



# MEMBERS' HANDBOOK

## Update No. 232

(Issued 30 September 2019)

<b>Document Reference and Title</b>	<b>Instructions</b>	<b>Explanations</b>
<b>VOLUME III</b>		
<a href="#">Contents of Volume III</a>	Discard the existing pages i - v and replace with the revised pages i - v.	Revised contents pages
<a href="#">Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Clarified)</a>	Replace cover page, pages 2, 3 and 19 with revised cover page, pages 2, 3 and 19.	Note 1
<b>HONG KONG STANDARDS ON QUALITY CONTROL</b>		
<a href="#">HKSQC 1 (Clarified) Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements</a>	Replace cover page, pages 7, 16, 17 and 27 with revised cover page, pages 7, 16, 17 and 27.	- ditto -
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<a href="#"><u>HKSA 250 (Revised) Consideration of Laws and Regulations in an Audit of Financial Statements</u></a>	Replace cover page and pages 2, 10, 12, 16 and 18 with revised cover page and pages 2, 10, 12, 16 and 18.	- ditto -
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<a href="#"><u>HKSA 610 (Revised 2013) Using the Work of Internal Auditors</u></a>	Replace cover page, pages 2, 11 and 15 with revised cover page, pages 2, 11 and 15.	- ditto -
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## HONG KONG STANDARDS ON RELATED SERVICES

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## PRACTICE NOTES

<a href="#"><u>PN 620.2 (Revised), Communication between the Auditor and the Insurance Authority</u></a>	Discard PN 620.2 revised in January 2018 and replace with PN 620.2 (Revised) revised in September 2019.	Note 2
<a href="#"><u>PN 810.1 (Revised), Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules</u></a>	Insert after PN 810 (Revised) revised in January 2018.	- ditto -
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PN 830 (Revised), <i>Reports by the Auditor under the Banking Ordinance</i>	Discard PN 830 (Revised) revised in April 2016.	Note 3

## HONG KONG AUDITING PRACTICE GUIDANCE

<a href="#"><u>HKAPG 1000 Special Considerations in Auditing Financial Instruments</u></a>	Replace cover page, pages 2, 24 and 45 with revised cover page, pages 2, 24 and 45.	Note 1
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### Notes:

1. Conforming amendments as a result of *Code of Ethics for Professional Accountants* (“revised Code”). These conforming amendments which became effective on 15 June 2019 have the same effective date as the revised Code.

In order for readers to easily identify all the changes, the marked-ups to the relevant standards are posted at: <https://www.hkicpa.org.hk/-/media/Document/SSD/update/232note1.pdf>

2. In April 2019, the Insurance Authority issued the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules (“Rules”) under section 129 of the Insurance Ordinance (Cap. 44)(“Ordinance”) to provide guidance to licensed insurance broker companies under the new regulatory regime. The Rules will replace the Guideline on Minimum

Requirements for Insurance Brokers (“Minimum Requirements”) which ceased to be effective on 23 September.

PNs 620.2, 810.1 and 810.2 are revised to incorporate the changes arising from the Rules which came into operation on 23 September 2019. Other than the changes to the names of the Rules and section numbers, please also note the following:

PN 620.2 (Revised), *Communication between the Auditor and the Insurance Authority*

- Extant paragraph 52 is amended and revised as paragraph 54 to reflect IA's expectation on communication with auditors on compliance matters of an authorized insurer/licensed insurance broker company

PN 810.1 (Revised), *Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules*

- The practice note is renamed to "Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules";
- References to the Minimum Requirements are replaced by those of the Rules;
- Recommended audit procedures in extant Appendix 1 are updated for reporting under the Rules;
- Extant Appendix 2 is updated to provide examples of unmodified limited assurance report for a licensed insurance broker company's compliance with the Rules;
- Extant Appendix 5 is renamed as Appendix 3 and is revised to provide examples of suggested modified wording for a report by an auditor where a licensed insurance broker company has not complied with the Rules; and
- Extant Appendix 3 (example report for an incorporated insurance broker which is a member of an approved body of insurance brokers on compliance with the Minimum Requirements) and Appendix 4 (example of a report of factual finding for an approved body of insurance brokers on compliance with the Minimum Requirements by its constituent members) are no longer applicable under the new regulatory regime and are removed from the practice note.

For ease of reference, key revisions relating to regulatory requirements are double underlined in paragraphs 14, 16 to 19, 33, 41 to 42, 51 to 54 of the practice note.

Practice Note 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Ordinance*

- Paragraphs 2, 5, 7, 56 to 58 are revised to align references to the relevant provisions of the Amendment Ordinance.

In order for readers to easily identify all the changes, the marked-up version of the updated PNs is posted at: <https://www.hkicpa.org.hk/-/media/Document/SSD/update/232note2.pdf>

3. PN 830 (Revised) is superseded by PN 830 (Revised), *Reports by the Auditor under the Banking Ordinance* revised in December 2018.



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Glossary  
Issued September 2009; revised July 2010, December 2012,  
February 2015, September 2019

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Effective as of 15 December 2009

# **Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services**



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

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# GLOSSARY OF TERMS RELATING TO HONG KONG STANDARDS ON QUALITY CONTROL, AUDITING, REVIEW, OTHER ASSURANCE AND RELATED SERVICES <sup>1</sup>

(September 2019)

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*Access controls* - Procedures designed to restrict access to on-line terminal devices, programs and data. Access controls consist of "user authentication" and "user authorization." "User authentication" typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. "User authorization" consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect:

- (a) Unauthorized access to on-line terminal devices, programs and data;
- (b) Entry of unauthorized transactions;
- (c) Unauthorized changes to data files;
- (d) The use of computer programs by unauthorized personnel; and
- (e) The use of computer programs that have not been authorized.

\**Accounting estimate* - An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where HKSA 540 <sup>2</sup> addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

\**Accounting records* - The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

*Agreed-upon procedures engagement* - An engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures may misinterpret the results.

\**Analytical procedures* - Evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

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\* Denotes a term defined in the HKSAs.

† Denotes a term defined in HKSQC 1.

<sup>1</sup> In the case of public sector engagements, the terms in this glossary should be read as referring to their public sector equivalents.

Where accounting terms have not been defined in the pronouncements of the Hong Kong Institute of Certified Public Accountants, reference should be made to the Glossary of Terms published by the Hong Kong Institute of Certified Public Accountants.

<sup>2</sup> HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

*Purchased offset* - An emissions deduction in which the entity pays for the lowering of another entity's emissions (emissions reductions) or the increasing of another entity's removals (removal enhancements), compared to a hypothetical baseline.

*Quantification* - The process of determining the quantity of GHGs that relate to the entity, either directly or indirectly, as emitted (or removed) by particular sources (or sinks).

\*†*Reasonable assurance (in the context of audit engagements, and in quality control)* - A high, but not absolute, level of assurance.

*Reasonable assurance engagement* - (see *Assurance engagement*)

*Recalculation* - Consists of checking the mathematical accuracy of documents or records.

\**Related party* - A party that is either:

- (a) A related party as defined in the applicable financial reporting framework; or
- (b) Where the applicable financial reporting framework establishes minimal or no related party requirements:
  - (i) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
  - (ii) Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
  - (iii) Another entity that is under common control with the reporting entity through having:
    - a. Common controlling ownership;
    - b. Owners who are close family members; or
    - c. Common key management.

However, entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

*Related services* - Comprise agreed-upon procedures and compilations.

\*†*Relevant ethical requirements* - Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Chapter A, Parts 1, 3, 4A and 4B, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) together with national requirements that are more restrictive. In the context of HKSRE 2400 (Revised), relevant ethical requirements are defined as the ethical requirements the engagement team is subject to when undertaking review engagements. These requirements ordinarily comprise Chapter A, Parts 1, 3 and 4A, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code), together with national requirements that are more restrictive. In the context of HKSRS 4410 (Revised), relevant ethical requirements are defined as the ethical requirements the engagement team is subject to when undertaking compilation engagements. These requirements ordinarily comprise Chapter A, Parts 1 and 3, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code), together with national requirements that are more restrictive.

*Removal* - The GHGs that the entity has, during the period, removed from the atmosphere, or that would have been emitted to the atmosphere had they not been captured and channeled to a sink.

HKSQC 1  
Issued June 2009; revised July 2010, May 2013, February 2015,  
January 2019, September 2019

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Effective as of 15 December 2009

*Hong Kong Standard on Quality Control 1*

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# **Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements**



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

- (q) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Chapter A, Parts 1, 3, 4A and 4B, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) together with national requirements that are more restrictive.
- (r) Staff – Professionals, other than partners, including any experts the firm employs.
- (s) Suitably qualified external person – An individual outside the firm with the competence and capabilities to act as an engagement partner, for example, a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

## Requirements

### Applying, and Complying with, Relevant Requirements

- 13. Personnel within the firm responsible for establishing and maintaining the firm's system of quality control shall have an understanding of the entire text of this HKSQC, including its application and other explanatory material, to understand its objective and to apply its requirements properly.
- 14. The firm shall comply with each requirement of this HKSQC unless, in the circumstances of the firm, the requirement is not relevant to the services provided in respect of audits and reviews of financial statements, and other assurance and related services engagements. (Ref: Para. A1)
- 15. The requirements are designed to enable the firm to achieve the objective stated in this HKSQC. The proper application of the requirements is therefore expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm shall consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this HKSQC to meet the stated objective.

### Elements of a System of Quality Control

- 16. The firm shall establish and maintain a system of quality control that includes policies and procedures that address each of the following elements:
  - (a) Leadership responsibilities for quality within the firm.
  - (b) Relevant ethical requirements.
  - (c) Acceptance and continuance of client relationships and specific engagements.
  - (d) Human resources.
  - (e) Engagement performance.
  - (f) Monitoring.
- 17. The firm shall document its policies and procedures and communicate them to the firm's personnel. (Ref: Para. A2-A3)



## Conformity and Compliance with International Standards on Quality Control

60. As of September 2019, this HKSQC conforms with International Standard on Quality Control (ISQC) 1 "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSQC ensures compliance with ISQC 1.

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## Application and Other Explanatory Material

### Applying, and Complying with, Relevant Requirements

#### *Considerations Specific to Smaller Firms* (Ref: Para. 14)

- A1. This HKSQC does not call for compliance with requirements that are not relevant, for example, in the circumstances of a sole practitioner with no staff. Requirements in this HKSQC such as those for policies and procedures for the assignment of appropriate personnel to the engagement team (see paragraph 31), for review responsibilities (see paragraph 33), and for the annual communication of the results of monitoring to engagement partners within the firm (see paragraph 53) are not relevant in the absence of staff.

#### **Elements of a System of Quality Control** (Ref: Para. 17)

- A2. In general, communication of quality control policies and procedures to firm personnel includes a description of the quality control policies and procedures and the objectives they are designed to achieve, and the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. Encouraging firm personnel to communicate their views or concerns on quality control matters recognizes the importance of obtaining feedback on the firm's system of quality control.

#### *Considerations Specific to Smaller Firms*

- A3. Documentation and communication of policies and procedures for smaller firms may be less formal and extensive than for larger firms.

### Leadership Responsibilities for Quality within the Firm

#### *Promoting an Internal Culture of Quality* (Ref: Para. 18)

- A4. The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures, and the requirement to:
- (a) perform work that complies with professional standards and applicable legal and regulatory requirements; and
  - (b) issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards high quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support

and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

- A5. Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Promoting such an internal culture includes:
- (a) Establishment of policies and procedures that address performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, in order to demonstrate the firm's overriding commitment to quality;
  - (b) Assignment of management responsibilities so that commercial considerations do not override the quality of work performed; and
  - (c) Provision of sufficient resources for the development, documentation and support of its quality control policies and procedures.

*Assigning Operational Responsibility for the Firm's System of Quality Control (Ref: Para. 19)*

- A6. Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

**Relevant Ethical Requirements**

*Compliance with Relevant Ethical Requirements (Ref: Para. 20)*

- A7. The Code establishes the fundamental principles of professional ethics, which include:
- (a) Integrity;
  - (b) Objectivity;
  - (c) Professional competence and due care;
  - (d) Confidentiality; and
  - (e) Professional behavior.
- A8. Chapter A, Part 2 and Chapter C of the Code illustrates how the conceptual framework is to be applied in specific situations. It provides examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles and also provides examples of situations where safeguards are not available to address the threats.
- A9. The fundamental principles are reinforced in particular by:
- The leadership of the firm;
  - Education and training;
  - Monitoring; and
  - A process for dealing with non-compliance.

Considerations specific to public sector audit organizations

- A51. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

*Differences of Opinion* (Ref: Para. 43)

- A52. Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.
- A53. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

*Engagement Documentation*

Completion of the Assembly of Final Engagement Files (Ref: Para. 45)

- A54. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement is to be completed. Where no such time limits are prescribed in law or regulation, paragraph 45 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.
- A55. Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation (Ref: Para. 46)

- A56. Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there are responsibilities under law, regulation or relevant ethical requirements to do so.<sup>6</sup> Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.
- A57. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that:
- Enable the determination of when and by whom engagement documentation was created, changed or reviewed;

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<sup>6</sup> See, for example, Chapter A, Part 1, paragraph 114.1 A1 and Part 3, paragraph R360.26 of the Code.

Framework  
Issued March 2014; revised September 2019

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# Hong Kong Framework for Assurance Engagements



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## Ethical Principles and Quality Control Standards

5. Quality control within firms that perform assurance engagements, and compliance with ethical principles, including independence requirements, are widely recognized as being in the public interest and an integral part of high-quality assurance engagements. Such engagements are performed in accordance with HKSAAs, which are premised on the basis that:
  - (a) The members of the engagement team and the engagement quality control reviewer (for those engagements where one has been appointed) are subject to Chapter A, Parts 1, 3, 4A and 4B, and Chapter C of the Code related to assurance engagements, or other professional requirements, or requirements in law or regulation, that are at least demanding; and
  - (b) The practitioner performing the engagement is a member of a firm that is subject to HKSQC 1,<sup>2</sup> or other professional requirements, or requirements in law or regulation, regarding the firm's responsibility for its system of quality control, that are at least as demanding as HKSQC 1.

### *The Code*<sup>2a</sup>

6. Chapter A, Part 1 of the Code establishes the following fundamental principles with which the practitioner is required to comply:
  - (a) Integrity;
  - (b) Objectivity;
  - (c) Professional competence and due care;
  - (d) Confidentiality; and
  - (e) Professional behaviour.
7. Chapter A, Part 1 also provides a conceptual framework for professional accountants to apply to identify threats to compliance with the fundamental principles, evaluate the significance of the threats identified, and apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.
8. Chapter A, Part 3 of the Code describes how the conceptual framework in Chapter A, Part 1 applies in certain situations to professional accountants in public practice, including independence. The Code defines independence as comprising both independence of mind and independence in appearance. Independence safeguards the ability to form an assurance conclusion without being affected by influences that might compromise that conclusion. Independence enhances the ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

### *HKSQC 1*

9. HKSQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for assurance engagements. Compliance with HKSQC 1 requires, among other things, that the firm establish and maintain a system of quality control that includes policies and procedures addressing each of the following elements, and that it documents its policies and procedures and communicates them to the firm's personnel:
  - (a) Leadership responsibilities for quality within the firm;

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<sup>2</sup> Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>2a</sup> The Code has an additional Chapter C, which are either local application or represent an amplification of provisions in Chapter A. There are relevant sections in Chapter A, Parts 1 and 3 for which there are additional requirements in Chapter C or additional local requirements.

HKSA 200  
Issued June 2009; revised July 2010, May 2013, February 2015,  
January 2016, June 2017, September 2019

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Effective for audits of financial statements  
for periods beginning on or after 15 December 2009

*Hong Kong Standard on Auditing 200*

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# **Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing**



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### *Complying with Relevant Requirements*

22. Subject to paragraph 23, the auditor shall comply with each requirement of an HKSA unless, in the circumstances of the audit:
- (a) The entire HKSA is not relevant; or
  - (b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A74-A75)
23. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an HKSA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Ref: Para. A76)

### *Failure to Achieve an Objective*

24. If an objective in a relevant HKSA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the HKSAs, to modify the auditor's opinion or withdraw from the engagement (where withdrawal is possible under applicable law or regulation). Failure to achieve an objective represents a significant matter requiring documentation in accordance with HKSA 230.<sup>4</sup> (Ref: Para. A77-A78)

## **Conformity and Compliance with International Standards on Auditing**

25. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the forgoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 200.

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## **Application and Other Explanatory Material**

### **An Audit of Financial Statements**

#### *Scope of the Audit* (Ref: Para. 3)

- A1. The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the HKSAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

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<sup>4</sup> HKSA 230, *Audit Documentation*, paragraph 8(c)

required is on whether the financial statements are prepared, in all material respects, in accordance with the framework. Unless specifically stated otherwise, references in the HKSA to the auditor's opinion cover both forms of opinion.

## Definitions

### *Financial Statements* (Ref: Para. 13(f))

- A14. Some financial reporting frameworks may refer to an entity's economic resources or obligations in other terms. For example, these may be referred to as the entity's assets and liabilities, and the residual difference between them may be referred to as equity or equity interests.
- A15. Explanatory or descriptive information required to be included in the financial statements by the applicable financial reporting framework may be incorporated therein by cross-reference to information in another document, such as a management report or a risk report. "Incorporated therein by cross-reference" means cross-referenced from the financial statements to the other document, but not from the other document to the financial statements. Where the applicable financial reporting framework does not expressly prohibit the cross-referencing of where explanatory or descriptive information may be found, and the information has been appropriately cross-referenced, the information will form part of the financial statements.

### **Ethical Requirements Relating to an Audit of Financial Statements** (Ref: Para. 14)

- A16. The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise Chapter A, Parts 1, 3 and 4A, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to an audit of financial statements together with national requirements that are more restrictive.
- A17. Chapter A, Part 1 of the Code establishes the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles. The fundamental principles with which the auditor is required to comply by the Code are:
- (a) Integrity;
  - (b) Objectivity;
  - (c) Professional competence and due care;
  - (d) Confidentiality; and
  - (e) Professional behavior.

Chapter A, Part 3, and Chapter C of the Code illustrate how the conceptual framework is to be applied in specific situations.

- A18. In the case of an audit engagement it is in the public interest and, therefore, required by the Code, that the auditor be independent of the entity subject to the audit. The Code describes independence as comprising both independence of mind and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

HKSA 220  
Issued June 2009; revised July 2010, May 2013,  
February 2015, August 2015, June 2017, January 2019, September 2019

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Effective for audits of financial statements  
for periods beginning on or after 15 December 2009

*Hong Kong Standard on Auditing 220*

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# **Quality Control for an Audit of Financial Statements**



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- (ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.
- (k) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
- (l) Personnel – Partners and staff.
- (m) Professional standards – HKICPA engagement standards, as defined in the HKICPA's *Preface to the Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, and relevant ethical requirements.
- (n) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Chapter A, Parts 1, 3 and 4A, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to an audit of financial statements.
- (o) Staff – Professionals, other than partners, including any experts the firm employs.
- (p) Suitably qualified external person – An individual outside the firm with the competence and capabilities to act as an engagement partner, for example, a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits of historical financial information or of an organization that provides relevant quality control services.

## Requirements

### Leadership Responsibilities for Quality on Audits

8. The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. (Ref: Para. A3)

### Relevant Ethical Requirements

9. Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. (Ref: Para. A4-A5)
10. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action. (Ref: Para. A5)

### Independence

11. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall: (Ref: Para. A5)
  - (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

## Conformity and Compliance with International Standards on Auditing

26. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 220.

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## Application and Other Explanatory Material

### System of Quality Control and Role of Engagement Teams (Ref: Para. 2)

- A1. HKSQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.

HKSQC 1 contains requirements which are at least as demanding as its international equivalent, ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*<sup>\*</sup>, as it addresses all the elements referred to in ISQC 1 and imposes obligations on the firm that achieve the aims of the requirements set out in ISQC 1.

### Reliance on the Firm's System of Quality Control (Ref: Para. 4)

- A2. Unless information provided by the firm or other parties suggest otherwise, the engagement team may rely on the firm's system of quality control in relation to, for example:
- Competence of personnel through their recruitment and formal training.
  - Independence through the accumulation and communication of relevant independence information.
  - Maintenance of client relationships through acceptance and continuance systems.
  - Adherence to applicable legal and regulatory requirements through the monitoring process.

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\* Issued by the International Auditing and Assurance Standards Board.

that case, as required by paragraph 11(c), the engagement partner reports to the relevant person(s) within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is possible under applicable law or regulation.

#### Considerations Specific to Public Sector Entities

- A7. Statutory measures may provide safeguards for the independence of public sector auditors. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 11. This may include, where the public sector auditor's mandate does not permit withdrawal from the engagement, disclosure through a public report, of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

#### Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 12)

- A8. HKSQC 1 requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.<sup>6</sup> Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- Whether the firm and the engagement team can comply with relevant ethical requirements; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

- A9. Law, regulation, or relevant ethical requirements<sup>7</sup> may require the auditor to request, prior to accepting the engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected non-compliance with laws and regulations to the proposed successor auditor. For example, where the predecessor auditor has withdrawn from the engagement as a result of identified or suspected non-compliance with laws and regulations, the Code requires that the predecessor auditor, on request by a proposed successor auditor, provides all such facts and other information concerning such non-compliance that, in the predecessor auditor's opinion, the proposed successor auditor needs to be aware of before deciding whether to accept the audit appointment.<sup>8</sup>

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<sup>6</sup> HKSQC 1, paragraph 27(a)

<sup>7</sup> See, for example, Chapter A, Part 3, paragraph R320.8 of the Code.

<sup>8</sup> See, for example, Chapter A, Part 3, paragraphs R360.22, 360.22 A1, R360.23 and 360.23 A1 of the Code.



