (see paragraphs 196 to 215 below); and
  - f. the scheme actuary - is responsible for reviewing the sufficiency of the scheme's assets and preparing the actuarial certificate for defined benefit schemes (see paragraphs 25 to 32 below).

11. While the trustee/administrator is ultimately responsible for the proper operation of a retirement scheme, he may choose to delegate some or all of his management functions to a third party. Where the trustee has delegated any function to a service provider (such as the administration or the investment function), the trustee/administrator must ensure that there are internal control procedures in place to monitor the activities of the service providers. The trustee/administrator must ensure that the service providers have carried out their duties in accordance with the agreements and the trustee/administrator is notified of any material changes relating to the eligibility of the service providers or material breach of obligations by the service providers.

### **Audit requirements**

12. The audit requirements of MPF schemes and ORSO schemes are set out respectively in Parts II and III of this Practice Note below.
13. The auditor ensures that he/ she is familiar with Hong Kong Accounting Standard 26 "Accounting and Reporting by Retirement Benefit Plans" which deals with accounting and reporting by the plan to all participants as a group.

### **Commentary on the application of Hong Kong Standards on Auditing (HKSA)s**

#### **Compliance with HKSA)s**

14. HKSA)s apply to the audits of the financial statements of any entity, irrespective of the size of the entity, its legal form, or the nature of its activities. The commentary which is set out in paragraphs 15 to 44 below identifies the special considerations arising from the application of individual HKSA)s to the audits of the financial statements of retirement schemes. Where no special considerations arise from a particular HKSA, no material is included.

#### **Engagement letters**

15. The auditor issues engagement letters in accordance with the principles and requirements of HKSA 210 "*Agreeing the Terms of Audit Engagements*". Specific issues which the auditor would address in engagement letters applicable to retirement schemes include:
- a. the nature and scope of the auditor's reporting responsibilities under the MPFSO/ORSO, the General Regulation, the MPF Code and the relevant guidelines issued by the MPFA;
  - b. the extent of the auditor's rights to obtain information and explanations from the relevant employer and/or persons to whom the trustee/administrator has delegated some or all of his duties;
  - c. the fact that the audit will be planned so that there is a reasonable expectation of detecting material misstatements in the financial statements resulting from breaches of trust or statute. It should be made clear, however, that the audit should not be relied on to detect all breaches which may exist; and
  - d. the extent of the auditor's responsibility for information/documents which may be contained in the documents containing the audited financial statements of the scheme.

#### **Planning**

16. The auditor plans the audit in accordance with HKSA 300 "*Planning an Audit of Financial Statements*". Consideration of specific matters related to retirement schemes may also include:
- a. whether the trustee/administrator has a sound understanding of the legislation and rules governing the scheme as set out under the trust deed, the insurance agreement

and/or the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA;

- b. whether the trustee/administrator has the necessary training and skills required to maintain the records of the scheme (both financial and non-financial), given that the trustee/administrator may have to maintain membership records, make investment decisions and administer benefit payments; and
  - c. whether there is close involvement of the employer in a "directly invested scheme". Direct investment is a term used to describe a method of investment for a scheme by which securities are held directly in the name of the trustees.
17. The operation of a retirement scheme can involve complex technical issues and calculations in areas in which the auditor cannot be expected to be expert. During the course of the audit it may be necessary for the auditor to obtain confirmations from other professional advisers such as actuaries, fund managers and solicitors. The audit planning would therefore include details of the advisers and the extent to which reliance would be placed on information provided by them.

#### **Internal controls**

18. The auditor considers internal controls in accordance with HKSA 315 (Revised), "*Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*".
19. The trustee/administrator has a duty to maintain adequate accounting records and systems to enable his duties to be carried out including discharging his responsibilities for investment decisions and safeguarding the scheme's assets.
20. The nature and extent of a scheme's accounting systems, procedures and internal controls depend mainly upon the size of the scheme, the extent to which the trustee/administrator delegates the administration of the scheme to third parties and the nature of its investments.
21. Where a trustee/administrator delegates the management of a significant part of the scheme's operations to a third party, the auditor considers the requirements of HKSA 402 "*Audit Considerations Relating to an Entity Using a Service Organization*". In particular, the auditor would need to assess the systems and controls the trustee/administrator has in place to monitor and control the activities of the third party, and those of the third party itself. This may involve corresponding with the auditor of the third party.
22. Where some or all of the scheme is administered in-house, the size of the scheme and the size of the employer's operations determine the scope for developing internal controls and therefore whether formalised procedures and internal controls for certain transactions exist. For example, in a small scheme the infrequency of particular types of transactions such as benefits payable on the death in service of members, may result in no formal control being in place. It may also be difficult for the trustee/administrator to achieve a proper segregation of duties. In such instances, it is unlikely that the auditor is able to place reliance on those internal controls.

#### **Computer systems**

23. The auditor considers the requirements of HKSA 315 (Revised) and also to the matters set out in paragraph 24 below.
24. The processing and recording of a large number of scheme member records and related transactions frequently involve the use of computer systems. Typical examples of scheme administration functions that are performed by computerised procedures include:
- a. calculation of contributions receivable;

- b. calculation of benefits payments and vested benefits;
- c. generation of computer cheques for benefit payments;
- d. allocation of investment income and expenses; and
- e. scheme accounting function.

### **Review of actuarial information**

#### *General*

- 25. The requirement for actuarial reviews only applies to defined benefit schemes. Under a defined contribution scheme the vested benefit (the member's contributions and a proportion of the employer's contributions plus the net investment return on both) is more readily identifiable from the scheme's accounting records.
- 26. Without actuarially determined disclosures in the financial statements of a defined benefit scheme, the financial statements only give limited information about the state of affairs of the scheme. Actuarial reviews are necessary to assess, amongst other things, the ability of the scheme to pay the defined benefits in the future.
- 27. The ORSO (section 31) requires an actuarial review to be performed at least once every three years and the report to be given to the administrator within six months of the date at which the review takes place. However schemes where solvency is an issue require a review every year. The primary purpose of this review is to monitor the solvency and funding of the scheme.
- 28. Accordingly, the full actuarial certificate arising from this review is required by the ORSO (schedule 2) to include the following statements:
  - a. that, in the course of the actuarial review, the actuary has had regard to the financial condition of the scheme;
  - b. that the assets of the scheme were (or, in the case of a qualified certificate, were not) sufficient to meet its aggregate vested liability at the valuation date;
  - c. that, following his review, the actuary has made recommendations as regards funding of the scheme;
  - d. that, following his review, the actuary has received a copy of a written undertaking by the relevant employer of the scheme to the administrator of the scheme that he will contribute to the scheme's funds in accordance with those recommendations; and
  - e. that, provided the scheme is funded in accordance with the actuary's recommendations the actuary would expect that the scheme's assets would be sufficient to meet its aggregate vested liability throughout the next three years, and, at a specified date, they would be sufficient to meet the scheme's aggregate past service liability.
- 29. In the event that a qualified actuarial certificate is issued, the auditor is advised to refer to Part 2 of Schedule 2 to the ORSO (which details information to be given by the actuary).
- 30. In addition to the statutory requirements set out above, actuarial reports can provide an assessment of a defined benefit scheme's progress in achieving its objective of providing members' future benefits. The results of an actuarial review are used to determine the appropriate contribution level and to indicate any surplus or deficiency in the funding of the retirement scheme.



31. A practical way of showing the level of funding of a scheme is for the actuary to indicate the trend in the values of the following from the latest valuation and from previous valuations, if they are available:
- a. the amount of aggregate vested liabilities; and
  - b. the amount of aggregate past service liabilities.

32. The actuary arrives at the actuarial valuation by taking the discounted value of future benefits that are expected to arise in the scheme in respect of members, and comparing this with the value of scheme assets, and the discounted value of future contributions. The actuary would also compare scheme assets with past service liabilities and vested liabilities. In doing so the actuary makes a number of assumptions, including earnings rate, inflation, salary increases and staff turnover rates.

*The auditor's responsibilities*

33. In considering the work of the actuary as audit evidence, the auditor considers the requirements of HKSA 500 "Audit Evidence" on information produced by a management expert.
34. As set out in paragraph 8 of HKSA 500, if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor is required to perform the following procedures:
- a. Evaluate the competence, capabilities and objectivity of that expert;
  - b. Obtain an understanding of the work of that expert; and
  - c. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Further guidance are set out in paragraphs A37 to A48 of HKSA 500. Additional specific considerations which apply in the audit of retirement schemes are set out below in paragraphs 35 to 39 below.

35. In evaluating the work of an actuary, the auditor is required to consider the following:
- a. the source data used;
  - b. the assumptions and methods used and their consistency; and
  - c. the results of the expert's work in the context of the auditor's overall knowledge.
36. The auditor would need to be satisfied as to the accuracy and reasonableness of the source data. The source data used is provided by the administrator and includes information on salaries, date of birth of members, date of joining the employer, date of joining the scheme, contribution rates, accumulation of member and employer contributions, benefit multiples and investments held.
37. The assumptions used comprise both ones which pertain to the scheme and the industry in which the scheme operates and ones which are used by actuaries generally, such as inflation and interest rates.
38. The appropriateness and reasonableness of assumptions and methods used and their application are the responsibility of the actuary. The auditor does not have the same expertise and, therefore, cannot always challenge the actuary's assumptions and methods. However, the auditor seeks to obtain an understanding of the assumptions and methods used and to consider whether they are appropriate and reasonable, based on the auditor's knowledge of the business and the results of other audit procedures.

39. The auditor would also consider the consistency of the actuary's assumptions and the funding method used to calculate the members' future benefits. By changing the assumptions and funding method, the valuation changes and this affects the surplus or deficiency in the fund and the required contribution rates. Any such changes in assumptions or funding method should be explained by the actuary. The auditor would also give special attention to the consistency of the margin between the projected returns of the scheme and the projected salary rises. If the results of the actuary's work do not provide sufficient appropriate audit evidence or if the results are not consistent with other audit evidence, the auditor would seek to resolve the matter. This may involve discussions with the administrator and the actuary, applying additional procedures, including possibly engaging another actuary.

*Deficiency of assets*

40. It is not uncommon for some of these calculations to show a deficiency of assets to meet the amount of members' benefits calculated. The auditor would review the actuary's recommendations to determine whether the relevant employer has made contributions to the scheme in accordance with such recommendations. These recommendations may include an increase in the amount of contributions or an extension of the period over which contributions are made.
41. The auditor would need to determine whether a deficiency may imply an inability of the scheme to meet its obligations as and when they fall due. Furthermore, in any year in which an actuarial certificate has not been prepared, the auditor would consider whether economic circumstances have eroded the value of the investments, which might also imply that the scheme may not be able to meet its obligations as and when they fall due. Such uncertainties may give rise to additional disclosure in the financial statements and/or the need to include an explanatory paragraph dealing with a fundamental uncertainty or a qualification in the auditor's report.

**Consideration of laws and regulations**

42. In accordance with HKSA 250 "*Consideration of Laws and Regulations in an Audit of Financial Statements*", the auditor considers the impact of the relevant requirements of the trust deed or scheme rules, the ORSO, the MPFSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA on their audit. As stated in HKSA 250, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The requirements in HKSA 250 are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

**The auditor's reports**

43. The principles set out in HKSA 700 (Revised), "*Forming an Opinion and Reporting on Financial Statements*" are applicable to auditor's report on retirement scheme financial statements. For ORSO schemes the auditor's reports are addressed in accordance with the trust deed or scheme rules. Where the deed is silent, the auditor's reports would be addressed to the administrator. For MPF schemes the auditor's reports are addressed to the trustee.

**Review of trustees' (or administrator's) report/scheme report/investment report**

44. The trustees' report, the scheme report and the investment report do not form part of the audited financial statements. However, as they will form part of the same document, the auditor refers to HKSA 720 (Revised), "*The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*" concerning the auditor's responsibilities in this area.

## Specific audit areas

### Investments

#### *General*

45. The trustee/administrator is responsible for the process of investing the scheme assets. The trustee/administrator must therefore ensure that investments conform to the requirements of the scheme's rules, restrictions imposed by the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA and the general duties and obligations established under trust law.
46. Most schemes allow trustees/administrators a wide range of investment choice. There are however, some restrictions imposed by the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA. Examples of such restrictions in respect of MPF and ORSO schemes are included in Parts II and III of this Practice Note respectively.
47. The audit of investment balances in a retirement scheme is essentially no different to the audit of investment balances in any other organisation, except where the trustee/administrator chooses to delegate the management of the investment portfolio to a third party. The audit implications of this situation are discussed in paragraph 21 above.

#### *Audit objectives*

48. The auditor would consider whether:
  - a. the investments of a scheme exist and are owned by the scheme;
  - b. all investments of the scheme have been accurately and completely recorded in the books of the scheme;
  - c. the investment policy of the scheme is in accordance with the terms of the scheme rules/trust deed, the MPFSO/ORSO (where applicable), the General Regulation (where applicable), the Exemption Regulation (where applicable), the relevant Rules, guidelines and codes issued by the MPFA;
  - d. all investments are appropriately valued; and
  - e. all investment balances are appropriately classified and disclosed in the financial statements of the scheme.

### Contributions

#### *General*

49. There are principally two types of contributions, namely:
  - a. employer financed; and
  - b. member financed.

These two categories can be further subdivided. For example, the employer contribution may take the form of a contribution based on a specified rate (by the MPFSO, trust deed or by the actuary), and member contributions may include contribution based on a specified rate, additional voluntary contribution or amounts rolled over from other schemes.

50. The trustee's/administrator's primary responsibility for contributions is to ensure that all contributions due have been paid over to the scheme on a timely basis, and have been recorded to the members' benefit completely and accurately. Specific responsibilities of the trustee/administrator for contributions are included in Parts II and III of this Practice Note below.
51. In fulfilling this responsibility the trustee/administrator must firstly ensure that all new members have been properly admitted to the scheme in accordance with the provisions of the governing rules or trust deed, members who have ceased their membership during the year have been appropriately removed from the membership register, and that details relating to all continuing members are properly carried forward in the scheme records. The trustee/administrator must ensure that all membership records are accurate.
52. The trustee/administrator is required to ensure that both employer and member contributions are made in accordance with the governing rules or other relevant agreements and as recommended by the actuary (in the case of a defined benefit scheme) and such contributions are made on a timely basis.