HKSA 240  
Issued July 2009; revised July 2010, May 2013, February 2015,  
January 2016, June 2017, January 2019, September 2019

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Effective for audits of financial statements  
for periods beginning on or after 15 December 2009

*Hong Kong Standard on Auditing 240*

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# **The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements**



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### Reporting Fraud to an Appropriate Authority Outside the Entity <sup>11a</sup>

44. If the auditor has identified or suspects a fraud, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A67-A69)
- (a) Require the auditor to report to an appropriate authority outside the entity.
  - (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

### Documentation

45. The auditor shall include the following in the audit documentation <sup>12</sup> of the auditor's understanding of the entity and its environment and the assessment of the risks of material misstatement required by HKSA 315 (Revised):<sup>13</sup>
- (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; and
  - (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level.
46. The auditor shall include the following in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by HKSA 330:<sup>14</sup>
- (a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and
  - (b) The results of the audit procedures, including those designed to address the risk of management override of controls.
47. The auditor shall include in the audit documentation communications about fraud made to management, those charged with governance, regulators and others.
48. If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall include in the audit documentation the reasons for that conclusion.

### Conformity and Compliance with International Standards on Auditing

49. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 240.
50. Additional local explanation is provided in footnote 11a, 25a and local guidance is provided in Appendix

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<sup>11a</sup> Additional local guidance is provided in Appendix 4.

<sup>12</sup> HKSA 230, *Audit Documentation*, paragraphs 8-11, and paragraph A6

<sup>13</sup> HKSA 315 (Revised), paragraph 32

<sup>14</sup> HKSA 330, paragraph 28

- Omitting, obscuring or misstating disclosures required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation.
- Concealing facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- Altering records and terms related to significant and unusual transactions.

A5. Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

### **Responsibility for the Prevention and Detection of Fraud**

*Responsibilities of the Auditor* (Ref: Para. 9)

A6. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the HKICPA's *Code of Ethics for Professional Accountants* (the Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the communication of identified or suspected non-compliance with laws and regulations to other auditors within a group, including a group engagement partner, component auditors or other auditors performing work at components of a group for purposes other than the audit of the group financial statements.<sup>15</sup>

*Considerations Specific to Public Sector Entities*

A7. The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.

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<sup>15</sup> See, for example, Chapter A, Part 3, paragraphs R360.16, 360.16 A1, R360.17, R360.18 and 360.18 A1 of the Code.

HKSA 250 (Revised)  
Issued June 2017; revised September 2019

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Effective for audits of financial statements  
for periods beginning on or after 15 December 2017

*Hong Kong Standard on Auditing 250 (Revised)*

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# **Consideration of Laws and Regulations in an Audit of Financial Statements**



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## Documentation

30. The auditor shall include in the audit documentation<sup>8</sup> identified or suspected non-compliance with laws and regulations and: (Ref: Para. A35–A36)
- (a) The audit procedures performed, the significant professional judgments made and the conclusions reached thereon; and
  - (b) The discussions of significant matters related to the non-compliance with management, those charged with governance and others, including how management and, where applicable, those charged with governance have responded to the matter.

## Conformity and Compliance with International Standards on Auditing

31. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 250. ISA 250 (Revised) has received the approval of the Public Interest Oversight Board (PIOB) which concluded that due process was followed in the development of the standard and that proper regard was paid to the public interest.
32. Additional local explanation is provided in footnotes 13a and 16a.

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## Application and Other Explanatory Material

### Responsibility for Compliance with Laws and Regulations (Ref: Para. 3–9)

- A1. 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 laws and regulations. Laws and regulations may affect an entity's financial statements in different ways: for example, most directly, they may affect specific disclosures required of the entity in the financial statements or they may prescribe the applicable financial reporting framework. They may also establish certain legal rights and obligations of the entity, some of which will be recognized in the entity's financial statements. In addition, laws and regulations may impose penalties in cases of non-compliance.
- A2. The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:
- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
  - Instituting and operating appropriate systems of internal control.
  - Developing, publicizing and following a code of conduct.
  - Ensuring employees are properly trained and understand the code of conduct.
  - Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
  - Engaging legal advisors to assist in monitoring legal requirements.

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<sup>8</sup> HKSA 230, *Audit Documentation*, paragraphs 8–11, and A6

- Environmental protection.
- Public health and safety.

#### Considerations Specific to Public Sector Entities

A7. In the public sector, there may be additional audit responsibilities with respect to the consideration of laws and regulations which may relate to the audit of financial statements or may extend to other aspects of the entity's operations.

#### Additional Responsibilities Established by Law, Regulation or Relevant Ethical Requirements (Ref: Para. 9)

A8. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the HKICPA's *Code of Ethics for Professional Accountants* (the Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the communication of identified or suspected non-compliance with laws and regulations to other auditors within a group, including a group engagement partner, component auditors or other auditors performing work at components of a group for purposes other than the audit of the group financial statements.<sup>11</sup>

#### Definition (Ref: Para. 12)

- A9. Acts of non-compliance with laws and regulations include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, by management or by other individuals working for or under the direction of the entity.
- A10. Non-compliance also includes personal misconduct related to the business activities of the entity, for example, in circumstances where an individual in a key management position, in a personal capacity, has accepted a bribe from a supplier of the entity and in return secures the appointment of the supplier to provide services or contracts to the entity.

### The Auditor's Consideration of Compliance with Laws and Regulations

#### *Obtaining an Understanding of the Legal and Regulatory Framework* (Ref: Para. 13)

- A11. To obtain a general understanding of the legal and regulatory framework, and how the entity complies with that framework, the auditor may, for example:
- Use the auditor's existing understanding of the entity's industry, regulatory and other external factors;
  - Update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;
  - Inquire of management as to other laws or regulations that may be expected to have a fundamental effect on the operations of the entity;
  - Inquire of management concerning the entity's policies and procedures regarding compliance with laws and regulations; and
  - Inquire of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation claims.

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<sup>11</sup> See Chapter A, Part 3, paragraphs R360.16, 360.16 A1, R360.17, R360.18 and 360.18 A1 of the Code.



*Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)*

- A23. As required by paragraph 22, the auditor evaluates the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular identified or suspected non-compliance will depend on the relationship of the perpetration and concealment, if any, of the act to specific control activities and the level of management or individuals working for, or under the direction of, the entity involved, especially implications arising from the involvement of the highest authority within the entity. As noted in paragraph 9, the auditor's compliance with law, regulation or relevant ethical requirements may provide further information that is relevant to the auditor's responsibilities in accordance with paragraph 22.
- A24. Examples of circumstances that may cause the auditor to evaluate the implications of identified or suspected non-compliance on the reliability of written representations received from management and, where applicable, those charged with governance include when:
- The auditor suspects or has evidence of the involvement or intended involvement of management and, where applicable, those charged with governance in any identified or suspected non-compliance.
  - The auditor is aware that management and, where applicable, those charged with governance have knowledge of such non-compliance and, contrary to legal or regulatory requirements, have not reported, or authorized reporting of, the matter to an appropriate authority within a reasonable period.
- A25. In certain circumstances, the auditor may consider withdrawing from the engagement, where permitted by law or regulation, for example when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances or the identified or suspected non-compliance raises questions regarding the integrity of management or those charged with governance, even when the non-compliance is not material to the financial statements. The auditor may consider it appropriate to obtain legal advice to determine whether withdrawal from the engagement is appropriate. When the auditor determines that withdrawing from the engagement would be appropriate, doing so would not be a substitute for complying with other responsibilities under law, regulation or relevant ethical requirements to respond to identified or suspected non-compliance. Furthermore, paragraph A9 of HKSA 220<sup>14</sup> indicates that some ethical requirements may require the predecessor auditor, upon request by the proposed successor auditor, to provide information regarding non-compliance with laws and regulations to the successor auditor.

**Communicating and Reporting Identified or Suspected Non-Compliance**

*Potential Implications of Identified or Suspected Non-Compliance for the Auditor's Report (Ref: Para. 26–28)*

- A26. Identified or suspected non-compliance with laws and regulation is communicated in the auditor's report when the auditor modifies the opinion in accordance with paragraphs 26–28. In certain other circumstances, the auditor may communicate identified or suspected non-compliance in the auditor's report, for example:

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<sup>14</sup> HKSA 220, *Quality Control for an Audit of Financial Statements*

jurisdictions, the auditor may be required to report misstatements to an appropriate authority in cases where management or those charged with governance fail to take corrective action.

- A30. In other cases, the relevant ethical requirements may require the auditor to determine whether reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity is an appropriate action in the circumstances. For example, the Code requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed, which may include reporting to an appropriate authority outside the entity.<sup>17</sup> The Code explains that such reporting would not be considered a breach of the duty of confidentiality under the Code.<sup>18</sup>
- A31. Even if law, regulation or relevant ethical requirements do not include requirements that address reporting identified or suspected non-compliance, they may provide the auditor with the right to report identified or suspected non-compliance to an appropriate authority outside the entity. For example, when auditing the financial statements of financial institutions, the auditor may have the right under law or regulation to discuss matters such as identified or suspected non-compliance with laws and regulations with a supervisory authority.
- A32. In other circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the auditor's duty of confidentiality under law, regulation or relevant ethical requirements.
- A33. The determination required by paragraph 29 may involve complex considerations and professional judgments. Accordingly the auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor's options and the professional or legal implications of taking any particular course of action.

#### Considerations Specific to Public Sector Entities

- A34. A public sector auditor may be obliged to report on identified or suspected non-compliance to the legislature or other governing body or to report them in the auditor's report.

#### **Documentation** (Ref: Para. 30)

- A35. The auditor's documentation of findings regarding identified or suspected non-compliance with laws and regulations may include, for example:
- Copies of records or documents.
  - Minutes of discussions held with management, those charged with governance or parties outside the entity.
- A36. Law, regulation or relevant ethical requirements may also set out additional documentation requirements regarding identified or suspected non-compliance with laws and regulations.<sup>19</sup>

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<sup>17</sup> See, for example, Chapter A, Part 3, paragraphs 360.21 A1 and 360.25 A1 – R360.27 of the Code.

<sup>18</sup> See, for example, Chapter A, Part 1, paragraph 114.1 A1 and Part 3, paragraph R360.26 of the Code.

<sup>19</sup> See, for example, Chapter A, Part 3, paragraph R360.28 of the Code.

HKSA 260 (Revised)  
Issued August 2015; revised January 2016, June 2017,  
January 2019, September 2019

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

*Hong Kong Standard on Auditing 260 (Revised)*

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# **Communication with Those Charged with Governance**



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would not be adequate. Written communications need not include all matters that arose during the course of the audit. (Ref: Para. A46–A48)

20. The auditor shall communicate in writing with those charged with governance regarding auditor independence when required by paragraph 17.

#### *Timing of Communications*

21. The auditor shall communicate with those charged with governance on a timely basis. (Ref: Para. A49–A50)

#### *Adequacy of the Communication Process*

22. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action. (Ref: Para. A51–A53)

#### **Documentation**

23. Where matters required by this HKSA to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.<sup>2</sup> (Ref: Para. A54)

#### **Conformity and Compliance with International Standards on Auditing**

24. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 260 (Revised), *Communication with Those Charged with Governance* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 260 (Revised).
25. Additional local guidance is provided in footnotes 1a and 1b.

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#### **Application and Other Explanatory Material**

##### **Those Charged with Governance** (Ref: Para. 11)

- A1. Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:
- In some jurisdictions, a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a "two-tier board" structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a "one-tier board" structure).
  - In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. In others, for example, some government entities, a body that is not part of the entity is charged with governance.

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<sup>2</sup> HKSA 230, *Audit Documentation*, paragraphs 8–11, and A6

- A27. Other significant matters arising during the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material misstatements of the other information that have been corrected.
- A28. To the extent not already addressed by the requirements in paragraphs 16(a)–(d) and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with HKSA 220.<sup>23</sup>

*Auditor Independence* (Ref: Para. 17)

- A29. The auditor is required to comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.<sup>24</sup>
- A30. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:
- (a) Threats to independence, which may be categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and
  - (b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm's own systems and procedures.
- A31. Relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances where breaches of independence requirements have been identified. For example, the HKICPA's *Code of Ethics for Professional Accountants* (the Code) requires the auditor to communicate with those charged with governance in writing about any breach and the action the firm has taken or proposes to take.<sup>25</sup>
- A32. The communication requirements relating to auditor independence that apply in the case of listed entities may also be appropriate in the case of some other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the nature and size of the business. Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities. On the other hand, there may be situations where communications regarding independence may not be relevant, for example, where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where the entity is owner-managed, and the auditor's firm and network firms have little involvement with the entity beyond a financial statement audit.

*Supplementary Matters* (Ref: Para. 3)

- A33. The oversight of management by those charged with governance includes ensuring that the entity designs, implements and maintains appropriate internal control with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

<sup>23</sup> See paragraphs 19–22 and A23–A32 of HKSA 220, *Quality Control for an Audit of Financial Statements*.

<sup>24</sup> HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraph 14

<sup>25</sup> See Chapter A, Part 4A, paragraphs R400.80 – R400.89 of the Code, which address breaches of independence.

HKSA 610 (Revised 2013)  
Revised July 2012, December 2012, May 2013, September 2019

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*Hong Kong Standard on Auditing 610 (Revised 2013)*

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# **Using the Work of Internal Auditors**

## **and Related Conforming Amendments**



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37. If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:
- (a) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;
  - (b) The basis for the decision regarding the nature and extent of the work performed by the internal auditors;
  - (c) Who reviewed the work performed and the date and extent of that review in accordance with HKSA 230;<sup>11</sup>
  - (d) The written agreements obtained from an authorized representative of the entity and the internal auditors under paragraph 33 of this HKSA; and
  - (e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

### Conformity and Compliance with International Standards on Auditing

38. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 610 (Revised 2013), *Using the Work of Internal Auditors* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 610 (Revised 2013).
39. Additional local guidance is provided in footnote 1a.

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### Application and Other Explanatory Material

#### Definition of Internal Audit Function (Ref: Para. 2, 14(a))

- A1. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

#### *Activities Relating to Governance*

- The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

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<sup>11</sup> HKSA 230, *Audit Documentation*



Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

- A10. The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.
- A11. Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:
- The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
  - Whether the internal audit function has appropriate quality control policies and procedures, for example, such as those policies and procedures in HKSQC 1<sup>16</sup> that would be applicable to an internal audit function (such as those relating to leadership, human resources and engagement performance) or quality control requirements in standards set by the relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements such as conducting periodic external quality assessments.

Circumstances When Work of the Internal Audit Function Cannot Be Used (Ref: Para. 16)

- A12. The external auditor's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competence of the internal audit function, and whether it applies a systematic and disciplined approach may indicate that the risks to the quality of the work of the function are too significant and therefore it is not appropriate to use any of the work of the function as audit evidence.
- A13. Consideration of the factors in paragraphs A7, A8 and A11 of this HKSA individually and in aggregate is important because an individual factor is often not sufficient to conclude that the work of the internal audit function cannot be used for purposes of the audit. For example, the internal audit function's organizational status is particularly important in evaluating threats to the objectivity of the internal auditors. If the internal audit function reports to management, this would be considered a significant threat to the function's objectivity unless other factors such as those described in paragraph A7 of this HKSA collectively provide sufficient safeguards to reduce the threat to an acceptable level.
- A14. In addition, the Code<sup>17</sup> states that a self-review threat is created when the external auditor accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the audit. This is because of the possibility that the engagement team will use the results of the internal audit service without properly evaluating those results or without exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. The Code<sup>18</sup> discusses the prohibitions that apply in certain circumstances and the threats and the safeguards that can be applied to reduce the threats to an acceptable level in other circumstances.

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<sup>16</sup> Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>17</sup> The HKICPA's *Code of Ethics for Professional Accountants* (the Code), Chapter A, Part 4A, paragraph R606.4

<sup>18</sup> The Code, Chapter A, Part 4A, paragraphs R605.5 – 606.4 A2

HKSA 700 (Revised)  
Issued August 2015; revised January 2016, August 2016,  
June 2017, September 2019

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

*Hong Kong Standard on Auditing 700 (Revised)*

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# **Forming an Opinion and Reporting on Financial Statements**



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52. When the auditor's report refers to both the other auditing standards and Hong Kong Standards on Auditing, the auditor's report shall identify the jurisdiction of origin of the other auditing standards.

#### **Supplementary Information Presented with the Financial Statements** (Ref: Para. A78–A84)

53. If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.
54. If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.

#### **Conformity and Compliance with International Standards on Auditing**

55. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 700 (Revised).
56. Additional local explanations are provided in footnotes 12a, 14a, 17a, 17b, 25a, 25b, 35a, 36a and 37a.
57. Additional local guidance is provided in the Appendix.

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#### **Application and Other Explanatory Material**

##### **Qualitative Aspects of the Entity's Accounting Practices** (Ref: Para. 12)

- A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
- A2. HKSA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.<sup>19</sup> In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:
- The selective correction of misstatements brought to management's attention during the audit (e.g., correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).

<sup>19</sup> HKSA 260 (Revised), *Communication with Those Charged with Governance*, Appendix 2

X Corporations Act."<sup>25b</sup> HKSA 210 deals with circumstances where there are conflicts between the financial reporting standards and the legislative or regulatory requirements.<sup>26</sup>

- A30. As indicated in paragraph A13, the financial statements may be prepared in accordance with two financial reporting frameworks, which are therefore both applicable financial reporting frameworks. Accordingly, each framework is considered separately when forming the auditor's opinion on the financial statements, and the auditor's opinion in accordance with paragraphs 25–27 refers to both frameworks as follows:
- (a) If the financial statements comply with each of the frameworks individually, two opinions are expressed: that is, that the financial statements are prepared in accordance with one of the applicable financial reporting frameworks (e.g., HKFRSs) and an opinion that the financial statements are prepared in accordance with the other applicable financial reporting framework (e.g., IFRSs). These opinions may be expressed separately or in a single sentence (e.g., the financial statements are presented fairly, in all material respects [...], in accordance with HKFRSs and IFRSs).
  - (b) If the financial statements comply with one of the frameworks but fail to comply with the other framework, an unmodified opinion can be given that the financial statements are prepared in accordance with the one framework (e.g., HKFRSs) but a modified opinion given with regard to the other framework in accordance with HKSA 705 (Revised).
- A31. As indicated in paragraph A15, the financial statements may represent compliance with the applicable financial reporting framework and, in addition, disclose the extent of compliance with another financial reporting framework. Such supplementary information is covered by the auditor's opinion if it cannot be clearly differentiated from the financial statements (see paragraphs 53–54 and related application material in paragraphs A78–A84). Accordingly,
- (a) If the disclosure as to the compliance with the other framework is misleading, a modified opinion is expressed in accordance with HKSA 705 (Revised).
  - (b) If the disclosure is not misleading, but the auditor judges it to be of such importance that it is fundamental to the users' understanding of the financial statements, an Emphasis of Matter paragraph is added in accordance with HKSA 706 (Revised), drawing attention to the disclosure.

#### Basis for Opinion (Ref: Para. 28)

- A32. The Basis for Opinion section provides important context about the auditor's opinion. Accordingly, this HKSA requires the Basis for Opinion section to directly follow the Opinion section in the auditor's report.
- A33. The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards.

#### Relevant ethical requirements (Ref: Para. 28(c))

- A34. The identification of the jurisdiction of origin of relevant ethical requirements increases transparency about those requirements relating to the particular audit engagement. HKSA 200 explains that relevant ethical requirements ordinarily comprise Chapter A, Parts 1, 3 and 4A,

<sup>25b</sup> For companies incorporated in Hong Kong, the applicable Corporations Act is the Hong Kong Companies Ordinance.

<sup>26</sup> HKSA 210, paragraph 18

and Chapter C of the Code related to an audit of financial statements.<sup>27</sup> When the relevant ethical requirements include those of the Code, the statement may also make reference to the Code. If the Code constitutes all of the ethical requirements relevant to the audit, the statement need not identify a jurisdiction of origin.

- A35. In some jurisdictions, relevant ethical requirements may exist in several different sources, such as the ethical code(s) and additional rules and requirements within law and regulation. When the independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant source(s) (e.g., the name of the code, rule or regulation applicable in the jurisdiction), or may refer to a term that is commonly understood and that appropriately summarizes those sources (e.g., independence requirements for audits of private entities in Jurisdiction X).
- A36. Law or regulation, or the terms of an audit engagement may require the auditor to provide in the auditor's report more specific information about the sources of the relevant ethical requirements, including those pertaining to independence, that applied to the audit of the financial statements.
- A37. In determining the appropriate amount of information to include in the auditor's report when there are multiple sources of relevant ethical requirements relating to the audit of the financial statements, an important consideration is balancing transparency against the risk of obscuring other useful information in the auditor's report.

#### Considerations specific to group audits

- A38. In group audits when there are multiple sources of relevant ethical requirements, including those pertaining to independence, the reference in the auditor's report to the jurisdiction ordinarily relates to the relevant ethical requirements that are applicable to the group engagement team. This is because, in a group audit, component auditors are also subject to ethical requirements that are relevant to the group audit.<sup>28</sup>
- A39. The HKSAs do not establish specific independence or ethical requirements for auditors, including component auditors, and thus do not extend, or otherwise override, the independence requirements of the Code or other ethical requirements to which the group engagement team is subject, nor do the HKSAs require that the component auditor in all cases to be subject to the same specific independence requirements that are applicable to the group engagement team. As a result, relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. HKSA 600<sup>29</sup> provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations where the component auditor does not meet the independence requirements that are relevant to the group audit.

#### Key Audit Matters (Ref: Para. 31)

- A40. Law or regulation may require communication of key audit matters for audits of entities other than listed entities, for example, entities characterized in such law or regulation as public interest entities.

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<sup>27</sup> HKSA 200, paragraph A16

<sup>28</sup> HKSA 600, paragraph A37

<sup>29</sup> HKSA 600, paragraphs 19–20

HKSA 720 (Revised)  
Issued August 2015; revised August 2016, June 2017, September 2019

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

*Hong Kong Standard on Auditing 720 (Revised)*

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# **The Auditor's Responsibilities Relating to Other Information**



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## Introduction

### Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to other information, whether financial or non-financial information (other than financial statements and the auditor's report thereon), included in an entity's annual report. An entity's annual report may be a single document or a combination of documents that serve the same purpose.
2. This HKSA is written in the context of an audit of financial statements by an independent auditor. Accordingly, the objectives of the auditor in this HKSA are to be understood in the context of the overall objectives of the auditor as stated in paragraph 11 of HKSA 200<sup>1</sup> The requirements in the HKSAs are designed to enable the auditor to achieve the objectives specified in the HKSAs, and thereby the overall objectives of the auditor. The auditor's opinion on the financial statements does not cover the other information, nor does this HKSA require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.
3. This HKSA requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit may indicate that there is a material misstatement of the financial statements or that a material misstatement of the other information exists, either of which may undermine the credibility of the financial statements and the auditor's report thereon. Such material misstatements may also inappropriately influence the economic decisions of the users for whom the auditor's report is prepared.
4. This HKSA may also assist the auditor in complying with relevant ethical requirements<sup>2</sup> that require the auditor to avoid being knowingly associated with information that the auditor believes contains a materially false or misleading statement, statements or information furnished recklessly, or omits or obscures information required to be included where such omission or obscurity would be misleading.
5. Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail, about amounts or other items in the financial statements, and other amounts or other items about which the auditor has obtained knowledge in the audit. Other information may also include other matters.
6. The auditor's responsibilities relating to other information (other than applicable reporting responsibilities) apply regardless of whether the other information is obtained by the auditor prior to, or after, the date of the auditor's report.
7. This HKSA does not apply to:
  - (a) Preliminary announcements of financial information; or
  - (b) Securities offering documents, including prospectuses.

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<sup>1</sup> HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*

<sup>2</sup> HKICPA's *Code of Ethics for Professional Accountants* (the Code), Chapter A, Part 1, R111.2 and R111.3

## Conformity and Compliance with International Standards on Auditing

26. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 720 (Revised).
27. Additional local guidance is provided in footnote 2a, 2b, 3a and 4a, Appendices 2 and 3.

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## Application and Other Explanatory Material

### Definitions

*Annual Report* (Ref: Para. 12(a))

- A1. Law, regulation or custom may define the content of an annual report, and the name by which it is to be referred, for entities in a particular jurisdiction; however, the content and the name may vary within a jurisdiction and from one jurisdiction to another.
- A2. An annual report is typically prepared on an annual basis. However, when the financial statements being audited are prepared for a period less than or more than a year, an annual report may also be prepared that covers the same period as the financial statements.
- A3. In some cases, an entity's annual report may be a single document and referred to by the title "annual report" or by some other title. In other cases, law, regulation or custom may require the entity to report to owners (or similar stakeholders) information on the entity's operations and the entity's financial results and financial position as set out in the financial statements (i.e., an annual report) by way of a single document, or by way of two or more separate documents that in combination serve the same purpose. For example, depending on law, regulation or custom in a particular jurisdiction, one or more of the following documents may form part of the annual report:
- Management report, management commentary, or operating and financial review or similar reports by those charged with governance (for example, a directors' report<sup>4a</sup>).
  - Chairman's statement.
  - Corporate governance statement.
  - Internal control and risk assessment reports.
- A4. An annual report may be made available to users in printed form, or electronically, including on the entity's website. A document (or combination of documents) may meet the definition of an annual report, irrespective of the manner in which it is made available to users.
- A5. An annual report is different in nature, purpose and content from other reports, such as a report prepared to meet the information needs of a specific stakeholder group or a report prepared to comply with a specific regulatory reporting objective (even when such a report is required to be publicly available). Examples of reports that, when issued as standalone documents, are not typically part of the combination of documents that comprise an annual report (subject to law,

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<sup>4a</sup> According to Schedule 5 of the Hong Kong Companies Ordinance, a director's report of a company incorporated in Hong Kong must contain a business review unless it satisfies the conditions as set out in section 388(3).

materially false or misleading statement, a statement furnished recklessly, or omits or obscures necessary information such that the other information is misleading.<sup>12</sup> Remaining alert for other indications that the other information appears to be materially misstated could potentially result in the auditor identifying such matters as:

- Differences between the other information and the general knowledge, apart from the knowledge obtained in the audit, of the engagement team member reading the other information that lead the auditor to believe that the other information appears to be materially misstated; or
- An internal inconsistency in the other information that leads the auditor to believe that the other information appears to be materially misstated.

**Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated** (Ref: Para. 16)

- A39. The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.
- A40. Conversely, the discussion with management may provide further information that supports the auditor's conclusion that a material misstatement of the other information exists.
- A41. It may be more difficult for the auditor to challenge management on matters of judgment than on those of a more factual nature. However, there may be circumstances where the auditor concludes that the other information contains a statement that is not consistent with the financial statements or the auditor's knowledge obtained in the audit. These circumstances may raise doubt about the other information, the financial statements, or the auditor's knowledge obtained in the audit.
- A42. As there is a wide range of possible material misstatements of the other information, the nature and extent of other procedures the auditor may perform to conclude whether a material misstatement of the other information exists are matters of the auditor's professional judgment in the circumstances.
- A43. When a matter is unrelated to the financial statements or the auditor's knowledge obtained in the audit, the auditor may not be able to fully assess management's responses to the auditor's inquiries. Nevertheless, based on management's further information or explanations, or following changes made by management to the other information, the auditor may be satisfied that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated. When the auditor is unable to conclude that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated, the auditor may request management to consult with a qualified third party (for example, a management's expert or legal counsel). In certain cases, after considering the responses from management's consultation, the auditor may not be able to conclude whether or not a material misstatement of the other information exists. Actions the auditor may then take include one or more of the following:
- Obtaining advice from the auditor's legal counsel;

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<sup>12</sup> The Code, Chapter A, Part 1, paragraphs R111.2 and R111.3

HKSA 810 (Revised)  
Issued August 2016; revised June 2017, September 2019

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Effective for engagements to report  
on summary financial statements  
for periods ending on or after 15 December 2016

*Hong Kong Standard on Auditing 810 (Revised)*

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# Engagements to Report on Summary Financial Statements



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## Conformity and Compliance with International Standards on Auditing

28. As of September 2019, this HKSA conforms with International Standard on Auditing (ISA) 810 (Revised), *Engagements to Report on Summary Financial Statements* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 810 (Revised).
29. Additional local explanations and guidance are provided in footnotes 2a, 2b, 2c, 2d, 2e, 6a, 6b, 11a and the Appendices 1, 2 and 3.

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## Application and Other Explanatory Material

### Engagement Acceptance (Ref: Para. 5-6)

- A1. The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities in relation to the summary financial statements in accordance with this HKSA. Application of this HKSA will not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor has not also audited the financial statements from which the summary financial statements are derived.
- A2. Management's agreement with the matters described in paragraph 6 may be evidenced by its written acceptance of the terms of the engagement.

### Criteria (Ref: Para. 6(a))

- A3. The preparation of summary financial statements requires management to determine the information that needs to be reflected in the summary financial statements so that they are consistent, in all material respects, with or represent a fair summary of the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure, there is an increased risk that they may not contain the information necessary so as not to be misleading in the circumstances. This risk increases when established criteria for the preparation of summary financial statements do not exist.
- A4. Factors that may affect the auditor's determination of the acceptability of the applied criteria include:
- The nature of the entity;
  - The purpose of the summary financial statements;
  - The information needs of the intended users of the summary financial statements; and
  - Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.
- A5. The criteria for the preparation of summary financial statements may be established by an authorized or recognized standards setting organization or by law or regulation. Similar to the case of financial statements, as explained in HKSA 210,<sup>13</sup> in many such cases, the auditor may presume that such criteria are acceptable.
- A6. Where established criteria for the preparation of summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry. Criteria that are acceptable in the circumstances will result in summary financial statements that:
- (a) Adequately disclose their summarized nature and identify the audited financial statements;

<sup>13</sup> HKSA 210, *Agreeing the Terms of Audit Engagements*, paragraphs A3 and A8-A9

A12. In contrast, paragraphs 14–15 deal with the auditor's responsibilities relating to information included in a document that also contains the summary financial statements and the auditor's report thereon. This information may include:

- Some or all of the same matters as those dealt with in the other information included in the annual report (e.g., when the summary financial statements and the auditor's report thereon are included in a summary annual report); or
- Matters that are not dealt with in the other information included in the annual report.

A13. In reading the information included in a document containing the summary financial statements and the auditor's report thereon, the auditor may become aware that such information is misleading and may need to take appropriate action. Relevant ethical requirements<sup>14</sup> require the auditor to avoid being knowingly associated with information that the auditor believes contains a materially false or misleading statement, statements or information furnished recklessly, or omits or obscures information required to be included where such omission or obscurity would be misleading.

*Information in a Document Containing the Summary Financial Statements that Deals with Some or All of the Same Matters as the Other Information in the Annual Report*

A14. When information is included in a document containing the summary financial statements and the auditor's report thereon and that information deals with some or all of the same matters as the other information included in the annual report, the work performed on that other information in accordance with HKSA 720 (Revised) may be adequate for the purposes of paragraphs 14–15 of this HKSA.

A15. When an uncorrected material misstatement of the other information has been identified in the auditor's report on the audited financial statements and that uncorrected material misstatement relates to a matter that is dealt with in the information in a document containing the summary financial statements and the auditor's report thereon, a material inconsistency between the summary financial statements and that information may exist or the information may be misleading.

*Information in a Document Containing the Summary Financial Statements that Deals with Matters Not Dealt with in the Other Information in the Annual Report*

A16. HKSA 720 (Revised), adapted as necessary in the circumstances, may be helpful to the auditor in determining the appropriate action to respond to management's refusal to make necessary revisions to the information, including considering the implications for the auditor's report on the summary financial statements.

**Auditor's Report on Summary Financial Statements**

*Elements of the Auditor's Report*

Title (Ref: Para. 16(a))

A17. A title indicating the report is the report of an independent auditor, for example, "Report of the Independent Auditor," affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others.

Addressee (Ref: Para. 16(b), 17)

A18. Factors that may affect the auditor's evaluation of the appropriateness of the addressee of the summary financial statements include the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

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<sup>14</sup> HKICPA's *Code of Ethics for Professional Accountants* (the Code), Chapter A, Part 1, paragraphs R111.2 and R111.3

HKSRE 2400 (Revised)  
Issued December 2012; revised January 2019, September 2019

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*Hong Kong Standard on Review Engagements 2400 (Revised)*

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# **Engagements to Review Historical Financial Statements**



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- (i) *Relevant ethical requirements*—Ethical requirements the engagement team is subject to when undertaking review engagements. These requirements ordinarily comprise Chapter A, Parts 1, 3 and 4A, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code), together with national requirements that are more restrictive.
- (j) *Special purpose financial statements*—Financial statements prepared in accordance with a special purpose framework.
- (k) *Special purpose framework*—A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.

## Requirements

### Conduct of a Review Engagement in Accordance with this HKSRE

- 18. The practitioner shall have an understanding of the entire text of this HKSRE, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A14)

#### *Complying with Relevant Requirements*

- 19. The practitioner shall comply with each requirement of this HKSRE, unless a requirement is not relevant to the review engagement. A requirement is relevant to the review engagement when the circumstances addressed by the requirement exist.
- 20. The practitioner shall not represent compliance with this HKSRE in the practitioner's report unless the practitioner has complied with all the requirements of this HKSRE relevant to the review engagement.

### Ethical Requirements

- 21. The practitioner shall comply with relevant ethical requirements, including those pertaining to independence. (Ref: Para. A15–A16)

### Professional Skepticism and Professional Judgment

- 22. The practitioner shall plan and perform the engagement with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A17–A20)
- 23. The practitioner shall exercise professional judgment in conducting a review engagement. (Ref: Para. A21–A25)

### Engagement Level Quality Control

- 24. The engagement partner shall possess competence in assurance skills and techniques, and competence in financial reporting, appropriate to the engagement circumstances. (Ref: Para. A26)

- (b) Results obtained from the procedures, and the practitioner's conclusions formed on the basis of those results; and
  - (c) Significant matters arising during the engagement, the practitioner's conclusions reached thereon, and significant professional judgments made in reaching those conclusions.
94. In documenting the nature, timing and extent of procedures performed as required in this HKSRE, the practitioner shall record:
- (a) Who performed the work and the date such work was completed; and
  - (b) Who reviewed the work performed for the purpose of quality control for the engagement, and the date and extent of the review.
95. The practitioner shall also document discussions with management, those charged with governance, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters.
96. If, in the course of the engagement, the practitioner identified information that is inconsistent with the practitioner's findings regarding significant matters affecting the financial statements, the practitioner shall document how the inconsistency was addressed.

### **Conformity and Compliance with International Standards on Review Engagements**

97. As of September 2019, this HKSRE conforms with International Standard on Review Engagements (ISRE) 2400 (Revised), "Engagements to Review Historical Financial Statements" except that references to the IESBA's Code of Ethics for Professional Accountants are replaced by the HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSRE ensures compliance with ISRE 2400 (Revised).
98. Additional local guidance is provided in footnote 11a, 13a of Appendix 1 and footnotes 20a, 22a, 24a, 27a, 29a, 30a and 31a of Appendix 2.

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A12. Various responsibilities relating to preparation of financial information and external financial reporting will fall to either management or those charged with governance according to factors such as:

- The resources and structure of the entity; and
- The respective roles of management and those charged with governance within the entity as set out in relevant law or regulation or, if the entity is not regulated, in any formal governance or accountability arrangements established for the entity (for example, as recorded in contracts, a constitution or other type of establishment documents of the entity).

For example, in small entities there is often no separation of the management and governance roles. In larger entities, management is often responsible for execution of the business or activities of the entity and reporting thereon, while those charged with governance oversee management. In some jurisdictions, the responsibility for preparation of financial statements for an entity is the legal responsibility of those charged with governance, and in some other jurisdictions it is a management responsibility.

*Limited Assurance – Use of the Term Sufficient Appropriate Evidence* (Ref: Para. 17(f))

A13. Sufficient appropriate evidence is required to obtain limited assurance to support the practitioner's conclusion. Evidence is cumulative in nature and is primarily obtained from the procedures performed during the course of the review.

**Conduct of a Review Engagement in Accordance with this HKSRE** (Ref: Para. 18)

A14. This HKSRE does not override laws and regulations that govern a review of financial statements. In the event that those laws and regulations differ from the requirements of this HKSRE, a review conducted only in accordance with laws and regulations will not automatically comply with this HKSRE.

**Ethical Requirements** (Ref: Para. 21)

A15. Chapter A, Part 1 of the Code establishes the fundamental principles of professional ethics practitioners must comply with, and provides a conceptual framework for applying those principles. The fundamental principles are:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

Chapter A, Parts 3 and 4A, and Chapter C of the Code illustrates how the conceptual framework is to be applied in specific situations. In complying with the Code, threats to the practitioner's compliance with relevant ethical requirements are required to be identified and appropriately addressed.

- Communications the entity has received, or expects to receive or obtain, from regulatory agencies.
  - Matters arising in the course of applying other procedures. When performing further inquiries in relation to identified inconsistencies, the practitioner considers the reasonableness and consistency of management's responses in light of the results obtained from other procedures, and the practitioner's knowledge and understanding of the entity and the industry in which it operates.
- A86. Evidence obtained through inquiry is often the principal source of evidence about management intent. However, information available to support management's intent may be limited. In that case, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. Application of professional skepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matter(s) that would cause the practitioner to believe the financial statements may be materially misstated.
- A87. Performing inquiry procedures assists the practitioner also in obtaining or updating the practitioner's understanding of the entity and its environment, to be able to identify areas where material misstatements are likely to arise in the financial statements.
- A88. The practitioner may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, including fraud, which may differ from or go beyond this HKSRE, such as:
- (a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance and considering whether further action is needed;
  - (b) Communicating identified or suspected non-compliance with laws and regulations to an auditor, for example a group engagement partner;<sup>11</sup> and
  - (c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

Complying with any additional responsibilities may provide further information that is relevant to the practitioner's work in accordance with this HKSRE (e.g., regarding the integrity of management or, where appropriate, those charged with governance).

Inquiry about the entity's ability to continue as a going concern (Ref: Para. 48(f))

- A89. Often in smaller entities, management may not have prepared an assessment of the entity's ability to continue as a going concern, but instead may rely on knowledge of the business and anticipated future prospects. In these circumstances, it may be appropriate to discuss the medium and long-term prospects and financing of the entity with management, including consideration of whether management's contentions are not inconsistent with the practitioner's understanding of the entity.

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<sup>11</sup> See, for example, Chapter A, Part 3, paragraphs R360.31–360.35 A1 of the Code.

- A95. In some cases, the relevant ethical requirements may require the practitioner to report or to consider whether reporting identified or suspected fraud or non-compliance with laws and regulations to an appropriate authority outside the entity is an appropriate action in the circumstances. For example, the Code requires the practitioner to take steps to respond to identified or suspected non-compliance with laws and regulations, and consider whether further action is needed, which may include reporting to an appropriate authority outside the entity.<sup>12</sup> The Code explains that such reporting would not be considered a breach of the duty of confidentiality under the Code.<sup>13</sup>
- A96. Even if law, regulation or relevant ethical requirements do not include requirements that address reporting identified or suspected non-compliance, they may provide the practitioner with the right to report identified or suspected fraud or non-compliance with laws and regulations to an appropriate authority outside the entity.
- A97. In other circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the practitioner's duty of confidentiality under law, regulation or relevant ethical requirements.
- A98. The determination required by paragraph 52(d) may involve complex considerations and professional judgments. Accordingly, the practitioner may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or a professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The practitioner may also consider obtaining legal advice to understand the practitioner's options and the professional or legal implications of taking any particular course of action.

Events or conditions that may cast doubt regarding use of the going concern assumption in the financial statements (Ref: Para. 54)

- A99. The list of factors below gives examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. The list is not all-inclusive, and the existence of one or more of the items does not always signify that uncertainty exists about whether the entity can continue as a going concern.

#### Financial

- Net liability or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets
- Indications of withdrawal of financial support by creditors
- Negative operating cash flows indicated by historical or prospective financial statements
- Adverse key financial ratios
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
- Arrears or discontinuance of dividends

<sup>12</sup> See, for example, Chapter A, Part 3, paragraphs 360.36 A2–360.36 A3 of the Code.

<sup>13</sup> See, for example, Chapter A, Part 1, paragraph 114.1 A1 and Part 3, paragraph R360.37 of the Code.

HKSAE 3000 (Revised)  
Issued March 2014; revised February 2015, January 2019,  
September 2019

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*Hong Kong Standard on Assurance Engagements 3000 (Revised)*

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# **Assurance Engagements Other than Audits or Reviews of Historical Financial Information**



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## Introduction

1. This Hong Kong Standard on Assurance Engagements (HKSAE) deals with assurance engagements other than audits or reviews of historical financial information, which are dealt with in Hong Kong Standards on Auditing (HKSA) and Hong Kong Standards on Review Engagements (HKSREs), respectively. (Ref: Para. A21–A22)
2. Assurance engagements include both attestation engagements, in which a party other than the practitioner measures or evaluates the underlying subject matter against the criteria, and direct engagements, in which the practitioner measures or evaluates the underlying subject matter against the criteria. This HKSAE contains requirements and application and other explanatory material specific to reasonable and limited assurance attestation engagements. This HKSAE may also be applied to reasonable and limited assurance direct engagements, adapted and supplemented as necessary in the engagement circumstances.
3. This HKSAE is premised on the basis that:
  - (a) The members of the engagement team and the engagement quality control reviewer (for those engagements where one has been appointed) are subject to Chapter A, Parts 1, 3 and 4B, and Chapter C <sup>1a</sup> of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants (the Code) related to assurance engagements, or other professional requirements, or requirements in law or regulation, that are at least as demanding; and (Ref: Para. A30–A34)
  - (b) The practitioner who is performing the engagement is a member of a firm that is subject to HKSQC 1,<sup>1</sup> or other professional requirements, or requirements in law or regulation, regarding the firm's responsibility for its system of quality control, that are at least as demanding as HKSQC 1. (Ref: Para. A61–A66)
4. Quality control within firms that perform assurance engagements, and compliance with ethical principles, including independence requirements, are widely recognized as being in the public interest and an integral part of high-quality assurance engagements. Professional accountants in public practice will be familiar with such requirements. If a competent practitioner other than a professional accountant in public practice chooses to represent compliance with this or other HKSAEs, it is important to recognize that this HKSAE includes requirements that reflect the premise in the preceding paragraph.

## Scope

5. This HKSAE covers assurance engagements other than audits or reviews of historical financial information, as described in the *Hong Kong Framework for Assurance Engagements* (Assurance Framework). Where a subject-matter specific HKSAE is relevant to the subject matter of a particular engagement, that HKSAE applies in addition to this HKSAE. (Ref: Para. A21–A22)
6. Not all engagements performed by practitioners are assurance engagements. Other frequently performed engagements that are not assurance engagements, as defined by paragraph 12(a) (and therefore are not covered by the HKSAEs) include:
  - (a) Engagements covered by Hong Kong Standards on Related Services (HKSRS), such as agreed-upon procedure and compilation engagements;<sup>2</sup>

<sup>1a</sup> The Code has an additional Chapter C, which are either local application or represent an amplification of provisions in Chapter A. There are relevant sections in Chapter A, Parts 1, 3 and 4B for which there are additional requirements in Chapter C or additional local requirements.

<sup>1</sup> Hong Kong Standard on Quality Control (HKSQC) 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

<sup>2</sup> HKSRS 4400, Engagements to Perform Agreed-Up Procedures Regarding Financial Information, and HKSRS 4410 (Revised), Compilation Engagements

## Requirements

### Conduct of an Assurance Engagement in Accordance with HKSAEs

#### *Complying with Standards that are Relevant to the Engagement*

14. The practitioner shall comply with this HKSAE and any subject matter-specific HKSAEs relevant to the engagement.
15. The practitioner shall not represent compliance with this or any other HKSAE unless the practitioner has complied with the requirements of this HKSAE and any other HKSAE relevant to the engagement. (Ref: Para. A21–A22, A171)

#### *Text of an HKSAE*

16. The practitioner shall have an understanding of the entire text of an HKSAE, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A23–A28)

#### *Complying with Relevant Requirements*

17. Subject to the following paragraph, the practitioner shall comply with each requirement of this HKSAE and of any relevant subject matter-specific HKSAE unless, in the circumstances of the engagement the requirement is not relevant because it is conditional and the condition does not exist. Requirements that apply to only limited assurance or reasonable assurance engagements have been presented in a columnar format with the letter "L" (limited assurance) or "R" (reasonable assurance) after the paragraph number. (Ref: Para. A29)
18. In exceptional circumstances, the practitioner may judge it necessary to depart from a relevant requirement in an HKSAE. In such circumstances, the practitioner shall perform alternative procedures to achieve the aim of that requirement. The need for the practitioner to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the aim of the requirement.