*Audit objectives*

53. The auditor would consider whether:
- a. all contributions receivable from, or on behalf of, eligible members have been received and have been recorded in the correct period; and
  - b. contributions received have been made in accordance with the governing rules or other relevant agreements and, for defined benefit schemes, the recommendations of the actuary.

*Specific risk areas*

54. The main risks are those of completeness and accuracy. Completeness involves ensuring that all contributions are recorded, either as received or receivable. Accurate calculation is particularly relevant to defined contribution schemes where employer's contributions are based on a percentage of a member's salary. The auditor would also consider whether contributions receivable are recoverable, particularly if the employer has a significant level of contributions owing at the financial year end of the scheme.

**Benefits**

*General*

55. Benefits are normally paid by way of a lump sum. The amount and means of calculation of the benefit paid depend on the type of the scheme.
56. Where a scheme is a defined contribution scheme, the benefit paid will equal the members' vested benefit in the scheme which is the accumulation of the members' contributions plus the appropriate proportion of the employer's contributions and the investment return on both.
57. Where the scheme is a defined benefit scheme, the benefit paid is determined by the governing rules and is generally calculated on the basis of length of service and the members' salary, which may be based on current salary, an average salary or another method as determined by the scheme rules.
58. The trustee/administrator is primarily responsible for ensuring that all benefit payments which should have been made are correctly paid to bona fide members in accordance with the governing rules or the MPFSO/ORSO, the General Regulation, the Exemption Regulation, the relevant Rules, guidelines and codes issued by the MPFA.

59. In many cases, where an employee leaves an ORSO scheme, part or all of the employer's contributions plus the investment returns thereon in respect of that member may not be paid to the member. These forfeitures may be applied (depending on the rules of the scheme) in reducing the contributions of the employer, retained in the scheme for the benefit of members, or returned to the employer. The same rules will apply to voluntary contributions made by an employer to a MPF scheme.

*Audit objectives*

60. The auditor would consider whether:
- a. benefits paid and payable are bona fide, have been correctly calculated and have been recorded in the correct period; and
  - b. benefits have been paid in accordance with the scheme rules/trust deed and the MPFSO/ORSO, the Exemption Regulation (where applicable), the relevant Rules, guidelines and codes issued by the MPFA.

*Specific risk areas*

61. The principal audit risks in relation to benefits are those of completeness and accuracy. Completeness involves ensuring that all benefits are recorded either as paid or payable. Calculation of benefits paid is relevant, particularly with respect to defined benefit schemes, and benefits are paid to people who are not entitled to receive them.

**Pooling arrangements**

*General*

62. The ORSO (section 2(4)) permits pooling arrangements to be governed by a trust, provided that it is managed by a registered trust company. All MPF schemes must be governed by trust. The master trust deed sets out, amongst other things, the respective powers and duties of the pool trustee and the administrator. The ORSO (section 2(4)) also permits pooling arrangements to be the subject of or regulated by an insurance agreement (policy). This master policy sets out the respective powers and duties of the administrator, usually the insurer, and the relevant employer.
63. The ORSO (section 2(4)) requires that proper accounts and records are kept with respect to the pooling arrangement and its participating schemes, such that the value of the assets attributable to, and the liabilities of, each of its participating schemes are readily determinable. The General Regulation (section 78) requires that a separate account is established and maintained for each scheme member specifying that member's accrued benefits.
64. Where a scheme is a participating scheme in a pooling agreement, section 21(4A) of the ORSO provides that the asset separation requirement under section 21(1)(a) of the ORSO does not require the separation of the assets of the scheme from the assets of the other schemes vested in the administrator in his capacity as administrator of the pooling agreement.

*Audit implications*

65. For ORSO schemes, it is the responsibility of the pool administrator to prepare annual financial statements for each scheme participating in the pool, and to have those financial statements audited. The ORSO (section 20(7C)) requires that, unless exempted by the MPFA, the pool administrator appoints the same auditor to audit the financial statements of each scheme participating in the pool and all participating schemes should have a common year end. The trustee of a MPF scheme need not prepare individual financial statements for each participating employer.

66. The participation of a scheme in a pooling arrangement can have specific implications for the auditor as the audit evidence that the auditor requires to form the opinion could be derived from several sources.
67. For example, the pool trustee/administrator may appoint an auditor for the schemes administered by him who are not the auditor appointed by his shareholders to be his statutory auditor. In such instances, the auditor for the schemes would consider the extent to which he/she can rely on the work of the trustee's/administrator's auditor in testing the internal controls and systems of the pooling arrangement. It may be more efficient for the auditor of the schemes to independently assess the controls established by the trustee/administrator over the systems used to produce the scheme financial statements.

### **Abbreviated information for scheme members**

68. Many schemes produce abbreviated financial information for distribution to members which summarises the key financial highlights from the audited financial statements.
69. The auditor has no control over the issue of such abbreviated financial information, particularly, when the auditor is not asked to report on it. However, if the auditor becomes aware that such information has been or will be issued, the auditor would take steps towards ensuring that members are not given the impression that such abbreviated financial information itself constitutes audited financial statements. If the auditor has any concerns in this respect, the auditor would communicate them to the trustee/administrator and the auditor would consider the continuing appointment in the light of the trustee's/administrator's response.
70. If the auditor is asked to provide a report, the same concerns apply, and the auditor would make clear in the auditor's report the scope of the work the auditor has carried out, in particular any areas the auditor has not examined. The auditor would ensure that the report specifically refers to the fact that the financial information does not give a true and fair view and would indicate whether the opinion on the full financial statements had been qualified or not.

**PART II**  
**ADDITIONAL GUIDANCE RELEVANT TO**  
**THE AUDITOR OF A MPF SCHEME**

**General**

71. The reference in this Part to a retirement scheme or scheme means a MPF scheme.

**Reporting under sections 102 and 106 of the General Regulation**

72. Section 95 of the General Regulation requires the trustee to submit the financial statements of the scheme to an auditor annually, for the purpose of independent audit. All schemes, regardless of size or type, must be audited. A copy of the audited financial statements of the scheme is required to be submitted by the trustee to the MPFA within 6 months after the end of the scheme's financial period.
73. The first audit would be required in respect of the first financial period which should commence with the date on which the scheme was first registered under section 21 or 21A of the MPFSO and end on a date not more than 12 months from this date.

**Specific audit areas**

*Investments*

74. Under section 28 of the MPFSO, the MPFA has the authority to publish guidelines on forbidden investment practices in relation to a scheme.
75. The General Regulation imposes the following requirements in respect of investment of scheme assets:
- a. a capital preservation fund must comply with the investment restrictions as set out in section 37(2) of the General Regulation;
  - b. a scheme cannot enter a repurchase agreement unless it complies with the restrictions as set out in section 51 of the General Regulation;
  - c. a scheme cannot lend any securities unless it complies with the restrictions as set out in section 52 of the General Regulation;
  - d. an employer sponsored scheme is not allowed to invest more than 10% of the total assets of each constituent fund in "restricted securities" or make a loan other than a loan by way of a deposit with an authorised financial institution (General Regulation Part X);
  - e. a scheme must comply with Schedule 1 to the General Regulation which deals with "permissible investments", "currency exposure" and "pooled investment". The general restrictions for investments for a scheme are:
    - i. no more than 10% of the total funds of a constituent fund may be invested in securities and other permissible investments issued by any one person (General Regulation Schedule 1 section 2(1)); and
    - ii. no more than 10% of securities or other permissible investments of a particular class issued by one person may be acquired for the purposes of a constituent fund (General Regulation Schedule 1 section 2(2)).

The general restrictions for investments set out above are not applicable when the investment is made into approved pooled investment funds<sup>1</sup>. (The reporting and investment requirements of approved pooled investment funds are set out in relevant guidelines and the MPF Code issued by the MPFA.)

76. The General Regulation (Schedule 1 section 17) states that funds may be invested in a pooled investment fund, which may in turn be invested in one or more other pooled investment funds. Where the trustees of these pooled investment funds and the scheme are not the same, the auditor of the scheme would need to ensure that the trustee has monitoring procedures in place over the trustees of the pooled investment funds. These procedures may include:
- a. obtaining a copy of the report of internal controls and the accompanying auditor's report of the trustees of the pooled investment funds;
  - b. obtaining regular statement of compliance from the trustee that the investment restrictions are not breached; and
  - c. obtaining a copy of the financial statements of the trustee and of the pooled investment funds.
77. The auditor would need to perform such procedures as are considered necessary in order to obtain sufficient appropriate audit evidence to enable the auditor to report whether or not the requirements of section 28 of the MPFSO and sections 37(2), 51 and 52 and Part X of, and Schedule 1 to, the General Regulation have been complied with as at the end of the financial period and 2 other dates as the auditor preparing the auditor's report may elect, provided that the intervening period between the 2 other dates shall not be shorter than three months. Where a scheme has been in operation for less than a full year and the intervening period between the 2 other dates nominated is less than 3 months, approval must be obtained from the MPFA in writing to use those dates. In planning and performing this work, the auditor should refer to the principles in the Hong Kong Standard on Assurance Engagements (HKSAE) 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* applicable to assurance engagements.

#### *Contributions*

78. In respect of completeness of contributions under MPF, section 106(2) of the General Regulation states that information contained in a remittance statement submitted by an employer or particulars given by a self-employed person to the trustee shall be treated as conclusive evidence as to the amount of the member's relevant income. Accordingly, the auditor need not carry out further procedures to satisfy himself/ herself in respect of the completeness of the relevant income.

#### **The auditor's reports**

79. Section 102 of the General Regulation requires:
- a. the auditor's report, addressed to the trustee, in relation to the financial statements of a scheme and a financial period of it to state whether or not in the auditor's opinion:
    - i. the financial statements give a true and fair view of the financial position of the scheme as at the end of the period and of the financial transactions of the scheme for the period then ended; and
    - ii. the financial statements have been properly prepared, in all material respects, in accordance with sections 80, 81, 83 of the General Regulation; and

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<sup>1</sup> An example of an auditor's report for an approved pooled investment fund is included as Example 9 of Appendix 1 to this Practice Note.



- b. the auditor's report, addressed to the trustee, on a scheme's compliance with certain requirements of the MPFSO and General Regulation to state:
- i. whether or not in the auditor's opinion:
    - proper accounting and other records have been kept during the relevant financial period in respect of the constituent funds of the scheme, the scheme assets and all financial transactions entered into in relation to the scheme; and
    - the requirements specified in the guidelines made by the MPFA under section 28 of the MPFSO with respect to forbidden investment practices and the requirements of sections 37(2), 51 and 52 and Part X of, and Schedule 1 to, the General Regulation have been complied with in all material respects as at the end of the period and two such other dates in the period as the auditor preparing the auditor's report may elect, provided that the intervening period between such dates shall not be shorter than three months, or a shorter period allowed by the MPFA; and
  - ii. whether or not the assets of the scheme as at the end of the period were subject to any encumbrance, otherwise than as permitted by the General Regulation.
80. In addition, section 106 of the General Regulation requires the auditor to state whether the auditor has obtained all the information and explanations that the auditor has required.
81. Example auditor's reports are included in Appendix 1 to this Practice Note (examples 1 and 2).

## **Reporting under sections 18 and 115 of the General Regulation**

### **Prescribed capital adequacy requirements**

82. The MPFA requires all applicant trustees to meet the prescribed capital adequacy requirements (capital adequacy requirements) when applying for approval as trustee, and all trustees to comply with the capital adequacy requirements at all time.
83. The MPFSO (sections 20A and 20B) empowers the MPFA to suspend or revoke the approval of a trustee for failure to meet financial resources requirements, including capital adequacy requirements.
84. There are essentially two means by which a company can meet the capital adequacy requirements. These are referred to in this Practice Note as "the stand-alone basis" and "the group basis".
85. The stand-alone basis sets requirements for the company itself as follows:
- a. paid up share capital of at least \$150,000,000 (or its foreign currency equivalent);
  - b. net assets of at least \$150,000,000 (or its foreign currency equivalent); and
  - c. assets in Hong Kong of at least \$15,000,000.
86. "Assets in Hong Kong" is defined in section 10 of the General Regulation.

87. The alternate basis of meeting the capital adequacy requirements is the group basis. In this case the applicant trustee must be an associate of:
- a. a company or corporation that is a substantial financial institution (as defined by section 7 of the General Regulation) which provides continuous financial support (as defined under section 12 of the General Regulation) to the applicant trustee; or
  - b. a company or corporation having a subsidiary that is a substantial financial institution and provides continuous financial support to the applicant trustee.
88. Under the group basis, the applicant trustee is only required to maintain paid up share capital and net assets of \$30,000,000. The \$15,000,000 "assets in Hong Kong" requirement must still be met in full.
89. The substantial financial institution must itself have:
- a. a paid up share capital of at least \$150,000,000 (or its foreign currency equivalent) and net assets of at least the same amount. In the determination of net assets, certain subordinated debts may be excluded by virtue of section 7(2) of the General Regulation; and
  - b. given a written undertaking in a form acceptable to the MPFA to the extent that it commits itself to provide financial support to the applicant trustee such that the \$30,000,000 share capital and net asset position of the applicant trustee and the associate relationship between the institution and the trustee will be maintained. A written undertaking under section 12 of the General Regulation needs to be by deed or like form.

**Procedures performed by the auditor**

90. For the auditor's reports under sections 18 and 115 of the General Regulation, in planning and performing the work, the auditor should refer to the principles in the HKSAE 3000 (Revised) applicable to assurance engagements.
91. For the purposes of the auditor's report on the capital adequacy requirements of an applicant trustee, unless the date agreed between the applicant trustee and the MPFA is the financial year end of the applicant trustee, the auditor will be required to design substantive procedures at the date specified to enable the auditor to report whether or not the capital adequacy requirements have been complied with.
92. Such substantive procedures may include:
- a. obtaining evidence to support the amount of paid up share capital at the reporting date;
  - b. obtaining a balance sheet of the applicant trustee at the reporting date and reviewing the net asset position of the applicant trustee at that date;
  - c. obtaining evidence to support the existence of assets at the reporting date and the basis on which the assets are valued at that date;
  - d. extending existence testing of assets to verify the requirements for assets in Hong Kong are being met;
  - e. searching for unrecorded liabilities at the reporting date;
  - f. reviewing transactions before and after the balance sheet date to consider the reasonableness of the presentation of the balance sheet position at the reporting date;

- g. obtaining and reviewing the written undertaking in respect of continuous financial support as specified under section 12 of the General Regulation.