#### *Failure to Achieve an Objective*

19. If an objective in this HKSAE or a relevant subject matter-specific HKSAE cannot be achieved, the practitioner shall evaluate whether this requires the practitioner to modify the practitioner's conclusion or withdraw from the engagement (where withdrawal is possible under applicable law or regulation). Failure to achieve an objective in a relevant HKSAE represents a significant matter requiring documentation in accordance with paragraph 79 of this HKSAE.

### Ethical Requirements

20. The practitioner shall comply with Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding. (Ref: Para. A30–A34, A60)

### Acceptance and Continuance

21. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and assurance engagements have been followed by the firm, and shall determine that conclusions reached in this regard are appropriate.
22. The practitioner shall accept or continue an assurance engagement only when: (Ref: Para. A30–A34)



68. The practitioner's conclusion shall be clearly separated from information or explanations that are not intended to affect the practitioner's conclusion, including any Emphasis of Matter, Other Matter, findings related to particular aspects of the engagements, recommendations or additional information included in the assurance report. The wording used shall make it clear that an Emphasis of Matter, Other Matter, findings, recommendations or additional information is not intended to detract from the practitioner's conclusion. (Ref: Para. A159–A161)

*Assurance Report Content*

69. The assurance report shall include, at a minimum, the following basic elements:
- (a) A title that clearly indicates the report is an independent assurance report. (Ref: Para. A162)
  - (b) An addressee. (Ref: Para. A163)
  - (c) An identification or description of the level of assurance obtained by the practitioner, the subject matter information and, when appropriate, the underlying subject matter. When the practitioner's conclusion is phrased in terms of a statement made by the appropriate party, that statement shall accompany the assurance report, be reproduced in the assurance report or be referenced therein to a source that is available to the intended users. (Ref: Para A164)
  - (d) Identification of the applicable criteria. (Ref: Para. A165)
  - (e) Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria. (Ref: Para. A166)
  - (f) When the applicable criteria are designed for a specific purpose, a statement alerting readers to this fact and that, as a result, the subject matter information may not be suitable for another purpose. (Ref: Para. A167–A168)
  - (g) A statement to identify the responsible party and the measurer or evaluator if different, and to describe their responsibilities and the practitioner's responsibilities. (Ref: Para. A169)
  - (h) A statement that the engagement was performed in accordance with this HKSAE or, where there is a subject-matter specific HKSAE, that HKSAE. (Ref: Para. A170–A171)
  - (i) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1. (Ref: Para. A172)
  - (j) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements. (Ref: Para. A173)
  - (k) An informative summary of the work performed as the basis for the practitioner's conclusion. In the case of a limited assurance engagement, an appreciation of the nature, timing and extent of procedures performed is essential to understanding the practitioner's conclusion. In a limited assurance engagement, the summary of the work performed shall state that:

- (a) Express a qualified conclusion or adverse conclusion phrased in terms of the underlying subject matter and the applicable criteria; or
- (b) If specifically required by the terms of the engagement to phrase the conclusion in terms of a statement made by the appropriate party, express an unqualified conclusion but include an Emphasis of Matter paragraph in the assurance report referring to the statement made by the appropriate party that identifies and properly describes that the subject matter information is materially misstated. (Ref: Para. A192)

### **Other Communication Responsibilities**

78. The practitioner shall consider whether, pursuant to the terms of the engagement and other engagement circumstances, any matter has come to the attention of the practitioner that is to be communicated with the responsible party, the measurer or evaluator, the engaging party, those charged with governance or others. (Ref: Para. A193-A199)

### **Documentation**

79. The practitioner shall prepare on a timely basis engagement documentation that provides a record of the basis for the assurance report that is sufficient and appropriate to enable an experienced practitioner, having no previous connection with the engagement, to understand: (Ref: Para. A200–A204)
- (a) The nature, timing and extent of the procedures performed to comply with relevant HKSAEs and applicable legal and regulatory requirements;
  - (b) The results of the procedures performed, and the evidence obtained; and
  - (c) Significant matters arising during the engagement, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.
80. If the practitioner identifies information that is inconsistent with the practitioner's final conclusion regarding a significant matter, the practitioner shall document how the practitioner addressed the inconsistency.
81. The practitioner shall assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the assurance report. (Ref: Para. A205–A206)
82. After the assembly of the final engagement file has been completed, the practitioner shall not delete or discard engagement documentation of any nature before the end of its retention period. (Ref: Para. A207)
83. If the practitioner finds it necessary to amend existing engagement documentation or add new engagement documentation after the assembly of the final engagement file has been completed the practitioner shall, regardless of the nature of the amendments or additions, document:
- (a) The specific reasons for making the amendments or additions; and
  - (b) When, and by whom, they were made and reviewed.

### **Conformity and Compliance with International Standards on Assurance Engagements**

84. As of September 2019, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3000 (Revised), "Assurance Engagements other than Audits or Reviews of Historical Financial Information" except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSAE ensures compliance with ISAE 3000 (Revised).

- A27. Definitions are provided in the HKSAEs to assist in the consistent application and interpretation of the HKSAEs, and are not intended to override definitions that may be established for other purposes, whether by laws, regulations or otherwise.
- A28. Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related HKSAE or within the title and introduction of the appendix itself.

*Complying with Relevant Requirements (Ref: Para. 17)*

- A29. Although some procedures are required only for reasonable assurance engagements, they may nonetheless be appropriate in some limited assurance engagements.

**Ethical Requirements (Ref: Para. 3(a), 20, 22(a))**

- A30. Chapter A, Part 1 of the Code establishes the following fundamental principles with which the practitioner is required to comply:

- (a) Integrity;
- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

- A31. Chapter A, Part 1 of the Code also provides a conceptual framework for professional accountants to apply to:

- (a) Identify threats to compliance with the fundamental principles. Threats fall into one or more of the following categories:
  - (i) Self-interest;
  - (ii) Self-review;
  - (iii) Advocacy;
  - (iv) Familiarity; and
  - (v) Intimidation;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

- A32. Chapter A, Part 3 of the Code describes how the conceptual framework in the Code applies in certain situations to professional accountants in public practice, including:

- Professional appointment;
- Conflicts of interest;

- Second opinions;
- Fees and other types of remuneration;
- Inducements, including gifts and hospitality;
- Custody of client assets; and
- Responding to Non-Compliance with Laws and Regulations.

A33. The Code defines independence as comprising both independence of mind and independence in appearance. Independence safeguards the ability to form an assurance conclusion without being affected by influences that might compromise that conclusion. Independence enhances the ability to act with integrity, to be objective and to maintain an attitude of professional skepticism. Matters addressed in the Code with respect to independence include:

- Fees;
- Gifts and hospitality;
- Actual or threatened litigation;
- Financial interests;
- Loans and guarantees;
- Business relationships;
- Family and personal relationships;
- Recent service with an assurance client;
- Serving as a director or officer of an assurance client;
- Employment with an assurance client;
- Long association of personnel with an assurance client;
- Provision of non-assurance services to assurance clients other than audit and review engagement clients.

A34. Professional requirements, or requirements imposed by law or regulation, are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements when they address all the matters referred to in paragraphs A30–A33 and impose obligations that achieve the aims of the requirements set out in Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements.

### **Acceptance and Continuance**

*Preconditions for the Engagement* (Ref: Para. 24)

A35. In a public sector environment, some of the preconditions for an assurance engagement may be assumed to be present, for example:

In considering deficiencies identified in the firm's system of quality control that may affect the assurance engagement, the engagement partner may consider measures taken by the firm to rectify those deficiencies.

- A66. A deficiency in the firm's system of quality control does not necessarily indicate that an assurance engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the practitioner's report was not appropriate.

*Skills, Knowledge and Experience with Respect to the Underlying Subject Matter and Its Measurement or Evaluation* (Ref: Para. 31(c))

- A67. A practitioner may be requested to perform assurance engagements with respect to a wide range of underlying subject matter and subject matter information. Some may require specialized skills and knowledge beyond those ordinarily possessed by a particular individual.
- A68. The Code requires the professional accountant in public practice to agree to provide only those services that the professional accountant in public practice is competent to perform.<sup>4</sup> The practitioner has sole responsibility for the assurance conclusion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's expert. Nonetheless, if the practitioner using the work of a practitioner's expert, having followed this HKSAE, concludes that the work of that expert is adequate for the practitioner's purposes, the practitioner may accept that expert's findings or conclusions in the expert's field as appropriate evidence.

*Assignment of the Team*

Collective Competence and Capabilities (Ref: Para. 32)

- A69. HKSQC 1 requires the firm to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm is competent to perform the engagement and has the capabilities, including time and resources, to do so.<sup>5</sup>

Practitioner's Expert (Ref: Para. 32(a), 32(b)(i))

- A70. Some of the assurance work may be performed by a multi-disciplinary team that includes one or more practitioner's expert. For example, a practitioner's expert may be needed to assist the practitioner in obtaining an understanding of the underlying subject matter and other engagement circumstances or in one or more of the matters mentioned in paragraph 46R (in the case of a reasonable assurance engagement) or 46L (in the case of a limited assurance engagement).
- A71. When the work of a practitioner's expert is to be used, it may be appropriate to perform some of the procedures required by paragraph 52 at the engagement acceptance or continuance stage.

Other Practitioners (Ref: Para. 32(b)(ii))

- A72. The subject matter information may include information upon which another practitioner may have expressed a conclusion. The practitioner, in concluding on the subject matter information, may decide to use the evidence on which that other practitioner's conclusion is based to provide evidence regarding the subject matter information.
- A73. The work of another practitioner may be used in relation to, for example, an underlying subject matter at a remote location or in a foreign jurisdiction. Such other practitioners are not part of the engagement team. Relevant considerations when the engagement team plans to use the work of another practitioner may include:

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<sup>4</sup> The Code, Chapter A, Part 3, paragraphs 320.3 A4 and 320.3 A5

<sup>5</sup> HKSQC 1, paragraph 26

- Otherwise related to numerical values (for example, the number of observed deviations from a control may be a relevant quantitative factor when the subject matter information is a statement that the control is effective).

A98. When quantitative factors are applicable, planning the engagement solely to detect individually material misstatements overlooks the fact that the aggregate of uncorrected and undetected individually immaterial misstatements may cause the subject matter information to be materially misstated. It may therefore be appropriate when planning the nature, timing and extent of procedures for the practitioner to determine a quantity less than materiality as a basis for determining the nature, timing and extent of procedures.

A99. Materiality relates to the information covered by the assurance report. Therefore, when the engagement covers some, but not all, aspects of the information communicated about an underlying subject matter, materiality is considered in relation to only that portion that is covered by the engagement.

A100. Concluding on the materiality of the misstatements identified as a result of the procedures performed requires professional judgment. For example:

- The applicable criteria for a value for money engagement for a hospital's emergency department may include the speed of the services provided, the quality of the services, the number of patients treated during a shift, and benchmarking the cost of the services against other similar hospitals. If three of these applicable criteria are satisfied but one applicable criterion is not satisfied by a small margin, then professional judgment is needed to conclude whether the hospital's emergency department represents value for money as a whole.
- In a compliance engagement, the entity may have complied with nine provisions of the relevant law or regulation, but did not comply with one provision. Professional judgment is needed to conclude whether the entity complied with the relevant law or regulation as a whole. For example, the practitioner may consider the significance of the provision with which the entity did not comply, as well as the relationship of that provision to the remaining provisions of the relevant law or regulation.

*Understanding the Engagement Circumstances (Ref: Para. 45–47R)*

A101. Discussions between the engagement partner and other key members of the engagement team, and any key practitioner's external experts, about the susceptibility of the subject matter information to material misstatement, and the application of the applicable criteria to the facts and circumstances of the engagement, may assist the engagement team in planning and performing the engagement. It is also useful to communicate relevant matters to members of the engagement team, and to any practitioner's external experts not involved in the discussion.

A102. The practitioner may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond the practitioner's responsibilities under this HKSAE, such as:

- (a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance and considering whether further action is needed;
- (b) Communicating identified or suspected non-compliance with laws and regulations to an auditor;<sup>7</sup> and
- (c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

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<sup>7</sup> See, for example, Chapter A, Part 3, paragraphs R360.31–360.35 A1 of the Code.

governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the practitioner is required to report the identified or suspected non-compliance to an appropriate authority pursuant to anti-money laundering legislation.<sup>7a</sup> In these circumstances, the issues considered by the practitioner may be complex and the practitioner may consider it appropriate to obtain legal advice.

*Reporting of Identified or Suspected Non-Compliance with Laws and Regulations to an Appropriate Authority outside the Entity*

A195. Law, regulation or relevant ethical requirements may:

- (a) Require the practitioner to report identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity.
- (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.<sup>8</sup>

A196. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:

- (a) Law, regulation or relevant ethical requirements require the practitioner to report;
- (b) The practitioner has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements; or-
- (c) Law, regulation or relevant ethical requirements provide the practitioner with the right to do so.

A197. The reporting of identified or suspected non-compliance with laws and regulations in accordance with law, regulation or relevant ethical requirements may include non-compliance with laws and regulations that the practitioner comes across or is made aware of when performing the engagement but which may not affect the subject matter information. Under this HKSAE, the practitioner is not expected to have a level of understanding of laws and regulations beyond those affecting the subject matter information. However, law, regulation or relevant ethical requirements may expect the practitioner to apply knowledge, professional judgment and expertise in responding to such non-compliance. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

A198. In some circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the practitioner's duty of confidentiality under law, regulation, or relevant ethical requirements. In other cases, reporting identified or suspected non-compliance to an appropriate authority outside the entity would not be considered a breach of the duty of confidentiality under the relevant ethical requirements.<sup>9</sup>

A199. The practitioner may consider consulting internally (e.g., within the firm or network firm), obtaining legal advice to understand the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or a professional body (unless doing so is prohibited by law or regulations or would breach the duty of confidentiality).<sup>10</sup>

**Documentation** (Ref: Para. 79–83)

A200. Documentation includes a record of the practitioner's reasoning on all significant matters that require the exercise of professional judgment, and related conclusions. When difficult questions of principle or professional judgment exist, documentation that includes the relevant facts that were known by the practitioner at the time the conclusion was reached may assist in demonstrating the practitioner's knowledge.

<sup>7a</sup> Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

<sup>8</sup> See, for example, Chapter A, Part 3, paragraphs 360.36 A2–360.36 A3 of the Code.

<sup>9</sup> See, for example, Chapter A, Part 1, paragraph 114.1 A1 and Part 3, paragraph R360.37 of the Code.

<sup>10</sup> See, for example, Chapter A, Part 3, paragraph 360.39 A1 of the Code.

HKSAE 3402  
Issued May 2010, Revised December 2012, March 2014,  
January 2019, September 2019

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Effective for service auditors' assurance reports  
covering periods ending on or after 15 June 2011

*Hong Kong Standard on Assurance Engagements 3402*

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# **Assurance Reports on Controls at a Service Organization**



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



## Introduction

### Scope of this HKSAE

1. This Hong Kong Standard on Assurance Engagements (HKSAE) deals with assurance engagements undertaken by a practitioner<sup>1</sup> to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities' internal control as it relates to financial reporting. It complements HKSA 402,<sup>2</sup> in that reports prepared in accordance with this HKSAE are capable of providing appropriate evidence under HKSA 402. (Ref: Para. A1)
2. The "Hong Kong Framework for Assurance Engagements" (the Assurance Framework) states that an assurance engagement may be a "reasonable assurance" engagement or a "limited assurance" engagement and that an assurance engagement may be either an attestation engagement or a "direct" engagement.<sup>3</sup> This HKSAE only deals with reasonable assurance attestation engagements.<sup>4</sup>
3. This HKSAE applies only when the service organization is responsible for, or otherwise able to make a statement about, the suitable design of controls. This HKSAE does not deal with assurance engagements:
  - (a) To report only on whether controls at a service organization operated as described, or
  - (b) To report on controls at a service organization other than those related to a service that is likely to be relevant to user entities' internal control as it relates to financial reporting (for example, controls that affect user entities' production or quality control).

This HKSAE, however, provides some guidance for such engagements carried out under HKSAE 3000 (Revised). (Ref: Para. A2)

4. In addition to issuing an assurance report on controls, a service auditor may also be engaged to provide reports such as the following, which are not dealt with in this HKSAE:
  - (a) A report on a user entity's transactions or balances maintained by a service organization; or
  - (b) An agreed-upon procedures report on controls at a service organization.

### *Relationship with HKSAE 3000 (Revised), Other Professional Pronouncements and Other Requirements*

5. The service auditor is required to comply with HKSAE 3000 (Revised) and this HKSAE when performing assurance engagements on controls at a service organization. This HKSAE supplements, but does not replace, HKSAE 3000 (Revised), and expands on how HKSAE 3000 (Revised) is to be applied in a reasonable assurance engagement to report on controls at a service organization.
6. Compliance with HKSAE 3000 (Revised) requires, among other things, compliance with Chapter A, Parts 1, 3 and 4B, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to assurance engagements, or other professional requirements, or requirements imposed by law and

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<sup>1</sup> HKSAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, paragraph 12(r)

<sup>2</sup> HKSA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

<sup>3</sup> HKSAE 3000 (Revised), paragraph 12

<sup>4</sup> Paragraphs 13 and 53(k) of this HKSAE

**Ethical Requirements**

11. The service auditor shall comply with Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code relating to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding. (Ref: Para. A5)

**Management and Those Charged with Governance**

12. Where this HKSAE requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with the service organization, the service auditor shall determine the appropriate person(s) within the service organization's management or governance structure with whom to interact. This shall include consideration of which person(s) have the appropriate responsibilities for and knowledge of the matters concerned. (Ref: Para. A6)

**Acceptance and Continuance**

13. Before agreeing to accept, or continue, an engagement the service auditor shall:
  - (a) Determine whether:
    - (i) The service auditor has the capabilities and competence to perform the engagement; (Ref: Para. A7)
    - (ii) The criteria the practitioner expects to be applied by the service organization to prepare the description of its system are suitable and will be available to user entities and their auditors; and
    - (iii) The scope of the engagement and the service organization's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors.
  - (b) Obtain the agreement of the service organization that it acknowledges and understands its responsibility:
    - (i) For the preparation of the description of its system, and accompanying service organization's statement, including the completeness, accuracy and method of presentation of that description and statement; (Ref: Para. A8)
    - (ii) To have a reasonable basis for the service organization's statement accompanying the description of its system; (Ref: Para. A9)
    - (iii) For stating in the service organization's statement the criteria it used to prepare the description of its system;
    - (iv) For stating in the description of its system:
      - a. The control objectives; and
      - b. Where they are specified by law or regulation, or another party (for example, a user group or a professional body), the party who specified them;
    - (v) For identifying the risks that threaten achievement of the control objectives stated in the description of its system, and designing and implementing controls to provide reasonable assurance that those risks will not prevent achievement of the control objectives stated in the description of its system, and therefore that the stated control objectives will be achieved; and (Ref: Para. A10)

system includes control objectives and related controls at the subservice organization, and that the service auditor's procedures extended to controls at the subservice organization.

- (d) Identification of the applicable criteria, and the party specifying the control objectives.
- (e) A statement that the report and, in the case of a type 2 report, the description of tests of controls are intended only for user entities and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements. (Ref: Para. A48)
- (f) A statement that the service organization is responsible for:
  - (i) Preparing the description of its system, and the accompanying statement, including the completeness, accuracy and method of presentation of that description and that statement;
  - (ii) Providing the services covered by the service organization's description of its system;
  - (iii) Stating the control objectives (where not identified by law or regulation, or another party, for example, a user group or a professional body); and
  - (iv) Designing and implementing controls to achieve the control objectives stated in the service organization's description of its system.
- (g) A statement that the service auditor's responsibility is to express an opinion on the service organization's description, on the design of controls related to the control objectives stated in that description and, in the case of a type 2 report, on the operating effectiveness of those controls, based on the service auditor's procedures.
- (h) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1.
- (i) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements.
- (j) A statement that the engagement was performed in accordance with HKSAE 3402, *Assurance Reports on Controls at a Service Organization*, which requires that the service auditor plan and perform procedures to obtain reasonable assurance about whether, in all material respects, the service organization's description of its system is fairly presented and the controls are suitably designed and, in the case of a type 2 report, are operating effectively.
- (k) A summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion, and, in the case of a type 1 report, a statement that the service auditor has not performed any procedures

- (b) The controls related to the control objectives stated in the description were not suitably designed, in all material respects;
- (c) In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or
- (d) The service auditor is unable to obtain sufficient appropriate evidence,

the service auditor's opinion shall be modified, and the service auditor's assurance report shall include a section with a clear description of all the reasons for the modification.

### **Other Communication Responsibilities**

- 56. If the service auditor becomes aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall take appropriate action. (Ref: Para. A53)

### **Conformity and Compliance with International Standards on Assurance Engagements**

- 57. As of September 2019, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3402, "Assurance Reports on Controls at a Service Organization" except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSAE ensures compliance with ISAE 3402.
- 58. Additional local explanations are provided in footnotes 19a and 21a.

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### **Application and Other Explanatory Material**

#### **Scope of this HKSAE (Ref: Para. 1 and 3)**

- A1. Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives related to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Controls related to a service organization's operations and compliance objectives may be relevant to a user entity's internal control as it relates to financial reporting. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions or disclosures, or may pertain to evidence that the user auditor evaluates or uses in applying auditing procedures. For example, a payroll processing service organization's controls related to the timely remittance of payroll deductions to government authorities may be relevant to a user entity as late remittances could incur interest and penalties that would result in a liability for the user entity. Similarly, a service organization's controls over the acceptability of investment transactions from a regulatory perspective may be considered relevant to a user entity's presentation and disclosure of transactions and account balances in its financial statements. The determination of whether controls at a service organization related to operations and compliance are likely to be relevant to user entities' internal control as it relates to financial reporting is a matter of professional judgment, having regard to the control objectives set by the service organization and the suitability of the criteria.