If a group basis of meeting the capital adequacy requirements is chosen, the auditor would obtain evidence that the institution supporting the applicant trustee qualifies under the General Regulation and, where necessary, evidence of appropriate approval by the MPFA is provided.

- 93. If the reporting date is to be the financial year end of the company and the company is required to prepare financial statements which have been audited, then the auditor would have regard to the extent of the substantive tests performed for the audit of the financial statements in the consideration of the extent of the procedures in paragraph 92 above to be carried out.
- 94. For the purposes of the reporting on ongoing capital adequacy requirements, the auditor would plan to include the procedures suggested in paragraph 92 above in respect of the financial year end and the two dates selected to test the compliance with capital adequacy requirements in the audit work. However, there are other matters which the auditor may consider in forming the opinion:
  - a. the frequency by which management accounts or other financial information is prepared may influence the dates chosen by the auditor, especially if the audit procedures adopted plan to place reliance on the controls surrounding the preparation and review of the management information;
  - b. the auditor may choose to rely on the internal control processes adopted by the trustee in ensuring that capital levels can be monitored at all times, and test the controls in place in conjunction with a series of substantive tests.

#### **The auditor's reports pursuant to sections 18 and 115 of the General Regulation**

- 95. The General Regulation (section 18) requires that any applicant trustee applying to be an approved trustee must cause a report to be prepared by its auditor. The auditor's report is addressed to the applicant trustee and must state, in the opinion of the auditor, whether or not the applicant trustee complies with the capital adequacy requirements, as set out in section 11 of the General Regulation, on a specified date (agreed between the MPFA and the applicant trustee). The date referred to must be on or before the date on which the MPFA approves the applicant trustee as a trustee.
- 96. The auditor's report may contain such observations, elaborations, qualifications or explanations as the auditor considers necessary. The MPFA has the power to request remedial action by the applicant trustee within a specified time period. In such circumstances a second auditor's report would be required to be prepared by the auditor, stating whether or not in the auditor's opinion the qualification or matter raised has been rectified.
- 97. With respect to the ongoing capital adequacy requirements, section 114 of the General Regulation requires that the trustee prepares a report to the MPFA, stating whether or not the capital adequacy requirements were complied with throughout the period. If the requirements were not complied with, the reasons for non-compliance should be stated in the trustee's report.
- 98. Section 115 of the General Regulation requires the auditor to review the section 114 report issued by the trustee and issue an auditor's report, stating whether or not, in the auditor's opinion, the capital adequacy requirements were complied with at the financial year end of the approved trustee, and two other dates during the financial year, such dates being selected by the auditor. The two dates selected must be at least three months apart or such a shorter period the MPFA may allow. If the requirements were not met, the reasons for non-compliance are required to be stated in the auditor's report.

99. Both reports under sections 114 and 115 are to be submitted to the MPFA within six months of the financial year end of the trustee. In practice the requirements of sections 114 and 115, when taken together, will mean that the trustee will be required to prepare a draft section 114 report in time for the auditor to review and attach the auditor's report under section 115.
100. Suggested reports suitable for reporting on compliance with prescribed capital adequacy requirements are included in Appendix 1 to this Practice Note (examples 3 and 4).

## **Reporting under section 74(5)(b) of the General Regulation**

### **Trustee to review service providers' reports**

101. In accordance with section 74 of the General Regulation, the trustee requires each service provider appointed or engaged by the trustee to report any material breach of obligations or material changes to the trustee.
102. On an annual basis, the service provider is required to submit to the trustee within four months after the scheme's year end date, the audited financial statements together with a report from its auditor stating whether or not, in the auditor's normal course of duties<sup>2</sup>, the auditor has become aware of:
- a. any failure of the service provider to comply with the service provider's obligations under the contract of appointment or engagement entered into between the trustee and the service provider; and
  - b. any false declaration made by the service provider to the trustee or any other person, and if so, give particulars of the failure or false declaration.

### **The auditor's report pursuant to section 74(5)(b) of the General Regulation**

103. A copy of an example auditor's report as mentioned in paragraph 102 above is included in Appendix 1 to this Practice Note (example 5).

## **Reporting under section 113 of the General Regulation**

### **Trustee's report on control objectives and internal control measures**

#### *Requirements of trustee*

104. The MPFA requires all trustees to maintain an appropriate internal control framework with respect to the management and administration of schemes. Trustees are also required to submit an annual report to the MPFA on their control objectives and internal control measures (Trustee's Report).
105. Reference would be made to section 39 of the General Regulation for details of the control objectives and internal control measures that must be established for each scheme and be maintained at all times while the scheme is registered.
106. Certain schemes may be exempted from these requirements. Reference would be made to the relevant regulation for further information.
107. The General Regulation specifies the requirements for trustees to report to the MPFA and reference would be made to the General Regulation for details of these requirements. A Trustee's Report would normally set out:
- a. a statement of responsibility;

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<sup>2</sup> The auditor should obtain management representation specifically for reporting under section 74(5)(b) of the General Regulation.

- b. the trustee's control objectives in relation to the safeguarding of scheme assets, the recording of transactions and the compliance with the General Regulation;
  - c. details of each of the specific control procedures and measures designed to achieve the control objectives;
  - d. details of any significant changes to the control objectives, procedures and measures during the period;
  - e. details of any exceptions to the control objectives, procedures and measures during the period; and
  - f. an assertion by the trustee that it has reviewed the control objectives, and the control procedures and measures in operation.
108. In order that the statement by the trustee is fairly described, the trustee should include in the Trustee's Report a description of any material weaknesses identified which have, in its view, affected whether control procedures and measures are in place, or reduced the effectiveness, or prevented the operation, of control procedures and measures, if those weaknesses were not themselves identified and rectified within an appropriate time.

*Requirements of the auditor*

109. The MPFA requires the Trustee's Report on internal controls to be reviewed by the auditor (section 113 of the General Regulation), and the auditor is required to report to the trustee:
- a. whether or not appropriate control objectives were established and maintained for the scheme during the period to which the report relates;
  - b. if appropriate control objectives were so established and maintained, whether or not effective internal control measures were established and maintained for the purpose of achieving those objectives; and
  - c. whether or not those internal control measures (if any) were likely to have been sufficiently effective to provide a reasonable assurance that the control objectives established and maintained for the scheme would be achieved if those measures were fully and properly implemented.
110. The auditor is also required to state:
- a. whether or not, during the course of the review of the Trustee's Report, the auditor became aware of any shortcomings in the internal control measures that could materially affect the operation of the scheme (including its financial position) or the financial interests of scheme members; and
  - b. details of any such shortcomings the auditor became aware of.

*Requirements of both the trustee and auditor*

111. Both the Trustee's Report and the auditor's report on a review thereof under sections 112 and 113 of the General Regulation respectively are submitted to the MPFA in accordance with section 111 of the General Regulation. In practice the requirements of sections 112 and 113 of the General Regulation when taken together, will mean that the trustee will be required to prepare a draft Trustee's Report in time for the auditor to review and attach the auditor's report thereto under section 113 of the General Regulation.
112. The MPFA has issued guidelines relating to the reporting requirements of the trustee and auditor in respect of the internal control objectives and control measures for each scheme in "Guidelines on Internal Control Report for each Registered Scheme" ("MPFA Guidelines II.6").

113. It is recognised that the control objectives and procedures may differ from trustee to trustee depending on the trustee's own assessment and tolerance of the risk level in the organization, its specific operating system, size of the business, types of products on offer etc.
114. The MPFA Guidelines II.6 is not intended to prescribe specific control systems for all schemes and the measures described in the MPFA Guidelines II.6 are not intended to be exhaustive and in many instances alternative control procedures and measures may be equally appropriate and acceptable.
115. Even though trustees are not required to report on all the control objectives and measures applicable to their schemes, trustees are expected to ensure that a proper system of internal controls is in place for all aspects of their schemes' operations and are expected to ensure that as a minimum the requirements specified by the MPFA are complied with.
116. The auditor is expected to report on the design effectiveness of the internal controls and is therefore not expected to test or ascertain whether the control objectives or internal control measures were actually implemented during the period.
117. It is recognised that the auditor of the trustee may be different from the auditor of the scheme. It is also possible that different auditors may be appointed to each scheme managed by the same trustee.
118. If the Trustee's Report relates to only one scheme, then the Trustee's Report is submitted to the auditor of the scheme for review.
119. If the Trustee's Report relates to 2 or more schemes and the trustee specifies the financial period of one of the schemes to which the report relates as the relevant period nominated under section 111(1)(b) of the General Regulation, then the Trustee's Report is submitted to the auditor of that scheme for review.
120. If the Trustee's Report relates to 2 or more schemes and the financial year of the trustee is the relevant period nominated under section 111(1)(b) of the General Regulation, then the Trustee's Report is submitted to the auditor of the trustee for review.

**Procedures performed by the auditor**

121. In planning and performing this work, the auditor should refer to the principles in the HKSAE 3000 (Revised) applicable to assurance engagements.

*Terms of engagement*

122. In agreeing the terms of the engagement, the auditor would exclude liability in respect of any loss or damage caused by, or arising from, fraudulent acts, misrepresentation or wilful default on the part of the trustee, its directors, employees or agents. The auditor would also exclude liability to third parties. They would normally obtain a limitation in aggregate of the auditor's liability. It should be noted that it is not possible to limit liability in relation to death or personal injury caused by the negligence (within the meaning of section 2 of the Control of Exemption Clauses Ordinance) of the auditor.

*Planning the engagement*

123. In addition to the requirements contained in HKSAE 3000 (Revised), the following would need to be considered by the auditor:
- a. the structure with respect to a scheme operation may be different for each scheme. The auditor would need to understand the structure adopted in the administration and management of the scheme, i.e. who is and what are the custodian's responsibilities, who is and what are the trustee's responsibilities etc;

- b. the terms of the contract between the trustee and service providers such as the custodian, third party administrator and the investment manager of the scheme;
- c. the nature of services provided by the service providers and the extent to which the trustee's internal control measures interact with those of the service providers;
- d. the methods adopted by the trustee to evaluate the appropriateness of the specified control objectives of the scheme and the effectiveness of the major procedures and internal control measures for achieving those objectives;
- e. the type and extent of evidence supporting the trustee's evaluation/assertion about the effectiveness of the internal control procedures and measures;
- f. the nature of control procedures relevant to the responsibility of the trustee in ensuring that a proper system of internal controls is in place for all aspects of the scheme's operation; and
- g. matters affecting the industry, such as financial reporting practices, economic conditions, amendments to ordinances and regulations and technology changes.

*Situations where part of the trustee's responsibilities are outsourced to a third party*

124. The ultimate responsibility with respect to the implementation of, and ongoing compliance with, the necessary internal controls framework rests with the trustee. Where a trustee has delegated certain of its functions to another service provider, the auditor needs to consider the impact of this on the overall engagement with reference to HKSA 402—"Audit Considerations Relating to an Entity Using a Service Organization".

*Evaluating design effectiveness*

125. To evaluate the effectiveness of control procedures, the auditor would obtain a general understanding of the control environment and information system to identify matters that are likely to have a significant impact on the effectiveness of particular control procedures and measures.
126. Procedures to evaluate the effectiveness of a specific control are concerned with whether that control is suitably designed to comply with the suggested control measures in the MPFA Guidelines II.6. Such procedures will vary depending upon the nature of the specific control, the nature of the trustee's documentation of the specific control, and the complexity and sophistication of the trustee's operations and systems.
127. The auditor would evaluate the effectiveness of the control procedures based on the identified control objective. This evaluation would be based on whether the control procedures have been suitably designed to reduce to an acceptably low level the risks that threaten achievement of the objectives relevant to the area of activity. Where the auditor is unable to identify control procedures designed to provide reasonable assurance about the reduction of risk, this would constitute a weakness in relation to design effectiveness.
128. The auditor would focus on the significance of controls in achieving the control objectives rather than on specific controls in isolation. The absence or inadequacy of a control designed to achieve specific criteria may not be a deficiency if other controls specifically address the same criteria.

*Testing operating effectiveness*

129. It is recognised that the auditor cannot be aware of all the relevant control assertions made by the trustee in its report on internal controls, in particular as these might be affected by the other service providers' control procedures. The auditor does not have the responsibility to identify or test all the control objectives and procedures which have been included in the description of the control report prepared by the trustee and the auditor is not expected to test

or ascertain whether the control objectives or internal control measures were actually implemented during the period under review.

130. However it is envisaged that in order to enable the auditor to form an opinion on the design effectiveness and on whether those internal control measures were likely to have been sufficiently effective to provide a reasonable assurance that the control objectives established and maintained for the scheme would be achieved if those measures were fully and properly implemented, the auditor would be required to carry out a limited level of testing.
131. These tests would ordinarily include procedures such as enquiries of appropriate personnel, inspection of relevant documentation, observation of the trustee's operations, and reapplication of, and reperformance of, the control measures to a certain extent.
132. Tests of operating effectiveness are concerned with how the control procedures were applied, the consistency with which they were applied, and by whom they were applied. The auditor would also need to consider the period of time over which the control procedures were applied.
133. The nature of a control procedure often influences the nature of tests of operating effectiveness that can be performed. For example, the auditor may examine evidence regarding a control where such evidence exists, however documentary evidence regarding some control procedures often does not exist. In these circumstances, the tests of operating effectiveness may consist of enquiry and observation only.
134. The decision about what comprises sufficient appropriate evidence is a matter of professional judgement. The auditor would consider for example:
  - a. the significance of the control procedure in achieving the relevant objective; and
  - b. the nature and extent of any tests of operating effectiveness performed by the trustee (management, internal auditing or other personnel).
135. Management, internal auditing or other personnel of the trustee may provide the auditor with the results of their tests of the operating effectiveness of certain aspects of internal control. Although the auditor would consider the results of such tests when evaluating operating effectiveness, it is the auditor's responsibility to obtain sufficient appropriate evidence to support the auditor's conclusion and, if appropriate, corroborate the results of such tests. When evaluating whether sufficient appropriate evidence has been obtained, the auditor would consider that evidence obtained through direct personal knowledge, observation, re-performance (to a limited extent only), and inspection is more persuasive than information obtained indirectly, such as from management, internal auditing or other personnel of the trustee. Furthermore, judgements about the sufficiency and appropriateness of evidence obtained and other factors affecting the auditor's conclusion, such as the significance of identified control weaknesses, are those of the auditor.

**The auditor's report pursuant to section 113 of the General Regulation**

136. The auditor's report is addressed to the trustee.
137. The auditor's report depends on the specific terms of engagement agreed with the trustee, but it is normally expected to contain:
  - a. the title;
  - b. the addressee;
  - c. a statement as to the scope of the auditor's work;



- d. a section dealing with the responsibilities of the trustee:
  - i. if not included in the Trustee's Report, a statement that it is the responsibility of the trustee to design, implement and maintain the control procedures; and
  - ii. it should also specify that it is the trustee's responsibilities to ensure adequate controls are implemented in the monitoring of other service providers where some or all of the trustee's responsibilities have been outsourced to a third party;
- e. a section dealing with independence and quality control:
  - i. a statement that the auditor complies with the independence and other ethical requirements of the HKICPA's *Code of Ethics for Professional Accountants*; and
  - ii. A statement that the firm of which the auditor is a member applies Hong Kong Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*;
- f. a section dealing with the responsibilities of the auditor:
  - i. the auditor's responsibilities;
  - ii. a statement that the engagement was conducted in accordance with HKSAE 3000 (Revised) and with reference to this Practice Note;
  - iii. a statement that the auditor is not required to verify whether the controls were in fact implemented during the period under review and that the auditor have performed very limited tests on the control procedures; and
  - iv. a statement that the auditor's work was limited to ensuring whether control measures designed by the trustee were in line with those recommended in the MPFA Guidelines II.6;
- g. a statement that all control systems have inherent limitations and accordingly, errors and irregularities may occur and not be detected. Also, they cannot guarantee protection against fraudulent collusion especially on the part of those holding positions of authority or trust;
- h. the auditor's conclusion:
  - i. a statement as to whether or not appropriate control objectives were established and maintained for the scheme during the period to which the report relates;
  - ii. a statement as to whether or not effective internal control measures were established and maintained for the purpose of achieving those objectives during the period to which the report relates; and
  - iii. a statement as to whether or not those internal control measures (if any) were likely to have been sufficiently effective, in all material respects, to provide a reasonable assurance that the control objectives established and maintained for the scheme would be achieved if those measures were fully and properly implemented;
- i. a statement as to whether or not, during the course of the review of the Trustee's Report, the auditor became aware of any shortcomings in the internal control

measures that could materially affect the operation of the scheme (including its financial position) or the financial interests of scheme members;

- j. details of any such shortcomings that the auditor became aware of; and
- k. a statement as to the intended use of the report.

138. A suggested auditor's report suitable for such an engagement is included in Appendix 1 to this Practice Note (example 6).

*Report modifications*

139. The auditor would modify the auditor's report if any of the following conditions exist:

- a. there is a material weakness in the internal controls;
- b. there is a restriction on the scope of the engagement; or
- c. the trustee presents an assertion about only a segment of the internal controls, and not all the control objectives and control procedures as outlined in the General Regulation and the MPFA Guidelines II.6 are included in the Trustee's Report.

*Reporting material weaknesses in the internal controls*

140. Where the auditor has become aware of material weaknesses which are inadequately described in the Trustee's Report, the auditor would need to issue a modified conclusion<sup>3</sup> in the auditor's report and provide such a description in the auditor's report or a reference to such a description in the Trustee's Report. The auditor would also refer to any inaccurate or inadequate description of the trustee's control procedures in the Trustee's Report of which the auditor has become aware. It would also be helpful for the status of any corrective action taken by the trustee in relation to any reported weakness to be included in the auditor's report.

141. On occasions the trustee may seek to alter control objectives in order to prevent a modification in the report by the auditor. The auditor would assess carefully the appropriateness of any changes proposed to the Trustee's Report and the risks arising from this and consider the conclusion in the light of that assessment.

142. The trustee may express its intention to rectify a weakness at some future time. No conclusion would be given by the auditor in relation to such an expressed intention and the auditor's report would specifically state that fact. The auditor may, at the request of the trustee, test and report on any corrective action taken in respect of a weakness.

143. The engagement is not intended to be planned and carried out in such a way that all control weaknesses that may possibly exist within the trustee can be identified during the course of the engagement. Furthermore as the auditor is not expected to test whether the control objectives and internal control measures were actually implemented during the period under review, the auditor cannot be expected to identify all control weaknesses that may possibly exist within the trustee's operation over the management and administration of schemes. This limitation must be clearly stated in both the engagement letter and the auditor's report.

144. However the auditor would also consider the statutory requirements to report material weaknesses to the MPFA (see paragraphs 147 to 151 below).

145. During the course of the engagement, if the auditor becomes aware of significant deficiencies in the trustee's system of internal control, to the extent that the shortcomings identified during the course of the auditor's work may materially affect the operation and financial position of

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<sup>3</sup> In the circumstances where the auditor expresses a qualified conclusion or a disclaimer of conclusion or adverse conclusion, the auditor's report is to be modified accordingly as required in paragraph 69(l)(v) of HKSAE 3000 (Revised), Further guidance is set out in paragraphs 74 to 77, A182, A188 to A191 of HKSAE 3000 (Revised).

the scheme. The auditor is required to include details of the shortcomings of which the auditor became aware in the report.

146. The auditor's conclusion is based on the procedures determined to be necessary for the collection of sufficient appropriate evidence, that evidence being persuasive rather than conclusive in nature. The assurance provided by the auditor on the effectiveness of internal controls is however restricted because of the nature of internal controls and the inherent limitations of any set of internal controls and their operations. These limitations include:
- a. the trustee's usual requirement that the cost of an internal control does not exceed the expected benefits to be derived;
  - b. most internal controls tend to be directed at routine rather than non-routine transactions/events;
  - c. the potential for human error due to carelessness, distraction or fatigue, misunderstanding of instructions and mistakes in judgement;
  - d. the possibility of circumvention of internal controls through the collusion of employees with one another or with parties outside the trustee;
  - e. the possibility that a person responsible for exercising an internal control could abuse that responsibility, for example, a member of management overriding a control procedure;
  - f. the possibility that management may not be subject to the same internal controls applicable to other personnel; and
  - g. the possibility that internal controls may become inadequate due to changes in conditions, and compliance with procedures may deteriorate.

## **Communications between the auditor and the MPFA**

### **Ad hoc reports to the MPFA under section 103 of the General Regulation**

147. Section 103 of the General Regulation requires the auditor to report the following matters to the MPFA in writing, if the auditor becomes aware of them while performing the duties:
- a. any matter that would cause the auditor to qualify the auditor's report on the financial statements of the scheme;
  - b. non-compliance with the following sections of the General Regulation:
    - i. keeping proper accounting records (section 77); and
    - ii. keeping a separate account for each scheme member (section 78);
  - c. any transaction that has resulted in a misappropriation of the funds of the scheme or the scheme assets;
  - d. any payment from the funds of the scheme that is materially prejudicial to the interests of scheme members except where the trustee has fully reimbursed the scheme after the payment has been brought to the notice of the trustee;
  - e. any combining of the scheme assets with the funds of the trustee or the assets of any persons except where the custodian:
    - i. also holds the assets of one or more other scheme(s) or other financial schemes or undertakings; and

- ii. keeps a separate account of the scheme assets and those other assets in such a way as to enable them to be separately identified;
  - f. non-compliance with the legislation and guidelines on forbidden investment practices;
  - g. non-compliance with section 135 of the General Regulation which requires the trustee to inform the MPFA in writing within 7 days after the end of the settlement period of non-payment of or discrepancy in mandatory contribution.
148. The auditor has no obligation to seek out grounds for making a report under section 103 of the General Regulation, nor does the section place an obligation on the auditor to conduct the work in such a way that there is reasonable certainty that the auditor will discover a matter upon which the MPFA may need to act. It is only when the auditor does become aware in the ordinary course of the work of such a matter, or of circumstances which suggest the existence of such a matter, that the auditor would consider reporting under this section.
149. In the event that the auditor becomes aware of any matters in paragraph 147 above, the auditor may bring the matter to the trustee's attention in writing and request an explanation of the matter. The trustee is required to rectify the situation within such period as the auditor considers to be reasonable. If the trustee complies with the auditor's request in this respect, the auditor is not required to report the matter to the MPFA. However, the auditor must not give such notice:
- a. if the matter relates to a transaction, which in the opinion of the auditor, is or has resulted in a material misappropriation of the funds of the scheme or the scheme assets; or
  - b. if bringing the matter to the attention of the trustee could reasonably be expected to detrimentally affect the interests of the scheme members.
150. If on becoming aware of matters reported in accordance with paragraph 147 above, the MPFA is of the opinion that the matter is capable of being rectified, the MPFA may ask the trustee to rectify the matter. As soon as practicable after giving such a direction, the MPFA will request the auditor in writing to provide the MPFA with a further report as to whether or not the trustee has rectified the matter.
151. If upon receiving a request in writing from the MPFA to provide to them a further report as to whether or not the trustee has rectified the matter as specified in the letter, the auditor must as soon as practicable after the end of the period specified in the notice and at the expense of the trustee, issue such a report to the MPFA.

**Statutory protection under section 42A of the MPFSO**

152. The MPFSO (section 42A) introduces statutory protection for current and prior auditors from liability to their client for breach of confidentiality. Such statutory protection is available when the auditor communicates directly with the MPFA (whether or not in response to a request of the MPFA) in good faith, if the auditor became aware of the matter in the capacity as the auditor and on matters relevant to a function of the MPFA.
153. Section 42A of the MPFSO does not lay down any rules nor specify the circumstances in which the auditor is to communicate any matter to the MPFA. It provides a statutory mechanism whereby the auditor may make matters known to the MPFA without breaching the duty of confidentiality.
154. Confidentiality is an implied term of an auditor's contract with the client, but in certain circumstances and under conditions specified in section 42A of the MPFSO it does not prevail, since the auditor is entitled to communicate information or opinions on a matter relating to the business or affairs of the client relevant to the MPFA's functions without the duty of confidentiality owed to the client being regarded as having been breached.

155. Examples of circumstances in which the auditor may communicate a matter to the MPFA under section 42A of the MPFSO include:
- a. the auditor considers scheme members have incurred, or are at significant risk of incurring, a material loss as a result of a trustee carrying on business in a manner that is not fit and proper or that is in breach of the MPFSO or the General Regulation;
  - b. there is evidence of:
    - i. fraud, dishonesty or serious incompetence; or
    - ii. serious failure to observe requirements of the MPFSO or the General Regulation or conditions imposed on the trustee by the MPFA if such failure impacts scheme members;
  - c. it has come to the attention of the auditor that the procedures, records or systems fail significantly to comply with, or to demonstrate compliance with, requirements set by the MPFA to which the trustee or the scheme is subject; and
  - d. the position is such that because of a significant risk which is material to the collective interests of scheme members, the scheme members' interests would be better safeguarded if the MPFA were aware of the position.
156. Clearly the potential nature of matters which may be reported is very wide, but as explained in paragraph 159 below this does not, of itself, require the auditor to extend the scope of the work in order to discover matters and it will only be in exceptional circumstances that the auditor may choose to seek statutory protection.
157. Any protected communication can be made either on the auditor's initiative or in response to a request from the MPFA for information. The auditor would normally co-operate with the MPFA and respond to any requests from the MPFA for information, provided the auditor has no reason to doubt that the request is relevant to the MPFA's functions. The auditor may communicate a matter to the MPFA with the protection of section 42A of the MPFSO regardless of the source of that information, provided the auditor became aware of the matter in the capacity as the auditor of the scheme and the auditor does so in good faith.
158. Matters of which the auditor becomes aware "in the capacity as the auditor" may not be restricted to those matters identified by the auditor during the course of the audit work. The auditor may become aware of a matter which is relevant to the functions of the MPFA during the course of the work for the trustee other than audit work or through private discussions on social or other occasions, in which case the information will be known to them as individuals. In circumstances which suggest that a matter would be reported to the MPFA if knowledge of it had been obtained in the capacity as the auditor, it would be prudent to make enquiries in the course of the audit work in order to establish whether this is the case from information obtained in this capacity.
159. The auditor cannot be expected to be aware of all circumstances which, had the auditor known of them, would have led him/ her to exercise the right to communicate under section 42A of the MPFSO. This section does not require the auditor to change the scope of the audit or other work for the client, nor the frequency or timing of the visits. The auditor has no obligation to seek out grounds for making a report under section 42A of the MPFSO. The section does not place an obligation on the auditor to conduct the work in such a way that there is reasonable certainty that the auditor will discover a matter upon which the MPFA may need to act. It is only when the auditor does become aware in the ordinary course of the work of such a matter, or of circumstances which suggest the existence of such a matter, that the auditor would consider using the protection of section 42A of the MPFSO.
160. The MPFA recognises that it would not be appropriate for the auditor to report information which the auditor has obtained or matters which the auditor has identified through the professional relationship with another client, even though the information obtained or the

matters identified may relate to a trustee or a scheme. However, the MPFA expects the trustee to advise its auditor when it appoints a third party (including another department of the same firm) to review, investigate or report on any aspects of its records and systems and to provide the auditor with copies of reports by such a third party promptly after their receipt. The auditor can, if appropriate, make enquiries in the capacity as the auditor to ascertain whether any findings of the reports should be reported to the MPFA.