*Using the Work of the Internal Audit Function (Ref: Para. 34)*

A39. The nature, timing and extent of the service auditor's procedures on specific work of the internal auditors will depend on the service auditor's assessment of the significance of that work to the service auditor's conclusions (for example, the significance of the risks that the controls tested seek to mitigate), the evaluation of the internal audit function and the evaluation of the specific work of the internal auditors. Such procedures may include:

- Examination of items already examined by the internal auditors;
- Examination of other similar items; and
- Observation of procedures performed by the internal auditors.

*Effect on the Service Auditor's Assurance Report (Ref: Para. 36-37)*

A40. Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the service organization as is required of the service auditor when performing the engagement. The service auditor has sole responsibility for the opinion expressed in the service auditor's assurance report, and that responsibility is not reduced by the service auditor's use of the work of the internal auditors.

A41. The service auditor's description of work performed by the internal audit function may be presented in a number of ways, for example:

- By including introductory material to the description of tests of controls indicating that certain work of the internal audit function was used in performing tests of controls.
- Attribution of individual tests to internal audit.

**Written Representations (Ref: Para. 38 and 40)**

A42. The written representations required by paragraph 38 are separate from, and in addition to, the service organization's statement, as defined at paragraph 9(o).

A43. If the service organization does not provide the written representations requested in accordance with paragraph 38(c) of this HKSAE, it may be appropriate for the service auditor's opinion to be modified in accordance with paragraph 55(d) of this HKSAE.

**Other Information (Ref: Para. 42)**

A44. The Code requires that a service auditor not be associated with information where the service auditor believes that the information:

- (a) Contains a materially false or misleading statement;
- (b) Contains statements or information furnished recklessly; or
- (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.<sup>14</sup>

If other information included in a document containing the service organization's description of its system and the service auditor's assurance report contains future-oriented information such

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<sup>14</sup> The Code, Chapter A, Part 1, paragraphs R111.2 and R111.3

- Information about causative factors for identified deviations, to the extent the service auditor has identified such factors.

*Modified Opinions* (Ref: Para. 55)

- A50. Illustrative examples of elements of modified service auditor's assurance reports are contained in Appendix 3.
- A51. Even if the service auditor has expressed an adverse opinion or disclaimed an opinion, it may be appropriate to describe in the basis for modification paragraph the reasons for any other matters of which the service auditor is aware that would have required a modification to the opinion, and the effects thereof.
- A52. When expressing a disclaimer of opinion because of a scope limitation, it is not ordinarily appropriate to identify the procedures that were performed nor include statements describing the characteristics of a service auditor's engagement; to do so might overshadow the disclaimer of opinion.

**Other Communication Responsibilities** (Ref: Para. 56)

- A53. Appropriate actions to respond to the circumstances identified in paragraph 56, unless prohibited by law or regulation, may include:
- Obtaining legal advice about the consequences of different courses of action.
  - Communicating with those charged with governance of the service organization.
  - Determining whether to communicate with third parties (e.g., law, regulation or relevant ethical requirements may require the service auditor to report to an appropriate authority outside the entity or the external auditor of the service organization,<sup>17</sup> or establish responsibilities under which such reporting may be appropriate in the circumstances).
  - Modifying the service auditor's opinion, or adding an Other Matter paragraph.
  - Withdrawing from the engagement.

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<sup>17</sup> See, for example, Chapter A, Part 3, paragraphs R360.31 – 360.35 A1 of the Code.

HKSAE 3410  
Issued November 2012, revised March 2014, January 2019,  
September 2019

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Effective for service auditors' assurance reports  
covering periods ending on or after 30 September 2013

*Hong Kong Standard on Assurance Engagements 3410*

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# Assurance Engagements on Greenhouse Gas Statements



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

*Attestation and Direct Engagements*

5. The *Hong Kong Framework for Assurance Engagements* (the Assurance Framework) notes that an assurance engagement may be either an attestation engagement or a direct engagement. This HKSAE deals only with attestation engagements.<sup>3</sup>

*Procedures for Reasonable Assurance and Limited Assurance Engagements*

6. HKSAE 3000 (Revised) notes that an assurance engagement may be either a reasonable assurance engagement or a limited assurance engagement.<sup>4</sup> This HKSAE deals with both reasonable and limited assurance engagements.
7. In both reasonable assurance and limited assurance engagements on a GHG statement, the practitioner chooses a combination of assurance procedures, which can include: inspection; observation; confirmation; recalculation; reperformance; analytical procedures; and inquiry. Determining the assurance procedures to be performed on a particular engagement is a matter of professional judgment. Because GHG statements cover a wide range of circumstances, the nature, timing and extent of procedures are likely to vary considerably from engagement to engagement.
8. Unless otherwise stated, each requirement of this HKSAE applies to both reasonable and limited assurance engagements. Because the level of assurance obtained in a limited assurance engagement is lower than in a reasonable assurance engagement, the procedures the practitioner will perform in a limited assurance engagement will vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement.<sup>5</sup> Requirements that apply to only one or the other type of engagement have been presented in a columnar format with the letter “L” (limited assurance) or “R” (reasonable assurance) after the paragraph number. Although some procedures are required only for reasonable assurance engagements, they may nonetheless be appropriate in some limited assurance engagements (see also paragraph A90, which outlines the primary differences between the practitioner’s further procedures for a reasonable assurance engagement and a limited assurance engagement on a GHG statement). (Ref: Para. A4, A90)

*Relationship with HKSAE 3000 (Revised), Other Professional Pronouncements, and Other Requirements*

9. *The practitioner is required to comply with HKSAE 3000 (Revised) and this HKSAE when performing an assurance engagement to report on an entity’s GHG statement.* This HKSAE supplements, but does not replace, HKSAE 3000 (Revised), and expands on how HKSAE 3000 (Revised) is to be applied in an assurance engagement to report on an entity’s GHG statement. (Ref: Para. A17)
10. Compliance with HKSAE 3000 (Revised) requires, among other things, compliance with Chapter A, Parts 1, 3 and 4B, and Chapter C of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants (the Code) related to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding.<sup>6</sup> It also requires the engagement partner to be a member of a firm that

<sup>3</sup> HKSAE 3000 (Revised), paragraph 12(a)(ii)

<sup>4</sup> HKSAE 3000 (Revised), paragraph 12(a)(i)(b)

<sup>5</sup> HKSAE 3000 (Revised), paragraph 12(a)(iii)

<sup>6</sup> HKSAE 3000 (Revised), paragraphs 3(a), 20 and 34



- (g) If the GHG statement includes emissions deductions that are covered by the practitioner's conclusion, identification of those emissions deductions, and a statement of the practitioner's responsibility with respect to them. (Ref: Para. A136–A139)
- (h) Identification of the applicable criteria;
- (i) Identification of how those criteria can be accessed;
- (ii) If those criteria are available only to specific intended users, or are relevant only to a specific purpose, a statement alerting readers to this fact and that, as a result, the GHG statement may not be suitable for another purpose. The statement shall also restrict the use of the assurance report to those intended users or that purpose; and (Ref: Para. A140–A141)
- (iii) If established criteria need to be supplemented by disclosures in the explanatory notes to the GHG statement for those criteria to be suitable, identification of the relevant note(s). (Ref: Para. A131)
- (i) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1.
- (j) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements.
- (k) A description of the practitioner's responsibility, including:
- (i) A statement that the engagement was performed in accordance with HKSAC 3410, *Assurance Engagements on Greenhouse Gas Statements*; and
- (ii) An informative summary of the work performed as a basis for the practitioner's conclusion. In the case of a limited assurance engagement, an appreciation of the nature, timing, and extent of procedures performed is essential to understanding the practitioner's conclusion. In a limited assurance engagement, the summary of the work performed shall state that:
- 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; and
  - 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. (Ref: Para. A142–A144).
- (l) The practitioner's conclusion:
- (i) In a reasonable assurance engagement, the conclusion shall be expressed in a positive form; or

## Conformity and Compliance with International Standards on Assurance Engagements

79. As of September 2019, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3410, “Assurance Engagements on Greenhouse Gas Statements” except that references to IESBA’s Code of Ethics for Professional Accountants are replaced by HKICPA’s Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSAE ensures compliance with ISAE 3410.
80. Additional local guidance is provided in footnotes 28, 30a, 32 and 34a.

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## Application and Other Explanatory Material

### Introduction

#### *Assurance Engagements Covering Information in Addition to the GHG Statement (Ref: Para. 3)*

- A1. In some cases, the practitioner may perform an assurance engagement on a report that includes GHG information, but that GHG information does not comprise a GHG statement as defined in paragraph 14(m). In such cases, this HKSAE may provide guidance for such an engagement.
- A2. Where a GHG statement is a relatively minor part of the overall information that is covered by the practitioner’s conclusion, the extent to which this HKSAE is relevant is a matter for the practitioner’s professional judgment in the circumstances of the engagement.

#### *Key Performance Indicators Based on GHG Data (Ref: Para. 4(b))*

- A3. An example of a key performance indicator based on GHG data is the weighted average of emissions per kilometer of vehicles manufactured by an entity during a period, which is required to be calculated and disclosed by law or regulation in some jurisdictions.

#### *Procedures for Reasonable Assurance and Limited Assurance Engagements (Ref: Para. 8)*

- A4. Some procedures that are required only for reasonable assurance engagements may nonetheless be appropriate in some limited assurance engagements. For example, although obtaining an understanding of control activities is not required for limited assurance engagements, in some cases, such as when information is recorded, processed, or reported only in electronic form, the practitioner may nonetheless decide that testing controls, and therefore obtaining an understanding of relevant control activities, is necessary for a limited assurance engagement (see also paragraph A90).

#### *Independence (Ref: Para. 10 and 15)*

- A5. The Code adopts a threats and safeguards approach to independence. Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:
- Self-interest, for example, undue dependence on total fees from the entity.
  - Self-review, for example, performing another service for the entity that directly affects the GHG statement, such as involvement in the quantification of the entity’s emissions.

HKSAE 3420  
Issued April 2013, revised March 2014, December 2015,  
September 2019

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Effective for assurance reports  
dated on or after 15 December 2015

*Hong Kong Standard on Assurance Engagements 3420*

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# **Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus**



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

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**ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF  
PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS**

*Nature of Reasonable Assurance Engagement*

6. A reasonable assurance engagement to report on the compilation of pro forma financial information involves performing the procedures set out in this HKSAE to assess whether the applicable criteria used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether: (Ref: Para. A6)
- The related pro forma adjustments give appropriate effect to those criteria; and
  - The resulting pro forma column (see paragraph 11(c)) reflects the proper application of those adjustments to the unadjusted financial information.

It also involves evaluating the overall presentation of the pro forma financial information. The engagement, however, does not involve the practitioner updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information, or performing an audit or review of the financial information used in compiling the pro forma financial information.

*Relationship with HKSAE 3000 (Revised), Other Professional Pronouncements, and Other Requirements*

7. The practitioner is required to comply with HKSAE 3000 (Revised) and this HKSAE when performing an assurance engagement to report on the compilation of pro forma financial information included in a prospectus. This HKSAE supplements, but does not replace, HKSAE 3000 (Revised), and expands on how HKSAE 3000 (Revised) is to be applied in a reasonable assurance engagement to report on the compilation of pro forma financial information included in a prospectus.
8. Compliance with HKSAE 3000 (Revised) requires, among other things, compliance with Chapter A, Parts 1, 3 and 4B, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding.<sup>3</sup> It also requires the engagement partner to be a member of a firm that applies HKSQC 1,<sup>4</sup> or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1.

**Effective Date**

9. This HKSAE is effective for assurance reports dated on or after 15 December 2015.

**Objectives**

10. The objectives of the practitioner are<sup>4a</sup>:
- (a) To obtain reasonable assurance about whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria; and
  - (b) To report in accordance with the practitioner's findings.

**Definitions**

11. For purposes of this HKSAE, the following terms have the meanings attributed below:
- (a) Applicable criteria – The criteria used by the responsible party when compiling the pro forma financial information. Criteria may be established by an authorized or recognized standard-setting organization or by law or regulation<sup>2a</sup>. Where established criteria do not exist, they will be developed by the responsible party. (Ref: Para. A7–A9)

<sup>3</sup> HKSAE 3000 (Revised), paragraphs 3(a), 20 and 34

<sup>4</sup> HKSAE 3000 (Revised), paragraphs 3(b) and 31(a). Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>4a</sup> For reporting under the Listing Rules, refer to the Listing Rules 4.29(7)/ 7.31(7) as set out in Appendix 2.

**ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF  
PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS**

- (iv) A reference to the applicable criteria on the basis of which the responsible party has performed the compilation of the pro forma financial information, and the source of the criteria;
- (d) A statement that the responsible party is responsible for compiling the pro forma financial information on the basis of the applicable criteria;
- (e) A description of the practitioner's responsibilities, including statements that:
  - (i) The practitioner's responsibility is to express an opinion about whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria;
  - (ii) For purposes of this engagement, the practitioner is not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information, nor has the practitioner, in the course of this engagement, performed an audit or review of the financial information used in compiling the pro forma financial information; and
  - (iii) The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. Accordingly, the practitioner does not provide any assurance that the actual outcome of the event or transaction at that date would have been as presented;
- (f) A statement that the engagement was performed in accordance with HKSAE 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, which requires that the practitioner plan and perform procedures to obtain reasonable assurance about whether the responsible party has compiled, in all material respects, the pro forma financial information on the basis of the applicable criteria;
- (g) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1.
- (h) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements.
- (i) Statements that:
  - (i) A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether:
    - The related pro forma adjustments give appropriate effect to those criteria; and
    - The pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information;

**ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF  
PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS**

- (ii) The procedures selected depend on the practitioner's judgment, having regard to the practitioner's understanding of the nature of the entity, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances; and
- (iii) The engagement also involves evaluating the overall presentation of the pro forma financial information;
- (j) Unless otherwise required by law or regulation<sup>6b</sup>, the practitioner's opinion using one of the following phrases, which are regarded as being equivalent: (Ref: Para. A54–A56)
  - (i) The pro forma financial information has been compiled, in all material respects, on the basis of the [*applicable criteria*]; or
  - (ii) The pro forma financial information has been properly compiled on the basis stated;
- (k) The practitioner's signature;
- (l) The date of the report<sup>6c</sup>; and
- (m) The location in the jurisdiction where the practitioner practices.

### **Conformity and Compliance with International Standards on Assurance Engagements**

- 36. As of September 2019, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3420, "Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus" except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSAE ensures compliance with ISAE 3420.
- 37. Additional local explanation is provided in paragraph 1-1, paragraph 11(d) (second sentence), footnotes 2a, 4a, 4b, 5a, 5b, 5c, 5d, 5e, 5f, 5g, 5h, 5i, 5j, 5k, 6a, 6b, 6c, 8a, 9a, 10a and Appendices 2 – 4.

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### **Application and Other Explanatory Material**

#### **Scope of this HKSAE (Ref: Para. 1)**

- A1. This standard does not deal with circumstances where pro forma financial information is provided as part of the entity's financial statements pursuant to the requirements of an applicable financial reporting framework.

#### **Purpose of Pro Forma Financial Information Included in a Prospectus (Ref: Para. 4, 11(c), 14(c), 26(a))**

- A2. Pro forma financial information is accompanied by related explanatory notes that often disclose the matters set out in paragraph A42.
- A3. Different presentations of pro forma financial information may be included in the prospectus depending on the nature of the event or transaction and how the responsible party intends to illustrate the impact of such event or transaction on the unadjusted financial information of the entity. For example, the entity may acquire a number of businesses prior to an initial public offering. In such circumstances, the responsible party may choose to present a pro forma net asset statement to illustrate the impact of the acquisitions on the entity's financial position and key ratios such as debt to equity as if the acquired businesses had been combined with the entity at an earlier date. The responsible party may also choose to present a pro forma

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<sup>6b</sup> For reporting under the Listing Rules, refer to Listing Rules 4.29(7)/ 7.31(7) in Appendix 2.

<sup>6c</sup> For reporting under the Listing Rules, the accountant's report is normally dated on the same date as the investment circular in which it is included or to which it relates.

**ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF  
PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS**

income statement to illustrate what the results of operations might have been for the period ended on that date. In such cases, the nature of the pro forma financial information may be described by titles such as "Statement of Pro Forma Net Assets as at 31 December 20X1" and "Pro Forma Income Statement for the Year Ended 31 December 20X1."

**Compilation of Pro Forma Financial Information**

*Unadjusted Financial Information* (Ref: Para. 5, 11(f), 14(a))

- A4. In many cases, the source from which the unadjusted financial information has been extracted will be published financial information such as annual or interim financial statements.
- A5. Depending on how the responsible party chooses to illustrate the impact of the event or transaction, the unadjusted financial information may comprise either:
- One or more single financial statements, such as a statement of financial position and a statement of comprehensive income; or
  - Financial information that is appropriately condensed<sup>4b</sup> from a complete set of financial statements, for example, a statement of net assets.

**Nature of Reasonable Assurance Engagement** (Ref: Para. 6)

- A6. In this HKSAE, describing the pro forma financial information as being "properly compiled" means that the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.

**Definitions**

*Applicable Criteria* (Ref: Para. 11(a))

- A7. Where established criteria for compiling the pro forma financial information do not exist, the responsible party will have developed the criteria based on, for example, practice in a particular industry or the criteria of a jurisdiction that has developed established criteria, and disclosed that fact.
- A8. The applicable criteria for compiling the pro forma financial information will be suitable in the circumstances if they meet the requirements set out in paragraph 14.
- A9. Accompanying explanatory notes may include some additional detail about the criteria to describe how they illustrate the effects of the particular event or transaction. This may include, for example:
- The date at which the event is assumed to have occurred or the transaction been undertaken.
  - The approach used for allocating income, overheads, assets and liabilities between relevant businesses in a divestment.

**Engagement Acceptance**

*Capabilities and Competence to Perform the Engagement* (Ref: Para. 13(a))

- A10. The Code requires the practitioner to maintain appropriate professional knowledge and skill, including an awareness and understanding of relevant technical, professional and business developments, in order to provide competent professional service.<sup>7</sup> In the context of this requirement of the Code, relevant capabilities and competence to perform the engagement also include matters such as the following:
- Knowledge and experience of the industry in which the entity operates;
  - An understanding of the relevant securities laws and regulations and related developments;
  - An understanding of the listing requirements of the relevant securities exchange and of capital market transactions such as mergers, acquisitions and securities offerings;

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<sup>7</sup> The Code, Chapter A, Part 1, paragraphs R113.1–113.1 A2.



**ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF  
PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS**

Further Appropriate Action (Ref: Para. 23(b), 24)

A40. Further appropriate action that the practitioner may take includes, for example:

- In relation to the requirement in paragraph 23(b):
  - Discussing the matter with the responsible party.
  - Where possible under relevant law or regulation, making a reference in the practitioner's report to the modified audit opinion, review conclusion, or the Emphasis of Matter paragraph, if, in the practitioner's professional judgment, the matter is of sufficient relevance and importance to users' understanding of the pro forma financial information.
- In relation to the requirement in paragraph 24, where possible under relevant law or regulation, modifying the practitioner's opinion.
- Where possible under relevant law or regulation, withholding the report or withdrawing from the engagement.
- Seeking legal advice.

*Evaluating the Presentation of the Pro Forma Financial Information*

Avoiding Association with Misleading Financial Information (Ref: Para. 26(b))

A41. The Code requires that a practitioner not knowingly be associated with reports, returns, communications or other information that the practitioner believes:<sup>9</sup>

- (a) Contain a materially false or misleading statement;
- (b) Contain statements or information furnished recklessly; or
- (c) Omit or obscure information required to be included where such omission or obscurity would be misleading.

Disclosures Accompanying the Pro Forma Financial Information<sup>9a</sup> (Ref: Para. 14(c), 26(c))

A42. Appropriate disclosures may include matters such as:

- The nature and purpose of the pro forma financial information, including the nature of the event or transaction, and the date at which such event is assumed to have occurred or transaction been undertaken;
- The source from which the unadjusted financial information has been extracted, and whether or not an audit or review report on such a source has been published;
- The pro forma adjustments, including a description and explanation of each adjustment. This includes, in the case of acquiree or divestee financial information, the source from which such information has been extracted and whether or not an audit or review report on such a source has been published;
- If not publicly available, a description of the applicable criteria on the basis of which the pro forma financial information has been compiled; and
- A statement to the effect that the pro forma financial information has been compiled for illustrative purposes only and that, because of its nature, it does not represent the entity's actual financial position, financial performance, or cash flows.

Relevant law or regulation may require these or other specific disclosures.

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<sup>9</sup> The Code, Chapter A, Part 1, R111.2 and R111.3.

<sup>9a</sup> For reporting under the Listing Rules, refer to Listing Rules 4.29(2)/ 7.31(2) as set out in Appendix 2.