161. It should be noted that section 42A of the MPFSO will not provide protection to the auditor where the auditor could be held to have acted maliciously or in bad faith or if the information reported is outside the scope of that section. The MPFSO does not, therefore, provide complete immunity from all types of legal action by all parties affected, or subsequently affected, by the auditor's action in reporting to the MPFA. The auditor would consider taking legal or other professional advice before making the decision about whether, or in what manner, to report and in order, for example, to ensure that the form and content of the auditor's report are such as to secure the protection of section 42A of the MPFSO and that it only includes relevant material.
162. The auditor is protected, however, even if the information which the auditor communicates fall short of proof, or the opinion which the auditor communicates cannot be verified. An auditor who can demonstrate that he/ she has acted reasonably and in good faith in informing the MPFA of a reportable matter would not be held in breach of duty to the client even if, after an investigation, it were found there was not a matter which needed to be reported. These are areas where the auditor may wish to consider taking legal advice before making a report.
163. Whilst no breach of statutory duty may arise, it should be appreciated that there is no protection given by the MPFSO, if the auditor, after becoming aware of an occurrence, fail to report, promptly, or at all, to the MPFA. Furthermore, it should be recognised that speed of reporting is likely to be important in order to enable the MPFA to protect the interests of scheme members.

### **MPFA may require certain reports to be prepared by the auditor under section 30 of the MPFSO**

164. Under section 30 of the MPFSO, if at any time the MPFA reasonably believes that circumstances exist or have existed which may prejudice the accrued benefits of a member of a scheme, it may require a trustee, by written notice, to arrange for the auditor (who must be approved by the MPFA) to investigate whether such circumstances exist, or have existed, and to investigate any other matter relating to the trustee or the scheme as specified by the MPFA.
165. A copy of the auditor's report on the investigation must be provided to the MPFA and may be published or supplied to a scheme member that the MPFA believes may have been prejudiced.

### **Rights and duties of the auditor**

#### **Offence to obstruct**

166. Under section 107 of the General Regulation, it is an offence for the trustee of a scheme or a service provider appointed or engaged:
- a. not to allow the auditor of the scheme access to all accounting records and other records relating to the scheme and to the trustee of the scheme that are in the possession of that trustee or service provider;
  - b. not to give any information or explanation to the auditor as and when reasonably required by the auditor; and
  - c. to obstruct, hinder or delay the auditor in the performance of the auditor's duties or the exercise of the auditor's powers.

**Offence to make false or misleading statement**

167. A person who, in any document given to the auditor of a scheme, makes a statement that the person knows to be false or misleading in a material respect, or recklessly makes a statement which is false or misleading, commits an offence and is liable on conviction:
- a. to a fine and imprisonment for 12 months on the first occasion on which the person is convicted of the offence; and
  - b. to a fine of HK\$200,000 and to imprisonment for 2 years on each subsequent offence.

**Certain statements of the auditor not admissible evidence**

168. The following statements made by the auditor are not admissible in evidence in any civil or criminal proceedings against the auditor and they may not be made the grounds of a prosecution or other legal proceeding against the auditor:
- a. a statement made by the auditor in a notice to the MPFA under Part VIII of the General Regulation; or
  - b. a statement made in answer to an inquiry by the MPFA; or
  - c. reasons for the auditor's removal or resignation from office; or
  - d. reasons for not seeking reappointment.

**Removal and resignation of the auditor**

169. The removal of the auditor by the trustee will take effect if the auditor and the MPFA are notified in writing within 2 working days after the removal.
170. The auditor must write to the MPFA, within 2 working days of receiving the notice from the trustee, giving reasons why, in the auditor's opinion, he/ she was removed from office.
171. The auditor of a scheme may resign from office by giving written notice to the trustee.
172. An auditor who does not wish to be re-appointed for a further period, if the initial appointment was for a specified period, must notify the trustee in writing.
173. Where the auditor determines to resign in the circumstances set out in paragraphs 171 and 172 above, the written notice of this fact to the trustee must be accompanied by:
- a. a statement that, to the best of the auditor's knowledge and belief, there are no circumstances relating to the resignation or decision not to seek reappointment that would prejudicially affect the interests of the scheme members to a material extent; or
  - b. a statement specifying the circumstances giving rise to the resignation or decision not to accept re-appointment.
174. If a statement under paragraph 173(b) above is given to the trustee, a copy of the notice must be given to the MPFA within 2 working days after giving the notice to the trustee.

**PART III  
ADDITIONAL GUIDANCE RELEVANT TO  
THE AUDITOR OF AN ORSO SCHEME**

**General**

175. The reference in this Part to a retirement scheme or scheme means an ORSO scheme.

**Appointment of the auditor**

176. The ORSO (section 68) requires any statement, report or other document to be prepared by an auditor in respect of a Hong Kong domiciled scheme to be prepared by a Certified Public Accountant (Practising) as defined by section 2 of the Professional Accountants Ordinance.

177. For an offshore scheme, they must be prepared by a Certified Public Accountant (Practising) or any person who may lawfully practise as a professional accountant in the country or jurisdiction which is the domicile of the scheme and who holds such qualification as the MPFA may accept as being of a standard comparable to that of a Certified Public Accountant (Practising).

**Reporting under section 20 of the ORSO**

178. The ORSO (section 20) requires the administrator of a scheme to submit the financial statements of the scheme to an auditor annually, for the purpose of independent audit. With few exceptions (see section 20(5) of the ORSO), all schemes, regardless of size or type must be audited. A copy of the audited financial statements of the scheme is required to be submitted by the administrator to the MPFA within 6 months after the end of the scheme's financial period.

179. The first audit would be required in respect of the first financial period ending after the scheme is registered.

**Specific audit areas**

*Investments*

180. Section 27 of the ORSO sets out the investment requirement for an ORSO scheme. Section 27(2) imposes the following requirements in respect of investment of scheme assets:

- a. not more than 10% of the assets of the scheme shall consist of restricted investments;
- b. no assets of the scheme shall consist of a loan to the relevant employer of the scheme or an associate of the relevant employer;
- c. subject to subsection (3), no asset of the scheme acquired on or after 15 October 1993 shall consist of investments in the share capital of a body corporate which share capital is not –
  - i. listed on a recognized stock market as defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance; or
  - ii. publicly listed on a specified stock exchange as defined in that section.

For further details of the requirements, the auditor is required to refer to section 27 of the ORSO.



181. The auditor would need to perform such procedures as are considered necessary in order to obtain sufficient appropriate audit evidence to enable the auditor to report as to whether or not the requirements of section 27(2) of the ORSO in respect of investment restrictions have been complied with as regards the scheme as at the last day of the year and two other dates in the year as the auditor may elect, provided that the intervening period between all such dates shall not be shorter than three months. Where a scheme has been in operation for less than a full year and the requirements of section 27(2) cannot be satisfied in full, it is recommended that the auditor would select three dates which may not necessarily be three months apart. In planning and performing this work, the auditor should refer to the principles in the HKSAE 3000 (Revised) applicable to assurance engagements.

*Contributions*

182. The ORSO (section 20) also requires the auditor to include a statement as to whether or not, in the auditor's opinion, contributions payable to the scheme during the financial year have been paid in accordance with the scheme rules or the relevant undertaking under which they were payable.
183. The wording of the opinion on contributions is more specific than the opinion required on the financial statements. It requires the auditor to consider the amounts of contributions payable to the scheme and, where the trust deed or rules are specific, the dates of payment.
184. It may be necessary for the auditor to consider whether the results of audit tests or evidence on contributions require a qualified opinion to be given on contributions. Matters to be considered in this respect include the opinion in Form A issued by the employer's auditor (paragraphs 196 - 215 below) and whether any discrepancies favour one particular member or group of members and the extent to which the growth of the fund has suffered because of a failure to pay contributions to the scheme in a proper manner.
185. The auditor may, for example, in the case of a scheme having several participating employers, be unable to obtain sufficient evidence on contributions to give an unqualified opinion. The scope of the examination might be expressly stated as being limited to the transactions as recorded in the books of the scheme.
186. Section 27(2) of the ORSO prohibits loans from the scheme to the employer. Where contributions are outstanding these may, under some circumstances, become de facto loans.

*Accrued benefits*

187. The financial statements of a retirement scheme are required to disclose:
- a. the liability of the scheme in respect of the benefits which have accrued to members and beneficiaries as a result of their membership of the scheme up to the financial year end of the scheme (aggregate past service liabilities); and
  - b. the benefits to which members would have been entitled in the event that they had resigned from membership of the scheme as at the financial year end date (aggregated vested liabilities). These liabilities are calculated differently depending upon the type of the retirement scheme and therefore the auditing procedures vary.
188. The aggregate past service liability to members and beneficiaries of a defined contribution scheme is the accumulated contributions and allocated net earnings of the scheme. This is normally equivalent to the difference between the carrying amounts of the assets and the other liabilities (including forfeitures available to the employer by way of offset against future contributions or cash refund) of the scheme as at the financial year end date, less any reserves or other net earnings which have not been allocated for the benefit of members. This is normally the amount shown as the total balances of the members' accounts.

189. The aggregate past service liability for defined benefit schemes is the present value of the portion of expected future benefit payments which arise from membership of the scheme up to the financial year end.
190. The amount of the liability depends upon an actuarial review which makes reference to the scheme rules and assumptions such as expected future salary levels, mortality rates and membership turnover.
191. The gross liability is discounted to its present value by applying a discount rate consistent with the rate of return that the scheme would anticipate that it could achieve if, at the financial year end date, sufficient funds were available to meet accrued benefits as they fall due.
192. The procedures appropriate to this aspect of the audit usually include the review of the work of the actuary, which is discussed in paragraphs 25 to 41 above.
193. The aggregate vested liability of a defined contribution scheme is the accumulation of the members' contributions plus the appropriate proportion of the employer's contributions determined by the governing rules of the scheme and the net earnings of the scheme allocated on both balances as at the financial year end date. The aggregate vested liability of a defined benefit scheme is determined by the governing rules of the scheme and is generally calculated by the actuary on the basis of length of service and the salaries of the members as at the financial year end date.

#### **The auditor's reports**

194. Section 20 of the ORSO requires:
- a. the auditor's report in relation to the financial statements of a scheme and a financial year of it to state:
    - i. whether or not in the auditor's opinion the financial statements give a true and fair view of the disposition, at the last day of the year, of the scheme assets and liabilities and of its financial transactions for the year then ended;
    - ii. where:
      - the auditor has been denied access to the employer's books and records in contravention of section 20(7) of the ORSO; or
      - the auditor has not been given necessary information and explanations as required by section 20(7) of the ORSO,
 such fact; and
    - iii. such other information as the MPFA may specify in guidelines issued by it; and
  - b. the auditor's report on a scheme's compliance with certain requirements of the ORSO to state whether or not in the auditor's opinion:
    - i. proper accounts and records have been kept as regards all assets, liabilities and financial transactions of the scheme;
    - ii. where the scheme is a defined benefit scheme, the relevant undertaking has been complied with;
    - iii. where the scheme is a defined contribution scheme,
      - contributions have been made in accordance with the terms of the scheme; and

- a shortfall between the scheme's assets and the scheme's aggregate vested liability exists, and if so stating the amount of such shortfall at the last day of the year;
- iv. as at the end of the year the assets of the scheme were subject to any assignment, charge, pledge or other encumbrance except:
- the trust (if any) governing the scheme;
  - any charge or pledge created for the purposes of securing loans necessary for meeting the liabilities of the scheme; and
  - any option to acquire for valuable consideration any interest in the assets of the scheme granted in the normal course of business; and
- v. the requirements of section 27(2) of the ORSO in respect of investment restrictions have been complied with as regards the scheme as at the last day of the year and two such other dates in the year as the auditor may elect, provided that the intervening period between such dates shall not be shorter than three months.
195. The auditor's reports are addressed in accordance with the trust deed or scheme rules. Where the deed is silent, the auditor's reports would be addressed to the administrator. Example auditor's reports are included in Appendix 1 to this Practice Note (examples 7 and 8).

### **Responsibility and scope of work of the employer's auditor under section 20(7A) of the ORSO**

196. The ORSO (section 20(7A)) requires the relevant employer to appoint an auditor ( "the employer's auditor" ) who provides confirmation to the administrator's auditor not later than four months after the scheme's financial year end on such matters as may be reasonably required in order for the administrator's auditor to discharge his obligations. The ORSO defines "the administrator's auditor" as being the auditor who is forming the opinion on the scheme's financial statements. The employer's auditor does not need to be the same as the administrator's auditor. Separate engagement letters are required for the appointments of the employer's auditor and the administrator's auditor, whether or not they are the same firm.
197. The role of the employer's auditor is to report under "Forms A and B" as issued by the Registrar under section 20(7A) of the ORSO. Form A is the employer's auditor's statement issued to the administrator's auditor, and Form B is the statement on details of contributions. The employer's auditor is advised to refer to the Guidelines issued by the Registrar on the preparation of the Statement of the Employer's Auditor under section 20(7A) of the ORSO ("Registrar's Guidelines") for guidance.
198. The primary responsibility for completing Form B lies with the employer although in practice it is often completed by the administrator or with assistance from the administrator. Therefore, the employer's auditor would allow the employer to make amendments on the Form B prepared by the administrator if the information contained therein is not correct. Before carrying out any work on Form B, the employer's auditor would ensure that Form B is signed by the employer, or where Form B is signed by the administrator, that it is counter-signed by the employer.
199. The responsibility of the employer's auditor is to complete Form A which is addressed to the administrator's auditor and includes an opinion as to whether proper accounts and records have been kept in relation to contributions and whether Form B is in accordance with the books and records of the employer.

200. As the employer's auditor's work in relation to Forms A and B is usually not within the scope of a normal statutory audit of the financial statements of the employer, the employer's auditor would agree the terms of this engagement in writing with the employer.
201. Where the employer's auditor is not the statutory auditor for the annual audit of the financial statements of the employer, under paragraph 440.10 of the Code of Ethics for Professional Accountants under section 440 "Changes in a professional appointment", the employer's auditor is required to notify the statutory auditor of the work he is undertaking. This notification need not be given if the client advances a valid reason against it. The employer's auditor has the right to expect full co-operation of the statutory auditor in carrying out his assignment.
202. For a scheme that covers more than one relevant employer, the employer's auditor would set out in the engagement letter which relevant employers' Form B will be examined by him.