HKSIR 500  
Issued April 2014; revised December 2015, September 2019

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Effective for reports dated on or after 15 December 2015

*Hong Kong Standard on  
Investment Circular Reporting Engagements 500*

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# **Reporting on Profit Forecasts, Statements of Sufficiency of Working Capital and Statements of Indebtedness**



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

REPORTING ON PROFIT FORECASTS, STATEMENTS OF SUFFICIENCY OF WORKING CAPITAL AND STATEMENTS OF INDEBTEDNESS

- (b)
    - (i) that the reporting accountants' instructions and responsibilities for reporting are limited to the requirements under the regulations and do not constitute an audit;
    - (ii) that the directors assume full responsibility for the Profit Forecast under review; and
    - (iii) that the directors will signify their responsibility for formal adoption by the board;
  - (c) that the Profit Forecast is for:
    - (i) an expired accounting period;
    - (ii) the current (or unexpired) accounting period; or
    - (iii) the current and the immediately succeeding accounting period, provided that a sufficiently significant part of the current period has already elapsed;
  - (d) no material restrictions on the scope of the reporting accountants' work (for example, by restricting visits to overseas companies or material factory units) can normally be accepted unless the matter is dealt with in the reporting accountants' letter and in the published documents; and
  - (e) that the time within which the reporting accountants' letter is required is not so severely restricted that, having regard to the Issuer's circumstances and forecasting experience, and notwithstanding their best endeavours, it would be plainly impossible for the reporting accountants to obtain sufficient information to enable them properly to exercise their professional judgement.
27. In the case of a Profit Forecast in an investment circular relating to a new listing of equity securities, the sponsors should report whether or not they have satisfied themselves that the forecast has been stated by the directors after due and careful enquiry. In the case of a Profit Forecast in a document connected with an offer, the Takeover Code requires that any adviser mentioned in the document should also report on the forecast. The responsibilities of such persons are distinct from those of the reporting accountants. From the outset, liaison should be established with such other advisers to ensure that there is no doubt or misunderstanding on either side as to the respective responsibilities or as to the work which will be carried out by each party to enable it to fulfil its reporting function.
28. The reporting accountants should consider materiality when determining the nature, timing and extent of evidence-gathering procedures. Considering materiality requires the reporting accountants to understand and assess what factors might influence the decisions of the intended users. The reporting accountants may also consider factors such as the preciseness of the Profit Forecast being made by the Issuer's directors. The reporting accountants should make reference to HKSAE 3000 (Revised) for further guidance when determining materiality.
29. When reporting on the Profit Forecast, the reporting accountants should plan and perform the work in accordance with this HKSIR and with reference to HKSAE 3000 (Revised). HKSAE 3000 (Revised) requires, among other things, compliance with Chapter A, Parts 1, 3 and 4B, and Chapter C of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding.<sup>8</sup> It also requires the engagement partner to be a member of a firm that applies HKSQC 1,<sup>9</sup> or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. The degree of work

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<sup>8</sup> HKSAE 3000 (Revised), paragraphs 3(a), 20 and 34

<sup>9</sup> HKSAE 3000 (Revised), paragraphs 3(b) and 31(a). Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

- (c) whether the Profit Forecast under review represents the management's best estimate of results which they reasonably believe can and will be achieved as distinct from targets which the management have set as desirable;
- (d) whether all significant implications of management's assumptions have been taken into consideration. For example, if sales are assumed to grow beyond the entity's current plant capacity, the Profit Forecast will need to include the necessary investment in the additional plant capacity or the costs of alternative means of meeting the anticipated sales, such as subcontracting production. Reporting accountants would need to be satisfied that they are consistent with the purpose of the Profit Forecast and that there is no reason to believe they are clearly unrealistic;
- (e) the extent to which those areas that are particularly sensitive to variation will have a material effect on the results shown in the Profit Forecast. This will influence the extent to which the reporting accountants will seek appropriate evidence and the reporting accountants' evaluation of the appropriateness and adequacy of disclosure;
- (f) when any elapsed portion of the current period is included in the Profit Forecast, the extent to which procedures need to be applied to the historical information. Procedures will vary depending on the circumstances, for example, how much of the prospective period has elapsed;
- (g) the extent to which Profit Forecast results for expired periods are supported by reliable interim accounts;
- (h) the details of the procedures followed to generate the Profit Forecast and the extent to which it is built up from detailed profit forecasts of activity and cash flow;
- (i) the extent to which profits are derived from activities having a proven and consistent trend and those of a more irregular, volatile or unproven nature;
- (j) how the Profit Forecast takes account of any material unusual items and prior year adjustments, their nature, and how they are presented; and
- (k) whether adequate provision is made for foreseeable losses and contingencies and how the Profit Forecast takes account of factors which may cause it to be subject to a high degree of risk, or which may invalidate the assumptions.

#### **The reporting accountants' letter**

31. The reporting accountants' letter will be addressed to the directors and to the sponsors (in the case of a new listing of equity securities) and will normally include statements dealing with the following matters, so far as appropriate:
- (a) specific identification of the Profit Forecast and documents to which the letter refers;
  - (b) the fact that the directors are solely responsible for the Profit Forecast;
  - (c) that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1;
  - (d) that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Chapter A, Parts 1, 3 and 4B, and Chapter C of the Code related to assurance engagements;
  - (e) the fact that the reporting accountants have reviewed the accounting policies and calculations used in arriving at the Profit Forecast;

HKSRS 4410 (Revised)  
Revised July 2012, January 2019, September 2019

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Effective for compilation engagement  
reports dated on or after 1 July 2013

*Hong Kong Standard on Related Services 4410 (Revised)*

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# Compilation Engagements



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financial information to be presented fairly, in all material respects, or to give a true and fair view.

- (f) *Practitioner* – A professional accountant in public practice who conducts the compilation engagement. The term includes the engagement partner or other members of the engagement team, or, as applicable, the firm. Where this HKSRS expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “practitioner” is used. “Engagement partner” and “firm” are to be read as referring to their public sector equivalents where relevant.
- (g) *Relevant ethical requirements* – Ethical requirements the engagement team is subject to when undertaking compilation engagements. These requirements ordinarily comprise Chapter A, Parts 1 and 3, and Chapter C of the HKICPA’s *Code of Ethics for Professional Accountants* (the Code), together with local requirements that are more restrictive. (Ref: Para. A21)

## Requirements

### Conduct of a Compilation Engagement in Accordance with this HKSRS

- 18. The practitioner shall have an understanding of the entire text of this HKSRS, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

#### *Complying with Relevant Requirements*

- 19. The practitioner shall comply with each requirement of this HKSRS unless a particular requirement is not relevant to the compilation engagement, for example if the circumstances addressed by the requirement do not exist in the engagement.
- 20. The practitioner shall not represent compliance with this HKSRS unless the practitioner has complied with all requirements of this HKSRS relevant to the compilation engagement.

### Ethical Requirements

- 21. The practitioner shall comply with relevant ethical requirements. (Ref: Para. A19–A26)

### Professional Judgment

- 22. The practitioner shall exercise professional judgment in conducting a compilation engagement. (Ref: Para. A27–A29)

### Engagement Level Quality Control

- 23. The engagement partner shall take responsibility for:
  - (a) The overall quality of each compilation engagement to which that partner is assigned; and
  - (b) The engagement being performed in accordance with the firm’s quality control policies and procedures, by: (Ref: Para. A30)
    - (i) Following appropriate procedures regarding the acceptance and continuance of client relationships and engagements; (Ref: Para. A31)

- (e) Identification of the applicable financial reporting framework and, if a special purpose financial reporting framework is used, a description or reference to the description of that special purpose financial reporting framework in the financial information;
  - (f) Identification of the financial information, including the title of each element of the financial information if it comprises more than one element, and the date of the financial information or the period to which it relates;
  - (g) A description of the practitioner's responsibilities in compiling the financial information, including that the engagement was performed in accordance with this HKSRS, and that the practitioner has complied with relevant ethical requirements;
  - (h) A description of what a compilation engagement entails in accordance with this HKSRS;
  - (i) Explanations that:
    - (i) Since a compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or completeness of the information provided by management for the compilation; and
    - (ii) Accordingly, the practitioner does not express an audit opinion or a review conclusion on whether the financial information is prepared in accordance with the applicable financial reporting framework.
  - (j) If the financial information is prepared using a special purpose financial reporting framework, an explanatory paragraph that: (Ref: Para. A65–A67)
    - (i) Describes the purpose for which the financial information is prepared and, if necessary, the intended users, or contains a reference to a note in the financial information that discloses this information; and
    - (ii) Draws the attention of readers of the report to the fact that the financial information is prepared in accordance with a special purpose framework and that, as a result, the information may not be suitable for other purposes;
  - (k) The date of the practitioner's report;
  - (l) The practitioner's signature; and
  - (m) The practitioner's address.
41. The practitioner shall date the report on the date the practitioner has completed the compilation engagement in accordance with this HKSRS. (Ref: Para. A68)

### **Conformity and Compliance with International Standards on Related Services**

42. As of September 2019, this HKSRS conforms with International Standard on Related Services (ISRS) 4410 (Revised), "Compilation Engagements" except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSRS ensures compliance with ISRS 4410 (Revised).
43. Additional local guidance is provided in footnote 8a, footnote 9a of Appendix 1 and footnotes 9b, 9c, 10a, 10b and 11a of Appendix 2.

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*Financial Reporting Frameworks (Ref: Para. 10)*

A16. The financial information may be prepared in accordance with a financial reporting framework designed to meet:

- The common financial information needs of a wide range of users (that is, a “general purpose financial reporting framework”); or
- The financial information needs of specific users (that is, a “special purpose financial reporting framework”).

The requirements of the applicable financial reporting framework determine the form and content of the financial information. The financial reporting framework may, in some cases, be referred to as the “basis of accounting.”

A17. Examples of commonly used general purpose financial reporting frameworks are:

- Hong Kong Financial Reporting Standards (HKFRS).
- International Financial Reporting Standards (IFRS).
- Hong Kong Financial Reporting Standards for Private Entities (HKFRS-PE).
- Hong Kong Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF & SME-FRS).
- International Financial Reporting Standards for Small- and Medium-Sized Entities (IFRS for SMEs).

A18. Examples of special purpose financial reporting frameworks that may be used, depending on the particular purpose of the financial information, are:

- The tax basis of accounting used in a particular jurisdiction to prepare financial information to fulfill tax compliance obligations.
- For entities not required to use an established financial reporting framework:
  - A basis of accounting used in the financial information of a particular entity that is appropriate for the intended use of the financial information and the entity’s circumstances (for example, use of the cash basis of accounting with selected accruals, such as accounts receivable and accounts payable, leading to a balance sheet and income statement; or use of an established financial reporting framework that is modified to suit the particular purpose for which the financial information is prepared).
  - The cash basis of accounting leading to a statement of receipts and disbursements (for example, for the purpose of allocating the excess of cash receipts over disbursements to the owners of a rental property; or to record movements in the petty cash fund of a club).

**Ethical Requirements (Ref: Para. 21)**

A19. Chapter A, Part 1 of the Code establishes the fundamental principles of professional ethics that practitioners must comply with, and provides a conceptual framework for applying those principles. The fundamental principles are:

- (a) Integrity;



- (b) Objectivity;
- (c) Professional competence and due care;
- (d) Confidentiality; and
- (e) Professional behavior.

Chapter A, Part 3 of the Code illustrates how the conceptual framework is to be applied in specific situations. In complying with the Code, threats to the practitioner's compliance with relevant ethical requirements are required to be identified and appropriately addressed.

*Ethical Considerations Regarding the Practitioner's Association with Information (Ref: Para. 21, 24(a)–(d))*

- A20. Under the Code,<sup>5</sup> in applying the principle of integrity, a professional accountant is required to not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:
- (a) Contains a materially false or misleading statement;
  - (b) Contains statements or information furnished recklessly; or
  - (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

When a professional accountant becomes aware that the accountant has been associated with such information, the accountant is required by the Code to take steps to be disassociated from that information.

*Independence (Ref: Para. 17(g), 21)*

- A21. Notwithstanding that Chapter A, Part 4A—*Independence For Audit and Review Engagements* and Part 4B—*Independence For Assurance Engagements Other Than Audit and Review Engagements* of the Code do not apply to compilation engagements, local ethical codes or laws or regulations may specify requirements or disclosure rules pertaining to independence.

*Reporting of Identified or Suspected Non-Compliance with Laws and Regulations to an Appropriate Authority outside the Entity*

- A22. Law, regulation or relevant ethical requirements may:
- (a) Require the practitioner to report identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity.
  - (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.<sup>6</sup>
- A23. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:
- (a) Law, regulation or relevant ethical requirements require the practitioner to report;

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<sup>5</sup> The Code, Chapter A, Part 1, paragraphs R111.2 and R111.3.

<sup>6</sup> See, for example, Chapter A, Part 3, paragraphs 360.36 A2–360.36 A3 of the Code.

- (b) The practitioner has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements; or
  - (c) Law, regulation or relevant ethical requirements provide the practitioner with the right to do so.
- A24. Under paragraph 28 of this HKSRS, the practitioner is not expected to have a level of understanding of laws and regulations beyond that necessary to be able to perform the compilation engagement. However, law, regulation or relevant ethical requirements may expect the practitioner to apply knowledge, professional judgment and expertise in responding to identified or suspected non-compliance. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.
- A25. In some circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the practitioner's duty of confidentiality under law, regulation or relevant ethical requirements. In other cases, reporting identified or suspected non-compliance to an appropriate authority outside the entity would not be considered a breach of the duty of confidentiality under the relevant ethical requirements.<sup>7</sup>
- A26. The practitioner may consider consulting internally (e.g., within the firm or network firm), obtaining legal advice to understand the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or a professional body (unless doing so is prohibited by law or regulations or would breach the duty of confidentiality).<sup>8</sup>

**Professional Judgment (Ref: Para. 22, 24(e)(iii))**

- A27. Professional judgment is essential to the proper conduct of a compilation engagement. This is because interpretation of relevant ethical requirements and the requirements of this HKSRS, and the need for informed decisions throughout the performance of a compilation engagement, require the application of relevant knowledge and experience to the facts and circumstances of the engagement. Professional judgment is necessary, in particular, when the engagement involves assisting management of the entity regarding decisions about:
- The acceptability of the financial reporting framework that is to be used to prepare and present the financial information of the entity, in view of the intended use of the financial information and the intended users thereof.
  - The application of the applicable financial reporting framework, including:
    - Selection of appropriate accounting policies under that framework;

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<sup>7</sup> See, for example, Chapter A, Part 1, paragraph 114.1 A1 and Part 3, paragraph R360.37 of the Code.

<sup>8</sup> See, for example, Chapter A, Part 3, paragraph 360.39 A1 of the Code.

PN 620.2 (Revised)  
Revised February 2013, January 2018, September 2019

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Effective upon issue

*Practice Note 620.2 (Revised)*

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# **Communication between the Auditor and the Insurance Authority**



Hong Kong Institute of  
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香港會計師公會

**PRACTICE NOTE**

**620.2 (REVISED)**

**COMMUNICATION BETWEEN THE AUDITOR AND  
THE INSURANCE AUTHORITY**

*(Issued May 1998; revised September 2004 (name change); revised February 2013, January 2018,  
30 September 2019) Effective upon issue*

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Practice Note (PN) 620.2, *Communication between the Auditor and the Insurance Authority* 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.

## PRACTICE NOTE

### 620.2 (REVISED)

## COMMUNICATION BETWEEN THE AUDITOR AND THE INSURANCE AUTHORITY

*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.*

### Introduction

1. In this Practice Note all the sections mentioned below are in respect of the Hong Kong Insurance Ordinance ("the Ordinance") unless otherwise stated. The Insurance Companies Ordinance (Cap. 41) has been renamed as the "Insurance Ordinance" since section 4 of the Insurance Companies (Amendment) Ordinance 2015 ("Amendment Ordinance") came into operation on 26 June 2017.
2. In line with the overhaul of the insurance regulatory framework effected by the passing of the Amendment Ordinance, the Insurance Authority will take over the regulation of insurance intermediaries from the three self-regulatory organizations (i.e. the Insurance Agents Registration Board established under the Hong Kong Federation of Insurers, the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association) through a statutory licensing regime in Hong Kong. This change and corresponding provisions of the Amendment Ordinance took effect on 23 September 2019 ("commencement date"). Under the new regime, any company which wishes to apply to the Insurance Authority for a licence to operate as an insurance broker company, or to renew such licence, will have to be able to demonstrate its ability to comply, or continue to comply, amongst other things, with rules made by the Insurance Authority under section 129 of the Ordinance.
3. Section 53D of the Ordinance provides statutory protection for the auditor from liability to the client for breach of confidentiality when the auditor communicates directly with the Insurance Authority. Sections 15A(2), 53E and 53F impose a statutory obligation on the auditor to report certain matters directly to the Insurance Authority.
4. This Practice Note refers to the auditor, audits, reports on the annual financial statements and reports on the accounts and statements ("financial information") an authorized insurer or a licensed insurance broker company is required to submit to the Insurance Authority.
5. This Practice Note is applicable to:
  - a. an auditor or former auditor of an authorized insurer or a former insurer appointed under section 15 or section 4(1A) of Part 1 of Schedule 3 to the Ordinance ("Schedule 3");
  - b. an accountant or former accountant of an authorized insurer or a former insurer appointed in compliance with a requirement under section 35(1); and
  - c. an auditor or former auditor of a licensed insurance broker company appointed under section 72.

## Scope of the Ordinance

6. The Ordinance regulates the carrying on of insurance business in Hong Kong. One of the primary purposes of the Ordinance is the protection of policy holders and potential policy holders. The Insurance Authority is charged under section 4A with the functions set out below.
  - a. The principal function of the Insurance Authority shall be to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders (section 4A(1)).
  - b. Without limiting the generality of section 4A(1), the Insurance Authority shall:
    - i. be responsible for supervising an authorized insurer's and a licensed insurance intermediary's compliance with the provisions of the Ordinance;
    - ii. consider and propose reforms of the law relating to insurance business;
    - iii. promote and encourage the adoption of proper standards of conduct and sound and prudent business practices by authorized insurers;
    - iv. promote and encourage the adoption of proper standards of conduct by licensed insurance intermediaries;
    - v. review and, if necessary, propose reforms of the systems for regulating authorized insurers and licensed insurance intermediaries;
    - vi. regulate the conduct of insurance intermediaries through a licensing regime;
    - vii. promote the understanding by policy holders and potential policy holders of insurance products and the insurance industry;
    - viii. formulate effective regulatory strategies and facilitate the sustainable market development of the insurance industry, and promote the competitiveness of the insurance industry in the global insurance market;
    - ix. conduct studies into matters affecting the insurance industry;
    - x. assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate measures in relation to the insurance industry;
    - xi. co-operate with and assist financial services supervisory authorities of Hong Kong or of any place outside Hong Kong, whenever appropriate, to the extent permitted by the Ordinance; and
    - xii. perform functions imposed or conferred on the Insurance Authority by this or any other Ordinance (section 4A(2)).
  
7. Schedule 3 specifies the form and content of the financial information which an authorized insurer is required to submit annually to the Insurance Authority. The auditor is required to report on the financial information and the report will in general terms cover such matters as:
  - a. the maintenance of proper books and records by the insurer;
  - b. the proper preparation of the financial information;
  - c. the fairness of presentation of the financial information;
  - d. the valuation of assets and liabilities in accordance with applicable valuation regulations; and
  - e. the maintenance of assets in accordance with the Ordinance.

Detailed guidance is set out in PN 810.2 (Revised), *The Duties of the Auditor of an Insurer authorized under the Insurance Ordinance*.

8. Section 73(1) specifies the form of financial statements which a licensed insurance broker company, licensed by the Insurance Authority under section 64ZA, is required to provide to the Insurance Authority within 6 months after the end of each financial year. The auditor is required to report on the licensed insurance broker company's financial statements and compliance with rules made under section 129 that set out the following requirements:
  - a. capital and net assets;
  - b. professional indemnity insurance;
  - c. keeping of separate client accounts; and
  - d. keeping proper books and accounts.

In April 2019, the Insurance Authority published the *Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules* ("Rules") under section 129 of the Ordinance. The Rules prescribe the requirements applicable to licensed insurance broker companies. Detailed guidance is set out in PN 810.1 (Revised), *Licensed Insurance Brokers Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules*.

9. In addition, authorized insurers and licensed insurance broker companies who are incorporated in Hong Kong are required to prepare financial statements and to have them audited under the provisions of the Hong Kong Companies Ordinance.
10. In the course of performing the work necessary to discharge these routine audit reporting responsibilities, the auditor may become aware of matters which the auditor considers need to be brought to the Insurance Authority's attention through an "ad hoc report", other than through the medium of the routine formal audit report.
11. This Practice Note is concerned only with ad hoc communications between the auditor and the Insurance Authority:
  - a. by the auditor to the Insurance Authority under the obligations established in sections 15A(2), 53E and 53F;
  - b. by the auditor to the Insurance Authority under the protection of section 53D; and
  - c. by the Insurance Authority to the auditor under section 53A(3)(da) and (f).

It does not cover the auditor's approach to the audit of an authorized insurer or a licensed insurance broker company or the routine audit reporting responsibilities.

12. Certain expressions used in the Ordinance may be matters for legal interpretation. There may, therefore, be circumstances in which, notwithstanding the guidance in this Practice Note, the auditor will wish to take legal advice.

## **Reporting under the Ordinance**

13. The Insurance Authority expects that the management of an authorized insurer or a licensed insurance broker company will continue to be its primary source of information and that the normal authorized reporting procedures, including returns, discussions, examinations and any tripartite meetings will normally provide the Insurance Authority with most of the information it needs to carry out its responsibilities under the Ordinance.

14. Nevertheless, under the Ordinance, the auditor has various statutory responsibilities to report to the Insurance Authority on matters concerning its client (i.e. an authorized insurer or a licensed insurance broker company). Section 53D provides statutory protection to the auditor from liability for breach of confidentiality owed to its client when making a report in good faith in discharge of such a statutory responsibility or other reports to the Insurance Authority which the auditor may consider to be relevant to the functions of the Insurance Authority. These responsibilities and avenues available for reporting do not require the auditor to change the scope of the audit work, nor the frequency or timing of the visits.
15. The auditor is advised to bear in mind that the auditor's decision may have to stand up to examination at a future date on the basis of the following considerations:
  - a. what the auditor knew at the time;
  - b. what the auditor should have known in the course of the audit;
  - c. what the auditor should have concluded; and
  - d. what the auditor should have done.

**The auditor's notices to the Insurance Authority under section 15A(2)**

16. The auditor has a statutory duty to give immediate written notice to the Insurance Authority in the circumstances set out below.
  - a. If the auditor resigns (section 15A(2)(a)).
  - b. If the auditor decides not to seek reappointment (section 15A(2)(b)).
  - c. If the auditor decides to add a qualification or adverse statement to the auditor's report annexed to the financial information of the authorized insurer required to be submitted under Schedule 3 (section 15A(2)(c)).

The decision to give written notice would normally only be taken after extensive discussions with management and when a problem is either irremediable or when the circumstances indicate that the auditor intends to qualify.

Section 15A(2) applies to the auditor of an authorized insurer appointed under section 15 or section 4(1A) of Part 1 of Schedule 3.

**Ad hoc reports under sections 53E and 53F**

17. Sections 53E and 53F specify that an auditor should report directly to the Insurance Authority in certain cases relating to authorized insurers and licensed insurance broker companies.
18. Section 53E provides that where an auditor, during the discharge of the duties in that capacity:
  - a. becomes aware of any matter... which in the auditor's opinion adversely affects the financial condition of the insurer to a material extent, the auditor shall, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the matter (section 53E(1)); and
  - b. becomes aware of evidence...
    - i. of a failure by the insurer to comply with any conditions imposed under section 8(1)(a);



- ii. that there exists a ground on which the Insurance Authority would be prohibited by section 8(3)(a), (b), (d) or (f) from authorizing the insurer if the insurer were to make application in that behalf;
- iii. of a failure by the insurer to comply with any of the provisions of section 22, 22A or 23; or
- iv. of any default of the insurer in complying with any requirement under sections 27, 28, 29, 30, 31, 32, 33, 34 or 35(1),

the auditor shall, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the failure, ground or default (section 53E(3)).

Section 53E applies to:

- a. an auditor or former auditor of an authorized insurer or a former insurer appointed under section 15 or section 4(1A) of Part 1 of Schedule 3; and
- b. an accountant or former accountant of an authorized insurer  
or a former insurer appointed in compliance with a requirement under section 35(1).

19. Section 53F provides that where an auditor or a former auditor, during the discharge of the duties in that capacity, becomes aware of any evidence of a failure by:

- (i) a licensed insurance broker company;
- (ii) a former licensed insurance broker company; or
- (iii) a person who was formerly an authorized insurance broker within the meaning of the pre-amended Ordinance;

to comply with the specified rules<sup>1</sup>, he/she must, as soon as practicable thereafter, send to the Insurance Authority a report in writing of the failure (section 53F(1) and (2)).

20. These are statutory obligations and the following paragraphs of the Practice Note provide the auditor with procedures to follow when such circumstances arise.

### Reporting criterion under sections 53E and 53F

21. The auditor would take the initiative and ensure that an ad hoc report under sections 53E and 53F are made to the Insurance Authority if the conditions specified in paragraphs 18 and 19 exist. A distinction must be drawn here between an auditor's duty as stated in paragraph 18(a) and that stated in paragraphs 18(b) and 19. The duty under paragraphs 18(b) and 19 is clear and unequivocal; if the auditor becomes aware of a contravention of the provisions in the Ordinance and specified rules<sup>1</sup>, the auditor is not given any latitude for exercising judgement. The auditor is obliged to make a report. The duty under paragraph 18(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 authorized insurer's financial position in deciding whether reporting would be appropriate.

The HKICPA has developed a criterion for use by the auditor in deciding to take the initiative in making an ad hoc report under section 53E in addition to the regular audit reporting

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<sup>1</sup> Specified rules under section 53F refer to:

- (a) in relation to a licensed insurance broker company or a former licensed insurance broker company, means rules made under section 129 that set out the requirements in relation to the (i) capital and net assets; (ii) professional indemnity insurance; (iii) keeping of separate client accounts and (iv) keeping of proper books and accounts by a licensed insurance broker company; or
- (b) in relation to a person who was formerly an authorized insurance broker within the meaning of the pre-amended Ordinance, means the minimum requirements specified by the former authority under the pre-amended Ordinance.

responsibilities. The criterion is that the auditor would make the report when the auditor considers it expedient to do so in order for the Insurance Authority to protect the interests of policy holders because there has been a material loss or there exists a significant risk of material loss.

22. 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, or
    - ii. loss of control over the assets or records.
23. Examples of the circumstances in which the situation set out in paragraphs 21 and 22 may be met include:
- a. the auditor discovers a failure by the authorized insurer to comply with the relevant provisions of the Ordinance 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 authorized insurer.

#### **Reporting procedures under sections 53E and 53F**

24. In circumstances where the auditor concludes that an ad hoc report under sections 53E and 53F to the Insurance Authority is necessary, the auditor would normally adopt the procedures set out below, bearing in mind that speed may be of the essence and that the statutory obligation to report under sections 15A(2), 53E and 53F remains subject to the criterion discussed in paragraphs 21 - 23.
- a. The auditor would normally discuss the matter with the authorized insurer or licensed insurance broker company and explain the statutory duty to make a report to the Insurance Authority under sections 53E or 53F. In addition, the authorized insurer or licensed insurance broker company may be advised to make its own report to the Insurance Authority immediately.
  - b. The auditor would normally then immediately inform the Insurance Authority of the circumstances in writing. It is suggested that a copy of both the written notification and the ad hoc report be made to the directors or management of the authorized insurer or licensed insurance broker company.
25. The auditor is reminded that making an ad hoc report alone may not discharge all the responsibilities. For example, the auditor would consider the implications of the matter giving rise to the ad hoc report for the auditor's opinion on the financial statements.

#### **Other ad hoc communications by the auditor**

##### **Statutory protection under section 53D**

26. Section 53D provides that:
- "(1) No duty which a prescribed person may be subject to shall be regarded as contravened by reason of his communicating in good faith to the Insurance Authority, whether or not in response to a request made by the Insurance Authority, any information or opinion on a matter:

- a. of which he becomes aware in his capacity as a prescribed person...; and
  - b. which is relevant to any function of the Insurance Authority under this Ordinance.
- (2) For the avoidance of doubt, it is hereby declared that a matter referred to in subsection (1) may be a matter which relates to a person other than -
- (a) an authorized insurer;
  - (b) a former insurer;
  - (c) a licensed insurance broker company;
  - (d) a former licensed insurance broker company; or
  - (e) a person who was formerly an authorized insurance broker within the meaning of the pre-amended Ordinance.
27. For the purposes of section 53D, "prescribed person" in this context refers to:
- a. an auditor, former auditor
    - (i) of an authorized insurer or a former insurer; and
    - (ii) appointed under section 15 or section 4(1A) of Part 1 of Schedule 3;
  - b. an accountant, former accountant
    - (i) of an authorized insurer or a former insurer; and
    - (ii) appointed by the insurer or former insurer in compliance with a requirement under section 35(1); or
  - c. an auditor or former auditor of—
    - (i) a licensed insurance broker company;
    - (ii) a former licensed insurance broker company; or
    - (iii) a person who was formerly an authorized insurance broker within the meaning of the pre-amended Ordinance.
28. Section 53D does not lay down any rules nor specify the circumstances in which the auditor is to communicate any matter to the Insurance Authority. It provides a statutory mechanism whereby the auditor may make matters known to the Insurance Authority without breaching the auditor's duty of confidentiality.
29. This section of the Practice Note contains guidance on the circumstances in which matters (which fall outside those which the auditor is obliged to report (see paragraphs 16 to 25 above)) may be brought to the attention of the Insurance Authority by way of a report with statutory protection. In interpreting this guidance, the auditor is advised to bear in mind the fundamental objectives of the legislation, which are to ensure that the Insurance Authority is able to fulfil its functions summarised in paragraph 6.
30. Confidentiality is an implied term of an auditor's contract with the client, but in certain circumstances and under conditions specified in section 53D 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 Insurance Authority's functions without the duty of confidentiality owed to the client being regarded as having been contravened.
31. The matters which may be communicated under section 53D are any of those relevant to the Insurance Authority's functions under the Ordinance.

32. Matters which may be reported under the protection of section 53D will only arise in circumstances where the auditor is under no duty to report under sections 15A(2), 53E or 53F. Considerable care needs to be taken in disclosing matters arising during any tripartite meeting with the Insurance Authority as the auditor's knowledge of these matters may have been obtained while assisting the Insurance Authority other than in the capacity as the auditor (see paragraph 35).

Examples of circumstances in which the auditor may communicate a matter to the Insurance Authority under section 53D include:

- a. the auditor considers policy holders have incurred, or are at significant risk of incurring, a material loss as a result of authorized insurers or licensed insurance broker companies carrying on business in a manner that is not fit and proper<sup>2</sup> or that is in breach of the Ordinance;
  - b. there is evidence of
    - i. fraud, dishonesty, misconduct<sup>3</sup> or serious incompetence; or
    - ii. serious failure to observe requirements of the Ordinance or conditions imposed on the authorized insurer or the licensed insurance broker company by the Insurance Authority;
  - 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 Insurance Authority to which the authorized insurer or licensed insurance broker company is subject; and
  - d. the position is such that because of a significant risk which is material to the collective interests of policy holders, the policy holders' interests would be better safeguarded if the Insurance Authority were aware of the position, even if only to organise protective action.
33. Clearly the potential nature of matters which may be reported is very wide, but as explained in paragraph 36 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 such as those described in paragraph 51 that the auditor may choose to seek statutory protection.
34. Any protected communication can be made either on the auditor's initiative or in response to a request from the Insurance Authority for information. The auditor would normally cooperate with the Insurance Authority and respond to any requests from the Insurance Authority for information, provided the auditor has no reason to doubt that the request is relevant to the Insurance Authority's functions. The auditor may communicate a matter to the Insurance Authority with the protection of section 53D regardless of the source of that information, provided the auditor became aware of the matter in the capacity as the auditor of the client and the auditor does so in good faith.
35. 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 Insurance Authority during the course of the work for the authorized insurer or licensed insurance broker company other than audit work or through private discussions on social or other occasions, in which case the information will be known to the auditor as individual. In circumstances which suggest that a matter would be reported to the Insurance Authority 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

<sup>2</sup> For determination of fit and proper, refer to sections 14A and 64ZZA of the Ordinance at: <https://www.elegislation.gov.hk/hk/cap41>

<sup>3</sup> For definition of misconduct, refer to sections 41P(5) and 80 of the Ordinance at: <https://www.elegislation.gov.hk/hk/cap41>

capacity. In addition, a matter which is relevant to the functions of the Insurance Authority and which is identified during the course of work for the client 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 37). The auditor may follow the guidance set out in HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*<sup>4</sup>.

36. The auditor cannot be expected to be aware of all circumstances which, had the auditor known of them, would have led the auditor to exercise the right to communicate under section 53D. 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 53D. 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 Insurance Authority 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 53D.
37. The auditor would, however, ensure that the auditor is made aware of any other relationships which may exist between any department of the firm and the client which could affect the work as the auditor. The Insurance Authority expects that the auditor will ensure that the auditor is informed of all potentially exceptional circumstances (paragraphs 51 and 52) by all other departments within the firm which have a relationship with the authorized insurer or licensed insurance broker company. It would, therefore, be prudent for the audit firm to ensure any exceptional circumstances which may give rise to reports under section 53D are brought to the attention of the auditor of the client in order that the auditor can, if appropriate, make enquiries in the capacity as the auditor to ascertain whether such matters should be reported to the Insurance Authority.
38. The Insurance Authority 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 an authorized insurer or a licensed insurance broker company. However, the Insurance Authority expects an authorized insurer or a licensed insurance broker company 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 Insurance Authority.
39. It should be noted that section 53D 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 Ordinance 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 Insurance Authority. 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 report are such as to secure the protection of section 53D<sup>3</sup> and that it only includes relevant material.
40. The auditor is protected from a breach of confidentiality owed to its client even if the information which the auditor communicates falls short of proof, or the opinion which the auditor communicates cannot be verified so long as the auditor can demonstrate that it has acted reasonably and in good faith in informing the Insurance Authority of a reportable matter even if, after an investigation, it was 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.
41. Whilst no breach of statutory duty might arise, it should be appreciated that there is no protection given by the Ordinance if the auditor, after becoming aware of an occurrence, fail to

<sup>4</sup> HKSA 250 (Revised) issued in June 2017 is effective for audits of financial statements for periods beginning on or after 15 December 2017.

report, promptly, or at all, to the Insurance Authority. Furthermore, it should be recognised that speed of reporting is likely to be important in order to enable the Insurance Authority to protect the interests of policy holders.

### Meetings with the Insurance Authority

42. As part of the Insurance Authority's system of supervision of authorized insurers, meetings involving the Insurance Authority, the authorized insurer or licensed insurance broker company and its auditor may be called. These meetings may be categorised as "routine meetings" called by the Insurance Authority or "special meetings" which may be called by either the Insurance Authority, or the authorized insurer or licensed insurance broker company possibly at the auditor's suggestion.
43. The agenda for a tripartite meeting between the Insurance Authority, the authorized insurer or licensed insurance broker company and the auditor will be prepared by the initiating party and will include items requested by other parties and be circulated in advance. The auditor is expected to participate fully in tripartite meetings and to have regard to the breadth of the Insurance Authority's functions. Normally, however, it is expected that the auditor will discuss with the client any matter which is to be raised at a meeting with the Insurance Authority, before the meeting is held.
44. The auditor would be expected to discuss with the Insurance Authority the affairs of the authorized insurer or licensed insurance broker company including, if necessary, information about its policy holders or other companies within the group obtained in the course of that work. However, the Insurance Authority recognises that it would not be appropriate for the auditor to report to the Insurance Authority information about the authorized insurer or licensed insurance broker company which the auditor has obtained through the professional relationship with another client.
45. Meetings may be called by the Insurance Authority to assist in its forming a judgement on an authorized insurer or licensed insurance broker company. In particular discussions may cover:
  - a. the presentation and content of the annual financial statements;
  - b. the scope, conduct and outcome of the annual audit;
  - c. the scope and outcome of any report made under sections 53E and 53F;
  - d. explanations for, the reasons for and the nature of a qualified report or of a change in a previously reported intention to qualify a report;
  - e. 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; and
  - f. matters raised by the Insurance Authority or those which the authorized insurer, licensed insurance broker company or 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.
46. Any party may seek to call a tripartite meeting at any other time if important matters affecting the authorized insurer or licensed insurance broker company come to their attention as further discussed in paragraph 48. Normally, the auditor would raise the concerns with the authorized insurer or licensed insurance broker company first and if the problem cannot be resolved to the auditor's satisfaction, suggest that the authorized insurer or licensed insurance broker company asks the Insurance Authority to convene a meeting.
47. In exceptional circumstances, for example, those outlined in paragraphs 51 and 52 or after a reporting has been made to the Insurance Authority pursuant to section 53D, the auditor may consider it necessary to have a bipartite meeting with the Insurance Authority to discuss the

affairs of the authorized insurer or licensed insurance broker company or to draw the attention of the Insurance Authority to information about the authorized insurer or licensed insurance broker company without its knowledge. Before doing so, however, the auditor would consider taking timely legal advice and whether a representative of the authorized insurer or licensed insurance broker company at an appropriately senior level would be informed and invited to attend the meeting.

**Reporting via the authorized insurer or licensed insurance broker company**

- 48. Where the auditor becomes aware of a matter which, in the auditor's professional judgement, the auditor considers is not required to be reported under sections 15A(2), 53E or 53F but ought to be reported to the Insurance Authority, the auditor would consider the facts and, unless inappropriate in the circumstances (described in paragraph 51), discuss the matter with the management.
- 49. It is important for the auditor to act in a manner that will maintain the professional relationship with the client. Normally, therefore, the auditor would ask the authorized insurer or licensed insurance broker company to draw matters about which the auditor is concerned to the attention of the Insurance Authority. An example of the circumstances under which the auditor is not required to report, but the auditor might wish to persuade the client to inform the Insurance Authority, is where the auditor forms the opinion that management has reported materially misleading financial information to the Insurance Authority or becomes aware that management has failed, or does not intend, to report something and the failure to report is, or would be, materially misleading.
- 50. Where the authorized insurer or licensed insurance broker company will not himself inform the Insurance Authority 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 not adequate evidence that the client has properly reported the matter in question, the auditor would make such a report directly to the Insurance Authority.

**Reporting directly to the Insurance Authority**

- 51. In exceptional circumstances, where the auditor doubts whether management are fit and proper<sup>2</sup> persons to carry on the business of insurance or insurance broking or become aware of misconduct of management and it would be in the interest of protecting policy holders that the management of the authorized insurer or licensed insurance broker company should not be informed in advance, the auditor would report directly to the Insurance Authority after first considering the appropriateness of taking independent legal advice. Examples of such 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 the auditor believes that a fraud or other irregularity has been committed by the directors or senior management of the authorized insurer or licensed insurance broker company, or the auditor 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 authorized insurer or licensed insurance broker company in a prudent manner so as to protect the interests of policy holders, e.g. where the auditor 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 policy holders, or the auditor has evidence of the inclination so to act.
- 52. The auditor would also report directly to the Insurance Authority when speed is of the essence. For example, when the auditor becomes aware that the insurer or insurance broker company may be about to cease being authorized, the auditor would consider the need to disclose to the Insurance Authority any information in the auditor's possession relevant to its functions without

delay. The fact of such impending cessation of authorization may bring forward the desirability of disclosing matters to the Insurance Authority, as it is easier for the Insurance Authority to take appropriate action while the insurer or insurance broker company is still authorized, particularly where such matters have a bearing on the security of third party interests.

### **Communications by the Insurance Authority to the auditor under section 53A(3)(da) and (f)**

53. The Ordinance also deals with communications by the Insurance Authority to the auditor of an authorized insurer or a licensed insurance broker company.
  - a. Section 53A(3)(da) permits the communication of restricted information to the auditor of an authorized insurer or a licensed insurance broker company for the purpose of enabling or assisting the Insurance Authority to discharge its functions under the Ordinance without the consent of the person from whom it is received or to whom it relates.
  - b. Section 53A(3)(f) permits the communication by the Insurance Authority to the auditor of an authorized insurer or a licensed insurance broker company if, in the opinion of the Insurance Authority, such information is necessary for the auditor to discharge the duties under the Ordinance.
  
54. If the auditor of an authorized insurer or a licensed insurance broker company, during the course of the audit, has come to the auditor's attention on matters which render the auditor to have concerns about the compliance with the Ordinance in relation to the authorized insurer or a licensed insurance broker company, and cause the auditor to believe that it is of such importance that they could significantly affect the audit conclusion, the auditor may consider seeking clarification from the Insurance Authority. In such circumstances, the confirmation can be forwarded to the Insurance Authority specifying the details of the confirmation he/she is seeking from the Insurance Authority and the name of the authorized insurer or a licensed insurance broker company for the case in question. It should be noted that the auditor may not necessarily send to the Insurance Authority such request as a standing procedure to seek the Insurance Authority's confirmation in this respect. Auditors are expected to write to the Insurance Authority only when they have reasons to believe that such a confirmation is necessary due to matters involving breach of the Insurance Ordinance.
  
55. It should be noted that disclosure by the Insurance Authority of confidential information to the auditor is to the auditor only; the auditor is not free to pass that information to others, such as the client insurer or licensed insurance broker company without the consent of the Insurance Authority under section 53A(3D) of the Ordinance. In case where the confidential information affects the audit conclusion, the auditor may contact the Insurance Authority for discussion.



PN 810.1 (Revised)  
Issued September 2019

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Effective upon issue

*Practice Note 810.1 (Revised)*

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# **Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules**



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

LICENSED INSURANCE BROKER COMPANIES –  
COMPLIANCE WITH THE INSURANCE (FINANCIAL AND  
OTHER REQUIREMENTS FOR LICENSED INSURANCE  
BROKER COMPANIES) RULES

**PRACTICE NOTE  
810.1 (REVISED)  
LICENSED INSURANCE BROKER COMPANIES –  
COMPLIANCE WITH THE INSURANCE (FINANCIAL AND  
OTHER REQUIREMENTS FOR LICENSED INSURANCE  
BROKER COMPANIES) RULES**

*(Issued 30 September 2019, Effective upon issue)*

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Practice Note (PN) 810.1 (Revised), *Licensed Insurance Broker Companies - Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules* should be read in the context of the "Amended Preface to Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements" which sets out the application and authority of PNs.

**PRACTICE NOTE  
810.1 (REVISED)  
LICENSED INSURANCE BROKER COMPANIES –  
COMPLIANCE WITH THE INSURANCE (FINANCIAL AND  
OTHER REQUIREMENTS FOR LICENSED INSURANCE  
BROKER COMPANIES) RULES**

*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.*

## **Introduction**

1. In this Practice Note ("PN") all the sections mentioned below are in respect of the Insurance Ordinance ("the Ordinance") unless otherwise stated. The relevant provisions of the Insurance Companies (Amendment) Ordinance 2015 ("Amendment Ordinance") came into operation on 26 June 2017 and is implemented in three stages. In line with the overhaul of the insurance intermediaries regulatory framework effected by the passing of the Amendment Ordinance, the Insurance Authority ("IA") has taken over the regulation of insurance broker companies from The Hong Kong Confederation of Insurance Brokers and Professional Insurance Brokers Association and becomes the sole regulator to license and regulate all insurance intermediaries in Hong Kong. The corresponding provisions of the Amendment Ordinance took effect on 23 September 2019 ("commencement date"). Under the new regime for insurance intermediaries, any company which wishes to apply to the IA for an insurance broker company licence, or to renew such licence, among other things, will have to be able to demonstrate its ability to comply, or continue to comply, with the rules made by the IA under section 129 of the Ordinance.
2. The Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules ("Rules") were made by the IA under section 129 of the Ordinance and the main objective of these Rules is, for the purposes of the new sections 53F(4), 64T(2), 64ZA(4)(d), 64ZV(8)(e) and 73(1) ("New Sections") of the Ordinance, to prescribe the financial and other requirements for licensed insurance broker companies in relation to (a) capital and net assets; (b) professional indemnity insurance; (c) keeping of separate client accounts; (d) keeping of proper books and accounts; and (e) submission of audit and related information. The Rules took effect on the commencement date (i.e. 23 September 2019), replacing the relevant provisions in the Guideline on Minimum Requirements for Insurance Brokers ("Guideline") issued by the IA under the outgoing self-regulatory regime for insurance intermediaries.
3. Under section 2 of the Ordinance, a licensed insurance broker company means a company which is granted a licence under section 64ZA to carry on:
  - (a) regulated activities specified in section 1(a) of Part 1 of Schedule 1A to the Ordinance in one or more lines of business, as an agent of any policy holder or potential policy holder; and
  - (b) regulated activities specified in section 1(b), (c) and (d) of Part 1 of Schedule 1A to the Ordinance in one or more lines of business.