**Procedures performed by the employer's auditor**

203. The objective of the employer's auditor giving such an opinion in Form A is to provide the administrator's auditor with reliable audit evidence regarding contributions paid and payable for the financial year of the scheme.
204. The administrator's auditor is responsible for expressing an opinion on the financial statements of the scheme. Among other things, the administrator's auditor is required to report whether proper accounts and records have been kept; whether contributions have been made in accordance with the terms of the scheme and; for defined benefit schemes, whether the relevant undertaking has been complied with in respect of the financial year of the scheme.
205. It is therefore important that the employer's auditor plans and performs appropriate and sufficient procedures on Form B to justify his opinion given in Form A. This opinion provides an important part of the audit evidence required by the administrator's auditor in forming his opinion on the financial statements of the scheme.
206. In considering the nature and extent of procedures necessary, the employer's auditor would have regard to a number of factors, including:
- a. whether the financial year end of the scheme is the same as the financial year end of the employer;
  - b. whether the financial statements of the employer have been or are required to be audited;
  - c. whether the auditor's report on the employer's financial statements was qualified or unqualified;
  - d. the extent and nature of audit work performed on payroll and personnel records during the financial statement audit of the employer and the results of such audit work; and
  - e. the employer's auditor's general knowledge of the employer's business, internal controls and reliability of records.
207. Where the scheme is a defined benefit scheme, the employer's auditor would also have regard to the latest actuarial certificate and funding recommendations for the scheme as well as the "relevant undertaking" made by the employer to contribute to the scheme's funds in accordance with the actuary's recommendations. In such circumstances, the employer's auditor would pay particular attention to the column on Form B headed "percentage of payroll" under "Ordinary contributions from relevant employer".

**Dates of receipt and payment of contributions**

208. Where the date of receipt of a contribution by the administrator as shown on Form B differs by more than 14 calendar days from the date of payment as recorded in the employer's records, paragraph 23 of the Registrar's Guidelines requires that the opinion in Form A should be qualified in this respect and details of such differences should be provided in Form A.
209. The primary purpose of this qualification of opinion is to alert the administrator's auditor to the possibility of errors or irregularities arising which result in undue delay of contributions being credited to the scheme for the benefit of members. In determining what represents the "date of payment as recorded in the employer's records", the employer's auditor would have regard to the accounting system of the employer. The appropriate date may be determined from different records of the employer, depending upon the accounting system, but should usually represent the date of the cheque or other form of payment made by the employer in respect of the payment of contributions to the administrator.
210. For a scheme which the members or a class of members and their employers are exempted under section 5 of the MPFSO, the employer must pay all contributions to the scheme in respect of a "relevant" period by the due date. The term "relevant period" means each period in respect of which contributions are required to be paid. The due date by which employer contributions are required to have been paid to the scheme is:
- a. if the contribution requirements of a relevant scheme have specified the date on which the relevant employer is to pay a contribution, the due date for that contribution shall be the date so specified.
  - b. if the contribution requirements of a relevant scheme have not specified the date on which the relevant employer is to pay a contribution, the due date for the contribution for each relevant period shall be:
    - i. a day within a month next following the expiration of the relevant period as specified in a statement sent by the employer to the designated person; or
    - ii. if not so specified, the tenth day after the relevant period.

Such required date of payment should not be confused with the payroll date, although in some cases the contribution payment may be tied to the payroll date.

211. Where an employer fails to comply with its obligation to pay contributions by the due date the administrator is obliged to issue a written notice to the employer requiring the employer to pay the outstanding contributions within 30 days of the date of the notice. Such notice must be sent to the employer as soon as practicable after the administrator becomes aware of the failure by the employer to pay contributions by the due date.
212. Where the employer, despite the reminder from the administrator, still fails to pay the contributions which are in arrears the administrator is then obliged to notify the MPFA which, in turn, has the power to issue various payment notices to the employer and impose surcharges and financial penalties on the employer.

**Opinion by the employer's auditor (Form A)**

213. The employer's auditor is required to express his opinion in the general format set out in Form A. It is important that in expressing his opinion on whether proper accounts and records have been kept in relation to contributions, the employer's auditor indicates clearly whether or not the opinion is qualified, and if it is, precisely what the qualification(s) relate to. Similarly, in expressing his opinion on whether Form B is in accordance with the books and records of the relevant employer, the employer's auditor indicates whether or not the opinion is qualified, and if it is, the details of the exceptions identified. The employer's auditor would need to exercise professional judgement in deciding whether to include all or merely material exceptions identified by him in Form A.

214. The employer's auditor may find it desirable to reproduce Form A on the auditor's own letterheads. This is in order, provided that the contents of Form A conform to those specified in the Registrar's Guidelines. The template of Form A is included in Appendix 2 to this PN.
215. The employer's auditor's work on Form B is essentially an extension of a payroll audit. Therefore in forming an opinion in Form A in respect of whether proper accounts and records have been kept in relation to contributions, the employer's auditor considers whether the payroll and contribution details stated in Form B agree to the books kept by the employer. In addition, the employer's auditor considers whether sufficient personnel records have been kept in respect of each employee. Such personnel records may include the name of the employee, employment letter or contract, age, salary history, date of commencement of employment and date of joining the scheme, etc.

**MPFA may require certain reports to be prepared by the auditor under section 32 of the ORSO**

216. Under section 32 of the ORSO, the MPFA may under certain conditions require the administrator to cause an auditor approved by the MPFA to prepare a report on any matters specified in a written notice from the MPFA, and to supply the report to the MPFA. Such additional reports would constitute a separate appointment from that as the auditor of the financial statements of the scheme. Accordingly, any auditor appointed under these circumstances would agree the terms of this engagement in writing with the administrator.

## APPENDIX 1

### Example 1 - auditor's report on the financial statements of a MPF scheme - unqualified opinion

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a MPF scheme other than a listed scheme using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600<sup>4</sup> does not apply).
- The financial statements are prepared by the trustee of the scheme in accordance with HKFRSs (a general purpose framework<sup>5</sup>).
- The terms of the audit engagement reflect the description of the trustee's responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the scheme's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>6</sup>
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>7</sup>
- The auditor has obtained all of the other information<sup>8</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Mandatory Provident Fund Schemes (General) Regulation.

#### INDEPENDENT AUDITOR'S REPORT<sup>9</sup>

To the Trustee of XYZ Scheme **~~TO THE TRUSTEE OF XYZ SCHEME~~**

#### Report on the Audit of the Financial Statements

##### Opinion

We have audited the financial statements of XYZ Scheme ("the Scheme") set out on pages ..... to ....., which comprise the statement of net assets available for benefits as at [*year end date*], and the statement of changes in net assets available for benefits and [cash flow statement][statement of cash flows]<sup>10</sup> for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the financial statements give a true and fair view of the financial position of the Scheme as at [*year end date*], and of its financial transactions and cash flows for the year then ended

<sup>4</sup> HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>5</sup> HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 7(b)

<sup>6</sup> HKSA 570 (Revised), *Going Concern*.

<sup>7</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>8</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c)

<sup>9</sup> The auditor's report may be tailored to include reporting for constituent funds of the Scheme.

<sup>10</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Scheme in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised)*.]

### **Responsibilities of Trustee's Responsibility and Those Charged with Governance for the Financial Statements**<sup>11</sup>

The trustee is responsible for the preparation of the financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards HKFRSs issued by the Hong Kong Institute of Certified Public Accountants HKICPA and is responsible for ensuring that the financial statements have been properly prepared in accordance with sections 80, 81, 83 and 84 of the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"), and for such internal control as the trustee determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the trustee is responsible for assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the trustee either intends to liquidate the Scheme or to cease operations, or has no realistic alternative but to do so.

In addition, the trustee is required to ensure that the financial statements have been properly prepared in accordance with sections 80, 81, 83 and 84 of the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation").

Those charged with governance are responsible for overseeing the Scheme's financial reporting process.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our responsibility is to express an opinion on these financial statements based on our audit<sup>12</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence

<sup>11</sup> Throughout the illustrative auditor's reports, the terms trustee and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>12</sup> 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".



~~the economic decisions of users taken on the basis of these financial statements. These 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. In addition, we are required to assess whether the financial statements of the Scheme have been properly prepared, in all material respects, in accordance with sections 80, 81, 83 and 84 of the General Regulation.~~

~~Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.~~

~~As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:~~

- ~~• Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.~~
- ~~• Obtain an understanding of internal control relevant to the audit 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 Scheme's internal control.~~
- ~~• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the trustee.~~
- ~~• Conclude on the appropriateness of the trustee's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Scheme's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Scheme to cease to continue as a going concern.~~
- ~~• Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.~~

~~We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.~~

~~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 Scheme's preparation of 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 Scheme's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the trustee, 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.~~

*Opinion*

~~In our opinion, the financial statements give a true and fair view of the financial position of the Scheme as at [year end date], and of its financial transactions and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.~~

**Report on matters under the Mandatory Provident Fund Schemes (General) Regulation**

- a. In our opinion, the financial statements have been properly prepared, in all material respects, in accordance with sections 80, 81, 83 and 84 of the General Regulation.
- b. We have obtained all the information and explanations which, to the best of our knowledge and belief, are necessary for the purpose of our audit.

~~ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date] of the auditor's report~~

**Example 2 - auditor's report on a MPF scheme's  
compliance with certain requirements of the  
Mandatory Provident Fund Schemes Ordinance and the  
Mandatory Provident Fund Schemes (General) Regulation  
- unqualified opinion**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Trustee of XYZ Scheme

We have audited the financial statements of XYZ Scheme ("the Scheme") for the year ended [*year end date*] in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and have issued [an unqualified/a qualified] auditor's report thereon dated [*insert date here*].

Pursuant to section 102 of the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"), we are required to report whether the Scheme complied with certain requirements of the Mandatory Provident Fund Schemes Ordinance ("MPFSO") and the General Regulation.

*Trustee's Responsibility*

The General Regulation requires the trustee to ensure that:

- a. proper accounting and other records are kept in respect of the constituent funds of the Scheme, the Scheme assets and all financial transactions entered into in relation to the Scheme;
- b. the requirements specified in the guidelines made by the Mandatory Provident Fund Schemes Authority under section 28 of the MPFSO with respect to forbidden investment practices and the requirements of sections 37(2), 51 and 52 and Part X of, and Schedule 1 to, the General Regulation are complied with; and
- c. the Scheme assets are not subject to any encumbrance, otherwise than as permitted by the General Regulation.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the HKICPA, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>13</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to report on the Scheme's compliance with the above requirements based on the results of the procedures performed by us.<sup>14</sup>

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<sup>13</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>14</sup> 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".

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance on whether the Scheme has complied with the above requirements.

We have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 860.1 (Revised), which included reviewing, on a test basis, evidence obtained from the [Trustee][Administrator] regarding the Scheme's compliance with the above requirements.

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

### *Opinion*

Based on the foregoing:

1. in our opinion:
  - a. proper accounting and other records have been kept during the year ended *[year end date]* in respect of the constituent funds of the Scheme, the Scheme assets and all financial transactions entered into in relation to the Scheme; and
  - b. the requirements specified in the guidelines made by the Mandatory Provident Fund Schemes Authority under section 28 of the MPFSO with respect to forbidden investment practices and the requirements of sections 37(2), 51 and 52 and Part X of, and Schedule 1 to, the General Regulation have been complied with, in all material respects, as at *[year end date]*, *[.....]*<sup>\*</sup> and *[.....]*<sup>\*</sup>; and
2. as at *[year end date]*, the Scheme assets were not subject to any encumbrance, otherwise than as permitted by the General Regulation.

### *Intended Users and Purpose*

This report is intended solely for submission by the Trustee to the Mandatory Provident Fund Schemes Authority pursuant to section 102 of the General Regulation, and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
*[Auditor's Address]*  
Date

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\* *insert 2 other dates in the year selected by the auditor for performing the procedures on checking compliance provided that the intervening period between such dates is not shorter than 3 months.*

**Example 3 - auditor's report on an applicant trustee's compliance with prescribed capital adequacy requirements pursuant to section 18 of the Mandatory Provident Fund Schemes (General) Regulation - unqualified opinion**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT PURSUANT TO SECTION 18 OF THE MANDATORY PROVIDENT FUND SCHEMES (GENERAL) REGULATION**

To the Directors of XYZ Limited ("the Company")

Pursuant to section 18 of the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"), we have been requested to report on the Company's compliance with prescribed capital adequacy requirements.

*Directors' Responsibility*

Under the General Regulation, the directors are responsible for the Company's compliance with prescribed capital adequacy requirements.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>15</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to report on the Company's compliance based on the results of the procedures performed by us.<sup>16</sup>

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance on whether the Company has complied, in all material respects, with prescribed capital adequacy requirements.

We have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 860.1 (Revised), which included reviewing evidence obtained from the Company regarding the Company's compliance with the prescribed capital adequacy requirements.

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

*Opinion*

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<sup>15</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>16</sup> 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".

THE AUDIT OF RETIREMENT SCHEMES

Based on the foregoing, in our opinion the Company has complied, in all material respects, with prescribed capital adequacy requirements as set out in section 11[(2)/(3)] of the General Regulation as at *[insert date here]*.

*Intended Users and Purpose*

This report is intended solely for submission by the Company to the Mandatory Provident Fund Schemes Authority and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
*[Auditor's Address]*  
Date

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\* *the date agreed between the Company and the Mandatory Provident Fund Schemes Authority.*

**Example 4 - auditor's report on the trustee's compliance  
with prescribed capital adequacy requirements  
pursuant to section 115 of the Mandatory Provident  
Fund Schemes (General) Regulation - unqualified opinion**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT PURSUANT TO SECTION 115 OF THE  
MANDATORY PROVIDENT FUND SCHEMES (GENERAL) REGULATION**

To XYZ Trustee ("the Trustee")

Pursuant to section 115 of the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"), we have been requested to report on the Trustee's compliance with prescribed capital adequacy requirements.

*Management's Responsibility*

Under the General Regulation, management is responsible for the Trustee's compliance with prescribed capital adequacy requirements.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>17</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to report on the Trustee's compliance based on the results of the procedures performed by us.<sup>18</sup>

We have audited the financial statements of the Trustee for the year ended *[year end date]* in accordance with Hong Kong Standards on Auditing issued by the HKICPA, and have issued *[an unqualified/a qualified]* auditor's report thereon dated *[insert date here]*.

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance on whether the Trustee has complied, in all material respects, with prescribed capital adequacy requirements.

We have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 860.1 (Revised), which included reviewing, on a test basis, evidence obtained from the Trustee regarding the Scheme's compliance with the above requirements.

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

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<sup>17</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>18</sup> 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".

*Opinion*

Based on the foregoing, in our opinion the Trustee has complied, in all material respects, with prescribed capital adequacy requirements as set out in section 11[(2)/(3)] of the General Regulation as at [year end date], [.....] and [.....] \*.

*Intended Users and Purpose*

This report is intended solely for submission by the Trustee to the Mandatory Provident Fund Schemes Authority and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.

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

[Auditor's Address]Date [see note below]

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\* insert 2 other dates in the year selected by the auditor for performing procedures on checking compliance and such selected dates must be at least 3 months apart or such a shorter period the MPFA may allow.

Note: In practice, section 115 (5) of the General Regulation imposes a six month deadline for the submission of this report to the trustee in order that the trustee can comply with section 114 (1) of the General Regulation - submission of the trustee's and auditor's report to the MPFA.



**Example 5 - report by the auditor of a service provider for submission to the trustee pursuant to section 74(5)(b) of the Mandatory Provident Fund Schemes (General) Regulation**

**INDEPENDENT AUDITOR'S REPORT  
TO THE DIRECTORS OF XYZ LIMITED  
PURSUANT TO SECTION 74(5)(b) OF THE MANDATORY PROVIDENT FUND SCHEMES  
(GENERAL) REGULATION**

Pursuant to section 74(5)(b) of the Mandatory Provident Fund Schemes (General) Regulation ( "General Regulation" ), we have been requested to issue a report, in respect of the Service Agreements made between XYZ Limited ("the Company") and ABC Trustee dated *[insert date here]* ( "Service Agreements" ).

***Directors' Responsibility***

Under the General Regulation, ABC Trustee requires the Company to submit to it a report of any material event and an annual report that complies with section 74(5) of the General Regulation. The directors of the Company are responsible for complying with the requirement of ABC Trustee in submitting the abovementioned reports to it.

***Auditor's Responsibility***

It is our responsibility to issue a report stating whether or not, in our normal course of duties as the auditor of the Company<sup>19</sup>, we have become aware of:

1. any failure of the Company to comply with the Company's obligations under the Service Agreements; and
2. any false declaration made by the Company to ABC Trustee or any other person.

***Basis of conclusion***

We have audited the financial statements of the Company for the year ended *[year end date]* in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants ("the HKICPA"), and have issued [an unqualified/a qualified] auditor's report thereon dated *[insert date here]*. The objective of the audit of the financial statements of the Company is to enable us to express an opinion on whether such financial statements give a true and fair view of the financial position of the Company as at *[year end date]* and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

In preparing this report, we have also considered the guidance contained in Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA.

In relation to our conclusion below, we are not required to perform any procedures in addition to the normal course of audit to search for instances of non compliance with obligations under the Service Agreements or any false declarations made to ABC Trustee or any other person.

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<sup>19</sup> 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".

**Conclusion**

Based on the foregoing, nothing has come to our attention during the course of our audit of the financial statements of the Company for the year ended [*year end date*] that causes us to believe that the Company:

1. failed to comply with its obligations under the Service Agreements; and
2. made any false declaration to ABC Trustee or any other person.

**Use of this report**

This report is intended solely for submission by the Company to ABC Trustee as required under section 74(1) of the General Regulation and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[*Auditor's Address*]  
Date

**Example 6 - auditor's report on the review of the trustee's report on control objectives and internal control measures pursuant to section 113 of the Mandatory Provident Fund Schemes (General) Regulation - unqualified conclusion**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT PURSUANT TO SECTION 113 OF THE MANDATORY PROVIDENT FUND SCHEMES (GENERAL) REGULATION**

To XYZ Trustee

Pursuant to section 113 of the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"), we have been requested to review a report on control objectives and internal control measures dated *[insert date here]* ("Trustee's Report") which is required to be prepared by you as trustee under section 112 of the General Regulation.

*Scope*

This report covers our review of the Trustee's Report on the control objectives and internal control measures of XYZ Trustee applicable to the approved Mandatory Provident Fund Schemes for which the trustee is XYZ Trustee ("the Schemes"), and does not extend to any other control objectives or internal control measures of XYZ Trustee.

*Trustee's Responsibility*

Under the General Regulation, XYZ Trustee is responsible for:

1. ensuring that control objectives, as stated under section 39 of the General Regulation, are established and maintained with respect to the Schemes by ensuring that:
  - a. the assets of the Schemes are safeguarded in the interests of members of the Schemes;
  - b. the guidelines made by the Mandatory Provident Fund Schemes Authority ( "MPFA" ) under section 28 of the Mandatory Provident Fund Schemes Ordinance with respect to forbidden investment practices are not contravened;
  - c. the limitations and prohibitions imposed under the General Regulation with respect to the investment of the funds of the Schemes in restricted investments are complied with;
  - d. the requirements of section 37(2) of the General Regulation with respect to capital preservation fund, section 51 of the General Regulation with respect to repurchase agreements, section 52 of the General Regulation with respect to stock lending and Schedule 1 to the General Regulation with respect to permissible investments are complied with in relation to the Schemes; and
  - e. the funds of the Schemes and the assets of the Schemes are, except as permitted by the General Regulation, kept separate from those of the participating employers, XYZ Trustee and the service providers and other persons appointed or engaged for the purposes of the Schemes;
2. establishing and maintaining the following internal control measures and procedures for achieving the above control objectives:
  - a. monitoring investments to ensure that the control objectives referred to in paragraphs 1(b), (c) and (d) above are achieved;
  - b. monitoring the funds of the Schemes and the assets of the Schemes to ensure the objective referred to in paragraph 1(e) above is achieved, so that the funds of the

Schemes and the assets of the Schemes are kept separate from those of the participating employers, XYZ Trustee and any other persons (such as service providers); and

- c. ensuring the accuracy of statements, returns and reports required to be lodged with the MPFA; and
3. implementing the recommended measures outlined in the MPFA Guidelines II.6 "Guidelines on Internal Control Report for each Registered Scheme" ("MPFA Guidelines II.6").

#### *Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>20</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

#### *Auditor's Responsibility*

Our responsibility is to review the Trustee's Report and report in writing to XYZ Trustee on the review.<sup>21</sup>

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving conclusions 1 to 3 and obtain limited assurance in respect of any shortcomings in the internal control measures.

Our work was based upon obtaining an understanding of the control procedures in operation by enquiry of management and review of documents supplied to us.

In accordance with the MPFA Guidelines II.6, we are not required to test and ascertain whether the control objectives and internal control measures as described on pages [ ] to [ ] were actually implemented during the year ended [year end date]. Our work was limited to ensuring whether relevant control objectives and internal control measures were designed by XYZ Trustee for meeting each of the requirements specified in the General Regulation and the MPFA Guidelines II.6.

We have not performed an assessment of the adequacy or completeness of the control objectives in relation to the risks they are designed to address. Our work was limited to the objectives specified in the General Regulation and our conclusion relates solely to reporting that XYZ Trustee has designed control objectives and internal control measures in line with those recommended in the MPFA Guidelines II.6.

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

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<sup>20</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>21</sup> 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".

*Inherent Limitations*

Internal control measures designed to address specific control objectives are subject to inherent limitations of any internal control structure, and accordingly, errors or irregularities may occur and not be detected. Such measures cannot guarantee protection against fraudulent collusion especially on the part of those holding positions of authority or trust.

*Conclusion*

Based on the foregoing, in our opinion:

1. appropriate control objectives were established and maintained for the Schemes during the year ended *[year end date]*;
2. effective internal control measures were established and maintained for the purpose of achieving those objectives during the year ended *[year end date]*; and
3. those internal control measures were likely to have been sufficiently effective, in all material respects, to provide a reasonable assurance that the control objectives established and maintained for the Schemes would be achieved if those measures were fully and properly implemented.

During the course of our engagement, we did not become aware of any shortcomings in the internal control measures that could materially affect the operation of the Schemes (including their financial position) or the financial interests of members of the Schemes during the year ended *[year end date]*.

*OR*

During the course of our engagement, we became aware of the following shortcomings in the internal control measures that could materially affect the operation of the Schemes (including their financial position) or the financial interests of members of the Schemes during the year ended *[year end date]*:

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*Intended Users and Purpose*

This report is intended solely for submission by XYZ Trustee to the MPFA pursuant to section 112(3) of the General Regulation, and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
*[Auditor's Address]*  
Date

**Example 7 - auditor's report on the financial statements of an ORSO scheme - unqualified opinion**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an ORSO scheme other than a listed scheme using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600<sup>22</sup> does not apply).
- The financial statements are prepared by the administrator of the scheme in accordance with HKFRSs (a general purpose framework<sup>23</sup>).
- The terms of the audit engagement reflect the description of the administrator's responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the scheme's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>24</sup>
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>25</sup>
- The auditor has obtained all of the other information<sup>26</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Hong Kong Occupational Retirement Schemes Ordinance.

**INDEPENDENT AUDITOR'S REPORT**

~~TO THE ADMINISTRATOR~~ To the Administrator<sup>27</sup> of XYZ Scheme ~~OF XYZ SCHEME~~

[Report on the Audit of the Financial Statements]<sup>28</sup>

**Opinion**

We have audited the financial statements of XYZ Scheme ("the Scheme") set out on pages .... to ....., which comprise the statement of net assets available for benefits as at [*year end date*], and the statement of changes in net assets available for benefits and [cash flow statement][statement of cash flows]<sup>29</sup> for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

<sup>22</sup> HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>23</sup> HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 7(b)

<sup>24</sup> HKSA 570 (Revised), *Going Concern*.

<sup>25</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>26</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c)

<sup>27</sup> The term "administrator" is used in this Practice Note to refer to the trustee if an ORSO scheme is governed by a trust or the insurer if an ORSO scheme is the subject of or regulated by an insurance arrangement. The auditor's report is addressed in accordance with the trust deed or scheme rules. Where the deed is silent, the auditor's report is addressed to the administrator.

<sup>28</sup> The sub-title "Report on the Audit of the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on matters under section 20(3)(c) of the Hong Kong Occupational Retirement Schemes Ordinance Other Legal and Regulatory Requirements" is not applicable.

<sup>29</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

In our opinion, the financial statements give a true and fair view of the disposition of the assets and liabilities of the Scheme as at [year end date] and of its financial transactions and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Scheme in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).]

### **Responsibilities of Administrator's Responsibility and Those Charged with Governance for the Financial Statements**<sup>30</sup>

The administrator is responsible for the preparation of the financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards HKFRSs issued by the Hong Kong Institute of Certified Public Accountants HKICPA and the provisions of the Hong Kong Occupational Retirement Schemes Ordinance, and for such internal control as the administrator determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the administrator is responsible for assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the administrator either intends to liquidate the Scheme or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Scheme's financial reporting process.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our responsibility is to express an opinion on these financial statements based on our audit<sup>31</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. These 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.

<sup>30</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

<sup>31</sup> 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".

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Scheme's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the administrator.
- Conclude on the appropriateness of the administrator's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Scheme's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Scheme to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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 Scheme's preparation of 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 Scheme's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the administrator, 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.

### *Opinion*

In our opinion, the financial statements give a true and fair view of the disposition of the assets and liabilities of the Scheme as at [year end date] and of its financial transactions and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.



**[Report on matters under section 20(3)(c) of the Hong Kong Occupational Retirement Schemes Ordinance]<sup>4228</sup>**

*[The auditor shall state in the auditor's report such other information as the MPFA may specify in the guidelines issued by it. The auditor is required under the ORSO (section 20(3)(c)) to report by exception the following limitations on the scope of the work:*

- a. access to the employer's books and records has been denied; or*
- b. the auditor is unable to obtain all the information and explanations which, to the best of the knowledge and belief, are necessary for the purpose of the audit.]*

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date] of Auditor's Report

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**Example 8 - auditor's report on an ORSO scheme's  
compliance with certain requirements of the  
Occupational Retirement Schemes Ordinance - unqualified opinion**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the Administrator<sup>32</sup> of XYZ Scheme

We have audited the financial statements of XYZ Scheme ("the Scheme") for the year ended [*year end date*] in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and have issued [an unqualified/a qualified] auditor's report thereon dated [*insert date here*].

Pursuant to section 20 of the Occupational Retirement Schemes Ordinance ("ORSO"), we are required to report whether the Scheme complied with certain requirements of the ORSO.

*Administrator's Responsibility*

The ORSO requires the administrator to ensure that:

- a. proper accounts and records are kept as regards all assets, liabilities and financial transactions of the Scheme;

[*For a defined benefit scheme only*]

- b. the relevant undertaking, as defined under section 20(4) of the ORSO<sup>33</sup>, is complied with;

OR

[*For a defined contribution scheme only*]

- b. contributions are made in accordance with the terms of the Scheme;
- c. the assets of the Scheme are not subject to any assignment, charge, pledge or other encumbrance except for those specified in section 20(3)(b)(iii) of the ORSO<sup>34</sup>; and
- d. the requirements of section 27(2) of the ORSO<sup>35</sup> are complied with.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the HKICPA, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

<sup>32</sup> The term "administrator" is used to refer to the trustee if an ORSO scheme is governed by a trust or the insurer if an ORSO scheme is the subject of or regulated by an insurance arrangement. The auditors' report is addressed in accordance with the trust deed or scheme rules. Where the deed is silent, the auditors' report is addressed to the administrator.

<sup>33</sup> "relevant undertaking" is defined by section 20(4) and Schedule 2 Parts 1 and 2 paragraph 6 of the ORSO as a written undertaking by the relevant employer of the scheme (i.e. the employer who provides the employment which entitles or enables the employee to be a member of the scheme) to the administrator of the scheme to contribute to the scheme's fund in accordance with recommendations made by the actuary in the actuarial certificate issued as regards a particular registered scheme. Where more than one actuarial certificate has been issued, the undertaking referred to is the one in the most recent of those certificate which is applicable to the financial period under review.

<sup>34</sup> *The exceptions stated in section 20(3)(b)(iii) of the ORSO are as follows:*

- a. *the trust (if any) governing the scheme;*
- b. *any charge or pledge created for the purposes of securing loans necessary for meeting the liabilities of the scheme; and*
- c. *any option to acquire for valuable consideration any interest in the assets of the scheme granted in the normal course of business.*

<sup>35</sup> *Section 27(2) of the ORSO stipulates the investment restrictions.*

The firm applies Hong Kong Standard on Quality Control 1<sup>36</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to report on the Scheme's compliance with the above requirements based on the results of the procedures performed by us.<sup>37</sup>

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance about whether the Scheme has complied with the above requirements.

We have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 860.1 (Revised), which included reviewing, on a test basis, evidence obtained from the Administrator regarding the Scheme's compliance with the above requirements.

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

*Opinion*

Based on the foregoing, in our opinion:

1. proper accounts and records have been kept during the year ended *[year end date]* as regards all assets, liabilities and financial transactions of the Scheme;

*[For a defined benefit scheme only]*

2. the relevant undertaking, as defined under section 20(4) of the ORSO, has been complied with during the year ended *[year end date]*;

OR

*[For a defined contribution scheme only]*

2. contributions have been made in accordance with the terms of the Scheme during the year ended *[year end date]*; and  
*[If there is a shortfall]*  
at *[net assets statement date]* there was a shortfall amounting to HK\$..... between the Scheme's assets and the Scheme's aggregate vested liability;

OR

*[If there is no shortfall]*

at *[net assets statement date]* there was no shortfall between the Scheme's assets and the Scheme's aggregate vested liability;

3. at *[net assets statement date]* the assets of the Scheme were not subject to any assignment, charge, pledge or other encumbrance except for those specified in section 20(3)(b)(iii) of the ORSO; and

<sup>36</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>37</sup> 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".

THE AUDIT OF RETIREMENT SCHEMES

4. at *[net assets statement date]*, *[.....]* and *[.....]*<sup>38</sup> the requirements of section 27(2) of the ORSO have been complied with.

*Intended Users and Purpose*

This report is intended solely for submission by the administrator to the Mandatory Provident Fund Schemes Authority and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
*[Auditor's Address]*  
Date

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<sup>38</sup> Insert two other dates in the year selected by the auditors for performing the procedures on checking compliance provided that the intervening period between such dates is not shorter than three months.

**Example 9 - auditor's report on  
the financial statements of an APIF - unqualified opinion**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an APIF other than a listed fund using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600<sup>39</sup> does not apply).
- The financial statements are prepared by the manager/ trustee/ insurer of the fund in accordance with HKFRSs (a general purpose framework<sup>40</sup>).
- The terms of the audit engagement reflect the description of the manager's/ trustee's/ insurer's responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the fund's ability to continue as a going concern in accordance with HKSA 570 (Revised).<sup>41</sup>
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.<sup>42</sup>
- The auditor has obtained all of the other information<sup>43</sup> prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the relevant disclosure provisions of the constitutive documents of the fund, the Mandatory Provident Fund Schemes Ordinance, the Mandatory Provident Fund Schemes (General) Regulation, the Code on MPF Investment Funds, and Guidelines II.5 issued by the Mandatory Provident Fund Schemes Authority [and the Code on Unit Trusts and Mutual Funds issued by the Hong Kong Securities and Futures Commission].

**INDEPENDENT AUDITOR'S REPORT**

To the ~~[Trustee][Insurer]~~ of XYZ Fund **TO THE [TRUSTEE][INSURER] OF XYZ FUND**

**Report on the Audit of the Financial Statements**

**Opinion**

We have audited the financial statements of XYZ Fund ("the Fund") set out on pages ..... to ....., which comprise the statement of net assets attributable to [fundholders][unitholders] as at [year end date], and the statement of comprehensive income, the statement of changes in net assets attributable to [fundholders][unitholders] and [cash flow statement][statement of cash flows]<sup>44</sup> for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

<sup>39</sup> HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>40</sup> HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 7(b)

<sup>41</sup> HKSA 570 (Revised), *Going Concern*.

<sup>42</sup> HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>43</sup> HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 12(c)

<sup>44</sup> Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as at [year end date], and of its financial transactions and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

### **Basis for Opinion**

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HSAs") and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Scheme in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information – see Illustration 1 in Appendix 2 of HKSA 720 (Revised)*.]

### **Responsibilities of [[Manager's and] [Trustee's] [Insurer's] Responsibility and Those Charged with Governance for the Financial Statements<sup>45</sup>**

The [Manager and the] [Trustee][Insurer] of the Fund [are][is] responsible for the preparation of the financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards HKFRSs issued by the Hong Kong Institute of Certified Public Accountants HKICPA, and are responsible for ensuring that the financial statements have been properly prepared in accordance with the relevant disclosure provisions of the constitutive documents of the Fund ("the Constitutive Documents"), the Mandatory Provident Fund Schemes Ordinance ("the MPFSO"), the Mandatory Provident Fund Schemes (General) Regulation ("the General Regulation"), the Code on MPF Investment Funds ("the MPF Code"), and Guidelines II.5 issued by the Mandatory Provident Fund Schemes Authority ("the MPFA") [and the Code on Unit Trusts and Mutual Funds ("the Code") issued by the Hong Kong Securities and Futures Commission ("the SFC")]<sup>46</sup>, and for such internal control as the [manager and the] [trustee][insurer] determine[s] is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the [Manager and the] [Trustee][Insurer] of the Fund [are][is] responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the [Manager and the] [Trustee][Insurer] either [intend][intends] to liquidate the Fund or to cease operations, or [have][has] no realistic alternative but to do so.

In addition, the [Manager and the] [Trustee][Insurer] of the Fund [are][is] required to ensure that the financial statements have been properly prepared in accordance with the relevant disclosure provisions of the constitutive documents of the Fund ("the Constitutive Documents"), the Mandatory Provident Fund Schemes Ordinance ("the MPFSO"), the Mandatory Provident Fund Schemes (General) Regulation ("the General Regulation"), the Code on MPF Investment Funds ("the MPF Code"), and Guidelines II.5 issued by the Mandatory Provident Fund Schemes Authority ("the MPFA") [and the Code on Unit Trusts and Mutual Funds ("the Code") issued by the Hong Kong Securities and Futures Commission ("the SFC")]<sup>47</sup>.

<sup>45</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

<sup>46</sup> Delete if the Fund is only approved by the MPFA but not authorized by the SFC under section 104(1) of the Securities and Futures Ordinance.

<sup>47</sup> Delete if the Fund is only approved by the MPFA but not authorized by the SFC under section 104(1) of the Securities and Futures Ordinance.

Those charged with governance are responsible for overseeing the Fund's financial reporting process.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our responsibility is to express an opinion on these financial statements based on our audit<sup>48</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSA's will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. These 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. — In addition, we are also required to assess whether the financial statements of the Fund have been properly prepared, in all material respects, in accordance with the relevant disclosure provisions of the constitutive documents of the Fund, the MPFSO, the General Regulation, the MPF Code and Guidelines II.5 issued by the MPFA [and the Code issued by the SFC]<sup>47,22</sup>.

Paragraph 41(b) of HKSA 700 (Revised) explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) of HKSA 700 (Revised) explains that when law, regulation or HKSA's expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the [manager and the] [trustee][insurer].
- Conclude on the appropriateness of the [manager's and the] [trustee's][insurer's] use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and

<sup>48</sup> 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".

events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

~~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 judgement, 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 Fund's preparation of 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 Fund's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the [manager and the] [trustee][insurer], 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.~~

#### ~~Opinion~~

~~In our opinion, the financial statements give a true and fair view of the financial position of the Fund as at [year end date], and of its financial transactions and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.~~

#### **Report on matters under the relevant disclosure provisions of the Constitutive Documents, the MPFSO, the General Regulation, the MPF Code, and Guidelines II.5 issued by the MPFA [and the Code issued by the SFC]<sup>47</sup> Other Legal and Regulatory Requirements**

- (a) In our opinion, the financial statements have been properly prepared, in all material respects, in accordance with the relevant provisions of the constitutive documents of the Fund, the MPFSO, the General Regulation, the MPF Code and Guidelines II.5 issued by the MPFA [and the Code issued by the SFC]<sup>47,22</sup>; and
- (b) We have obtained all the information and explanations which, to the best of our knowledge and belief, are necessary for the purpose of our audit.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
[Auditor's Address]  
[Date]



**Example 10 - auditor's report on an APIF's compliance with certain requirements of the Mandatory Provident Fund Schemes Ordinance, the Mandatory Provident Fund Schemes (General) Regulation and the Code on MPF Investment Funds - unqualified opinion**

**INDEPENDENT AUDITOR'S ASSURANCE REPORT**

To the [Trustee][Insurer] of XYZ Fund

We have audited the financial statements of XYZ Fund ("the Fund") for the year ended *[year end date]* in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and have issued [an unqualified/a qualified] auditor's report thereon dated *[insert date here]*.

Pursuant to Guidelines II.5 and Code on MPF Investment Funds issued by the Mandatory Provident Fund Schemes Authority, we are required to report whether the Fund complied with certain requirements of the Mandatory Provident Fund Schemes Ordinance ("the MPFSO") and the Mandatory Provident Fund Schemes (General) Regulation ("General Regulation"), which are made applicable to the Fund through the Code on MPF Investment Funds.

*[Manager and the] [Trustee][Insurer]'s Responsibility*

The General Regulation requires the [manager and the] [trustee][insurer] to ensure that:

- a. proper accounting and other records are kept in respect of the Fund assets and all financial transactions entered into in relation to the Fund;
- b. the requirements specified in the guidelines made by the Mandatory Provident Fund Schemes Authority ("the MPFA") under section 28 of the MPFSO with respect to forbidden investment practices and the requirements of sections 37(2), 51 and 52 of, and Schedule 1 to, the General Regulation, which are made applicable to the Fund through the Code on MPF Investment Funds, are complied with; and
- c. the Fund assets are not subject to any encumbrance, otherwise than as permitted by section 65 of the General Regulation.

*Our Independence and Quality Control*

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the HKICPA, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1<sup>49</sup> and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

*Auditor's Responsibility*

Our responsibility is to report on the Fund's compliance with the above requirements based on the results of the procedures performed by us.<sup>50</sup>

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<sup>49</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>50</sup> 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".

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and with reference to Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance about whether the Fund has complied with the above requirements.

We have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 860.1 (Revised), which included reviewing, on a test basis, evidence obtained from the Administrator regarding the Scheme's compliance with the above requirements.

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

### *Opinion*

Based on the foregoing:

1. in our opinion:
  - a. proper accounting and other records have been kept during the year ended *[year end date]* in respect of the Fund assets and all financial transactions entered into in relation to the Fund; and
  - b. the requirements specified in the guidelines made by the MPFA under section 28 of the MPFSO with respect to forbidden investment practices and the requirements of sections 37(2), 51 and 52 of, and Schedule 1 to, the General Regulation, which are made applicable to the Fund through the Code on MPF Investment Funds, have been complied with, in all material respects, as at *[year end date]*, *[.....]*\* and *[.....]*\*.
2. as at *[year end date]*, the assets of the Fund were not subject to any encumbrance, otherwise than as permitted by section 65 of the General Regulation, which are made applicable to the Fund through the Code on MPF Investment Funds.

### *Intended Users and Purpose*

This report is intended solely for submission by the [manager and the] [trustee][insurer] to the Mandatory Provident Fund Schemes Authority and is not intended to be, and should not be, used by anyone for any other purpose.

ABC & Co.  
Certified Public Accountants (Practising) [or Certified Public Accountants]  
*[Auditor's Address]*  
Date

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\* *insert 2 other dates in the year selected by the auditor for performing the procedures on checking compliance provided that the intervening period between such dates is not shorter than 3 months.*

**APPENDIX 2**

**FORM - A**

**Occupational Retirement Schemes Ordinance (Cap. 426)**  
**("the Ordinance")**

**The Employer's Auditor's Statement to the**  
**Administrator's Auditor under section 20(7A) of the Ordinance**

Name of the Relevant Employer: \_\_\_\_\_  
(“the relevant employer”)

Name of the Occupational  
Retirement Scheme: \_\_\_\_\_  
(“the Scheme”)

Registration No. of the Scheme: \_\_\_\_\_

Types of Scheme (indicate by a tick in the appropriate boxes):-

- Defined contribution
- Defined benefit
- Governed by trust
- Subject of or regulated by insurance arrangement
- Participating in a pooling agreement:-  
Yes   
No

If “Yes”, name of pooling agreement: \_\_\_\_\_

- Participating in a group scheme   
(see Paragraph 10 of Registrar's Guidelines):-  
Yes   
No

If “Yes”, name of representative employer: \_\_\_\_\_

Name of employer's auditor: \_\_\_\_\_

Name of administrator's auditor: \_\_\_\_\_

Address of administrator's auditor: \_\_\_\_\_

THE AUDIT OF RETIREMENT SCHEMES

\*I/We, \_\_\_\_\_, of  
(name of employer's auditor)

\_\_\_\_\_  
(address of employer's auditor)

being the employer's auditor duly appointed under section 20(7B)(a) of the Ordinance, hereby state as follows:-

1. \*I/We have completed procedures on the Statement on Details of Contributions (Form B attached) for the financial year ended \_\_\_\_\_ in so far as they relate to the Scheme, having regard to the guidelines issued by the Registrar and in accordance with the pronouncements issued by Hong Kong Institute of Certified Public Accountants.
2. Based on these procedures in \*my/our opinion:-
  - (a) proper accounts and records \*have/have not been kept in relation to contributions; and
  - (b) the Statement on Details of Contributions is in accordance with the books and records of the relevant employer (\*except as noted here-under):-

\_\_\_\_\_  
(Signed)  
(Name of employer's auditor)

\_\_\_\_\_  
(Date)

\_\_\_\_\_  
(Place)

\* Delete whichever is not applicable.

(This Form and the attached Form B should be returned directly to the administrator's auditor.)