LICENSED INSURANCE BROKER COMPANIES –  
COMPLIANCE WITH THE INSURANCE (FINANCIAL AND  
OTHER REQUIREMENTS FOR LICENSED INSURANCE  
BROKER COMPANIES) RULES

Section 1 of Part 1 of Schedule 1A to the Ordinance specifies the following as an act of regulated activity:

- (a) the act of negotiating or arranging a contract of insurance;
  - (b) the act of inviting or inducing, or attempting to invite or induce, a person to enter into a contract of insurance;
  - (c) the act of inviting or inducing, or attempting to invite or induce, a person to make a material decision;
  - (d) the act of giving regulated advice.
4. Under the Ordinance, a licensed insurance broker company, among other things, is subject to specified rules made by the IA under section 129 of the Ordinance that set out the requirements ("requirements") in relation to:
- (i) the capital and net assets of a licensed insurance broker company;
  - (ii) the professional indemnity insurance ("PII") taken out by a licensed insurance broker company;
  - (iii) the keeping of separate client accounts by a licensed insurance broker company; and
  - (iv) the keeping of proper books and accounts by a licensed insurance broker company.
5. The IA, before granting an insurance broker company licence under section 64ZA of the Ordinance, or renew such licence under section 64ZV of the Ordinance, is required to satisfy himself that, among other things, (a) the applicant is a fit and proper person to carry on regulated activities in the lines of business concerned; (b) each director of the applicant and the controller in relation to the applicant (if any) are fit and proper persons to be associated with the carrying on of regulated activities in those lines of business; and (c) the applicant will be able to comply with the rules made by the IA under section 129 of the Ordinance.
6. In respect of the handling of client monies, a licensed insurance broker company is also required to comply with the requirements under section 71 of the Ordinance, separating client monies from the broker company's monies and pay client monies into the client account as soon as practicable after receiving them.

Under section 81(1) of the Ordinance, the IA may exercise disciplinary powers against a person if the IA is of the opinion that, at the time when the person is or was a regulated person, the person is or was not a fit and proper person or is or was guilty of misconduct (including a contravention of a provision of the Ordinance). Under the Guideline on "Fit and Proper" Criteria For Licensed Insurance Intermediaries issued by the IA<sup>1</sup>, the IA will consider the fitness and propriety of a licensed insurance broker company with regard to the compliance of the requirements in relation to capital, net assets, professional indemnity insurance, and keeping of separate client accounts and proper books and accounts as set out in the Ordinance and any rules made under section 129 of the Ordinance. The disciplinary powers available to the IA are provided in section 81(4) of the Ordinance, including revoking licenses, suspending licenses or imposing pecuniary penalty.

The auditor should read and understand the Ordinance, rules, guidelines, circulars and other regulatory instruments on the IA's website<sup>2</sup> before commencing work.

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<sup>1</sup> Available at: [https://www.ia.org.hk/en/legislative\\_framework/files/Eng\\_GL23\\_FPP.pdf](https://www.ia.org.hk/en/legislative_framework/files/Eng_GL23_FPP.pdf)

<sup>2</sup> Available at: [https://www.ia.org.hk/en/supervision/reg\\_ins\\_intermediaries/regulatory\\_instruments.html](https://www.ia.org.hk/en/supervision/reg_ins_intermediaries/regulatory_instruments.html)

## Reporting requirements

7. Section 73(1) of the Ordinance requires a licensed insurance broker company within 6 months after the end of each financial year to provide the IA with all of the following:
- (a) a copy of the audited profit and loss account for that year;
  - (b) a copy of the audited income and expenditure account for that year;
  - (c) a copy of the audited balance sheet as at the end of that year;
  - (d) an auditor's report on the financial statements;
  - (e) an auditor's report stating whether the auditor is of the opinion that the company has continued to comply with rules made under section 129 that set out the requirements—
    - (i) in relation to the capital and net assets of a licensed insurance broker company;
    - (ii) in relation to the PII taken out by a licensed insurance broker company;
    - (iii) in relation to the keeping of separate client accounts by a licensed insurance broker company; and
    - (iv) in relation to the keeping of proper books and accounts by a licensed insurance broker company;
  - (f) any other information that is prescribed by rules made under section 129.

## Scope

8. The purpose of this PN is to provide guidance on the report by the auditor referred to in paragraph 7(e) above which has come into operation on 23 September 2019. Key revisions to the requirements as a result of the corresponding provisions of the Ordinance under the statutory licensing regime for insurance intermediaries and Rules are double underlined in the respective parts of this PN for ease of reference.
9. For cross-over financial years beginning before 23 September 2019 and ending on or after 23 September 2019 (e.g. financial year ended on 30 September 2019, 31 December 2019, 31 March 2020 or 30 June 2020), the licensed insurance broker company should comply with:
- For the period up to 22 September 2019, (i) the pre-amended Ordinance before the New Sections came into effect, (ii) the Guideline and (iii) the applicable membership regulations, codes or guidelines issued by the approved body of insurance brokers with which the insurance broker is registered; and
  - For the period from 23 September 2019, (i) the Ordinance and (ii) the Rules.
10. When carrying out engagements on licensed insurance broker companies' compliance with the requirements on capital and net assets, PII, keeping of separate client accounts and keeping of proper books and accounts specified by the IA, auditors should refer to the following for requirements and guidance:
- For the reporting period up to 22 September 2019:
    - (i) the pre-amended Ordinance before the New Sections came into effect;
    - (ii) the Guideline;
    - (iii) Practice Note 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 Ordinance* issued by the HKICPA.

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- For the reporting period from 23 September 2019:
  - (i) the Ordinance;
  - (ii) the Rules; and
  - (iii) this PN.
- 11. It is emphasised that this PN does not cover audits of financial statements of licensed insurance broker companies and the auditor should ensure that audits of financial statements should be conducted in accordance with Hong Kong Standards on Auditing (HKSA) issued by the HKICPA. An auditor should refer to the guidance in paragraph 54 of PN 620.2 *Communication between the Auditor and the Insurance Authority* on sending a written request to the IA to enquire whether it has any matter to inform the auditor.
- 12. An auditor undertaking an engagement with reference to this PN would undertake a limited assurance engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* ("HKSAE 3000 (Revised)") to enable the auditor to express a conclusion whether, on the basis of the work undertaken, anything has come to the auditor's attention that causes the auditor to believe that the matters in respect of which the auditor is required to report (as further explained in this PN) have not been complied with.
- 13. As set out in paragraph 4 above, a licensed insurance broker company is subject to specified rules made by the IA under section 129 of the Ordinance. Details of these requirements are set out in paragraphs 14 to 54. If any breaches of the requirements in the Rules or Ordinance are noted by the auditor, either on the dates chosen for testing or on other dates, wording of the report by the auditor would be modified to give a specified report on whether or not they complied on the dates tested, and a statement that based on information provided to the auditor he/she is aware of breaches on other dates during the year. Examples of suggested modified wording where a licensed insurance broker company has not complied with the requirements are provided in Appendix 3.

## Requirements for compliance by licensed insurance broker companies

### Capital and net assets

14. Subject to the transitional arrangements of the Rules set out in paragraph 51 below, a licensed insurance broker company must at all times:
  - (a) maintain a paid-up share capital of not less than \$500,000 (Rule 3 of the Rules).
  - (b) maintain net assets of not less than \$500,000. The amount of net assets must be calculated in accordance with applicable accounting standards, and must—
    - (i) exclude intangible assets from the aggregate of the company's assets; and
    - (ii) exclude from the aggregate of the company's liabilities, on-balance sheet liabilities arising from a lease agreement entered into by the licensed insurance broker company in respect of any premises, up to an amount capped by the maximum value of its intangible assets arising from the same lease agreement.

(Rule 4 of the Rules)
15. Under Rule 2(1) of the Rules, *applicable accounting standards*, in relation to a licensed insurance broker company, means –
  - (a) if the company is incorporated in Hong Kong, the accounting standards generally accepted in Hong Kong; and
  - (b) if the company is a non-Hong Kong company as defined by section 2(1) of the Companies Ordinance (Cap. 622), the accounting standards generally accepted in Hong Kong or in the jurisdiction of the place of incorporation of the company, as the company may elect.

### Professional indemnity insurance

16. A licensed insurance broker company must maintain a PII policy that provides coverage for claims made against the company for liabilities arising from breaches of duty in the course of carrying on its regulated activities. The PII policy must have the following limit of indemnity for any one claim and in any one policy period of 12 months:
- (a) Must not be less than the greater of:
    - (i) 2 times the aggregate amount of the licensed insurance broker company's insurance brokerage income in the 12 consecutive months immediately before the commencement date of the policy period under its PII policy, up to a maximum of \$75,000,000; or
    - (ii) \$3,000,000.
  - (b) In relation to a licensed insurance broker company which is in its first 12 months of operation as a licensed insurance broker company, the limit of indemnity must not be less than \$3,000,000.
- (Rules 5(1), (2) and (3) of the Rules)
17. The PII policy referred to in paragraph 16 above must include a provision for at least one automatic reinstatement which, in the event of the limit of indemnity under the policy being reduced by losses or claims, operates to reinstate the limit of indemnity to an amount not less than the amount determined in accordance with paragraph 16(a) or (b) above (Rule 5(4) of the Rules).
18. Subject to the transitional arrangements of the Rules set out in paragraph 52 below, the deductible amount under the PII policy referred to in paragraph 16 above must not be more than 50% of the company's net assets as at the end of its financial year immediately before the commencement date of the policy period under the policy (Rule 5(5) of the Rules).
19. In relation to a licensed insurance broker company referred to in paragraph 16 (b) above, the deductible amount under the PII policy referred to in paragraph 16 above must not be more than 50% of the company's paid-up share capital as at the commencement date of the policy period under the policy (Rule 5(6) of the Rules).
20. The auditor might find it difficult to report whether a licensed insurance broker company has maintained a PII policy with a minimum limit of indemnity and maximum deductible, for example, in the case of paragraph 16(a)(i) above, where the 12 consecutive months immediately before the commencement date of the policy period under its PII insurance cover do not fall within a financial year.
21. An auditor faced with the above difficulty may request a copy of the calculation of the historical insurance brokerage income under review from the licensed insurance broker company and perform procedures over the company's calculation. In carrying out the procedures, the auditor may wish to consider the following:
- a. whether the calculation of historical insurance brokerage income is based on management accounts regularly prepared for the purpose of management and how reliable are these management accounts and whether the management accounts can be reconciled to historical audited financial information;
  - b. whether the calculation of historical insurance brokerage income is based on accounting policies consistent with the basis used in the audited financial statements;

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- c. whether the calculation of historical insurance brokerage income under review has been prepared on a basis consistent with that of prior years; and
  - d. the arithmetical accuracy of the calculation and the supporting information.
22. Under Rule 2(1) of the Rules, insurance brokerage income, in relation to a licensed insurance broker company, means the gross income derived from the business of carrying on regulated activities by the company.

**Keeping of separate client accounts**

23. A licensed insurance broker company that receives or holds client monies must maintain at least one client account (Rule 6(1) of the Rules).
24. The client account must be an account maintained with an authorized institution in the name of the licensed insurance broker company in the title of which the word "client" appears (Rule 6(2) of the Rules).
25. A licensed insurance broker company must give written notice to the authorized institution with which the client account is maintained as referred to in paragraph 23 above, stating that the client account is maintained by the company pursuant to section 71 of the Ordinance (Rule 6(3) of the Rules).
26. A licensed insurance broker company must keep proper records of the notice referred to in paragraph 25 above (Rule 6(4) of the Rules).
27. The monies specified in section 71(2) of the Ordinance, which a licensed insurance broker company is required to pay into a client account as soon as practicable after receiving them include –
- (a) monies received by the company from or on behalf of a policy holder or potential policy holder as premium payable to an insurer under a contract of insurance arranged by the company;
  - (b) monies received by the company from an insurer, a reinsurer, an insurance intermediary or any other party for the purpose of or relating to the settlement of a claim under a contract of insurance;
  - (c) monies received by the company from or on behalf of a policy holder or potential policy holder for any purposes which are incidental to the carrying on of regulated activities by the company in relation to the policy holder or potential policy holder; and
  - (d) other monies arising from the ordinary transactions of its business of carrying on regulated activities as specified in paragraph 31 below.
- (Rule 6(5) of the Rules)
28. A licensed insurance broker company may, for the purpose of complying with paragraph 23 above, pay into a client account such monies as may be necessary for the opening or maintenance of the account and such monies are taken to be client monies for this purpose (Rule 6(6) of the Rules).
29. No monies other than monies described under paragraphs 27 and 28 above may be paid into a client account maintained by a licensed insurance broker company (Rule 6(7) of the Rules).



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30. A licensed insurance broker company may only make the following withdrawals from a client account –
- (a) monies required to be paid to an insurer, a reinsurer or an insurance intermediary as premium under a contract of insurance arranged by the company;
  - (b) monies required to be paid to a policy holder, potential policy holder, a claimant or any other party who is entitled to receive the monies for the purpose of or relating to the settlement of a claim under a contract of insurance;
  - (c) monies drawn in accordance with written authority of a policy holder or potential policy holder;
  - (d) monies required to be paid by or on behalf of a policy holder or potential policy holder for any purposes which are incidental to the carrying on of regulated activities by the company in relation to the policy holder or potential policy holder;
  - (e) interest earned on monies in the client account in accordance with section 71(5) of the Ordinance;
  - (f) monies which are paid into the client account by mistake or accident and any interest earned on those monies; and
  - (g) other monies arising from the ordinary transactions of its business of carrying on regulated activities specified in paragraph 31 below.

(Rule 6(8) of the Rules)

31. The other monies arising from the ordinary transactions of the licensed insurance broker company's business of carrying on regulated activities referred to in paragraphs 27(d) and 30(g) above are –
- (a) premiums, renewal premiums, additional premiums and return premiums of all kinds;
  - (b) claims and other monies due under contracts of insurance;
  - (c) refunds to policy holders;
  - (d) policy loans and associated interests;
  - (e) fees, charges and levies relating to contracts of insurance; and
  - (f) premium discounts, commissions and brokerage.

(Rule 6(9) of the Rules)

32. Paragraph 29 above does not apply to monies which are paid by mistake or accident into a client account provided that the licensed insurance broker company takes remedial action promptly on discovery of the payment which was made by mistake or accident (Rule 6(10) of the Rules).

33. A licensed insurance broker company which holds or receives client monies must –
- (a) at least once a calendar month compare the total of the ledger balances of client monies with the total of –
- (i) the balances shown on the bank statements and passbooks (after allowing for all unrepresented items) of all client accounts; and
- (ii) any client monies held by the company that have not been deposited into a client account; and
- (b) as at the same date when a comparison is made pursuant to paragraph 33(a) above, prepare a reconciliation statement, which must show the cause of the difference, if any.

(Rule 6(11) of the Rules)

34. These requirements are designed to prevent a licensed insurance broker company from improperly handling client monies entrusted to it. In performing the engagement, the auditor should have a sufficient understanding of the internal controls relating to client monies.

The auditor would, in the course of conducting the limited assurance engagement, exercise professional judgment in determining whether there is undue delay by a licensed insurance broker company in depositing client monies into the client account.

The auditor should exercise professional judgment in considering whether additional procedures in addition to those set out in Appendix 1 are necessary for checking of client accounts and client monies.

35. It should be noted that section 71(1) of the Ordinance requires the licensed insurance broker company to keep client monies in a client account separate from his own monies and, under section 71(4), a licensed insurance broker may use client monies relating to a client only for the purposes of that client; the law does not require a licensed insurance broker company to keep separate accounts for individual clients. Although the Ordinance does not require licensed insurance broker companies to keep separate accounts for individual clients, it is of utmost importance that the company maintains records of the balances due from/to individual clients and reconciles these balances (on a client by client basis) sufficiently regularly to ensure client monies are properly kept in client accounts and client monies relating to a client are used only for the purposes of that client (see section 3 "Keeping of separate client accounts" of Appendix 1). While it is management's responsibility to ensure that balances due from/to individual clients are reconciled sufficiently regularly, the auditor should base on the size and complexity of the licensed insurance broker company's operations and use professional judgement when assessing this.

### **Keeping of proper books and accounts**

36. A licensed insurance broker company must, in relation to its business which constitutes the carrying on of regulated activities –
- (a) keep, where applicable, such accounting and other records (including records relating to the assets or affairs of the company's clients) as are sufficient to –
- (i) explain, and reflect the financial position and operation of, such business;
- (ii) enable financial statements that give a true and fair view of its financial position and financial performance to be prepared from time to time;
- (iii) account for all client monies that it receives or holds; and

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(iv) demonstrate –

(A) compliance by it with the Rules; and

(B) that there is no contravention of section 71(1), (3), (4), (5) and (6) of the Ordinance;

(b) keep those records in such manner as will enable an audit to be conveniently and properly carried out; and

(c) make entries in those records in accordance with applicable accounting standards.

(Rule 7(1) of the Rules)

37. A licensed insurance broker company must keep all records in writing in the Chinese or English language or in such a manner as to enable them to be readily accessible and readily converted into written form in the Chinese or English language (Rule 7(2) of the Rules).
38. A licensed insurance broker company must retain the records that are required to be kept under the Rules for at least 7 years (Rule 7(3) of the Rules).
39. It should be noted that the relevant provisions of the Companies Ordinance (Cap. 622) also require books of account to be kept for a period of 7 years.

**Submission of annual audited financial statements and reports by the auditor on compliance with the requirements**

40. A licensed insurance broker company must prepare the financial statements to be provided to the IA under section 73(1) of the Ordinance in accordance with applicable accounting standards (Rule 8(1) of the Rules).

41. The financial statements provided by a licensed insurance broker company under section 73(1) of the Ordinance in relation to a financial year must include the company's—

(a) insurance brokerage income for the financial year distinguishing between general business and long term business;

(b) aggregate balances of cash held in its client accounts as at the end of the financial year; and

(c) insurance premiums payable as at the end of the financial year.

(Rule 8(2) of the Rules)

42. Any document (except an auditor's report) provided by a licensed insurance broker company under section 73(1) of the Ordinance must be—

(a) approved by the directors of the company; and

(b) signed —

(i) by 2 directors of the company on its directors' behalf; or

(ii) in the case of the company having only one director, by the director.

(Rule 8(3) of the Rules)

43. The auditor's report on the financial statements provided by a licensed insurance broker

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company under section 73(1)(d) of the Ordinance in relation to a financial year must contain statements stating whether the financial statements, in the auditor's opinion, give a true and fair view of -

- (a) the financial position of the company as at the end of the financial year; and
- (b) the financial performance of the company for the financial year.

(Rule 9(1) of the Rules)

44. The auditor's report provided by a licensed insurance broker company under section 73(1)(e) of the Ordinance in relation to a financial year must contain statements stating whether, in the auditor's opinion, the company has continued to comply with the requirements under the Rules and the relevant provisions of the Ordinance in relation to –

- (a) the capital and net assets of the company;
- (b) the PII taken out by the company;
- (c) the keeping of separate client accounts by the company; and
- (d) the keeping of proper books and accounts by the company,

as at the end of the financial year and 2 such other dates in the financial year as the auditor may elect, provided that the intervening period between those 2 dates must not be shorter than 3 months.

(Rule 9(2) of the Rules)

45. A licensed insurance broker company must, within 6 months after the end of each financial year, provide the IA with the items as set out in paragraph 7 of this PN.

46. A licensed insurance broker company is required to continually comply with the requirements. In order to provide limited assurance, the auditor should obtain sufficient, appropriate evidence, as set out in paragraphs 48 to 60 in HKSAE 3000 (Revised), that the requirements have been met on a continuous basis.

47. The nature, timing and extent of procedures to be carried out are determined by the auditor's professional judgment in each individual case. It should be borne in mind when carrying out the tests that omissions from the books may be just as important as items included in them. The auditor may obtain evidence by performing procedures recommended in Appendix 1.

For the purposes of the auditor's reporting on compliance with the requirements by a licensed insurance broker company, the auditor needs to perform procedures as of 3 dates at the minimum. These 3 dates are as at the end of the financial year and 2 such other dates in the financial year as the auditor may elect, provided that the intervening period between those 2 dates must not be shorter than 3 months. The auditor may elect more than 2 other dates in the financial year if the auditor considers it necessary in order to ensure compliance throughout the financial year.

48. If anything is discovered which indicates that the requirements are not being complied with by the licensed insurance broker company, the auditor's responsibilities extend no further than stating in the auditor's report that the requirements have not been complied with and reporting the matter to the IA as soon as practicable in accordance with section 53F (further guidance on section 53F can be found in PN 620.2 (Revised), *Communication between the Auditor and the Insurance Authority*). Examples of suggested modified wording for the report by the auditor are attached in Appendix 3.

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The auditor is not expected to give details of the breaches nor to state the period over which the breach occurred. To report such additional information with any degree of completeness and accuracy would require considerable additional work by the auditor. If the IA requires such information, this should be considered a separate assignment.

49. Paragraph 78 of HKSAE 3000 (Revised) requires the auditor to consider, whether any matter has come to the attention of the auditor that is to be communicated to those charged with governance. Accordingly, the auditor should consider reporting the breaches noted from procedures performed to those charged with governance.

### **Transitional arrangements**

50. Transitional arrangements in paragraphs 51 to 54 below only apply to "specified insurance broker company", i.e. a company which was immediately before the commencement date, registered with an approved broker body as a member, and regarded as having been granted an insurance broker company licence under section 66 of Schedule 11 to the Ordinance on the commencement date. A licensed insurance broker company, other than a specified insurance broker company, is subject to the minimum amount of paid-up share capital and net assets of HK\$500,000 from the commencement date.

#### **Share capital and net assets**

51. For the period from the commencement date to 31 December 2023, the amount of paid-up share capital and net assets which a specified insurance broker company must maintain at all times pursuant to paragraph 14 of this PN respectively are –
- (a) for the period that begins on the commencement date and ends on 31 December 2021, not less than \$100,000; and
  - (b) for the period that begins on 1 January 2022 and ends on 31 December 2023, not less than \$300,000.

(Rule 2 of the Schedule to the Rules)

#### **Professional indemnity insurance**

52. Paragraph 18 of this PN does not apply to a specified insurance broker company for the period that begins on the commencement date and ends on 31 December 2023 (Rule 3 of the Schedule to the Rules).

#### **Client monies reconciliation**

53. Paragraph 33 of this PN does not apply to a specified insurance broker company for 6 months beginning on the commencement date (Rule 4 of the Schedule to the Rules).

#### **Audited financial statements**

54. Paragraph 41 of this PN does not apply to the audited financial statements of a specified insurance broker company for a financial year beginning before 1 January 2021 (Rule 5 of the Schedule to the Rules).

## Appendix 1

### Objectives and recommended procedures for the purpose of reporting on compliance with the Rules

The nature and extent of procedures to be carried out for the purposes of reporting on compliance by a licensed insurance broker company with the Rules are determined by the auditor's professional judgement in each individual case. The list given in this appendix is not exhaustive, nor is it intended that all the procedures suggested apply to every reporting engagement.

When conducting these suggested or other procedures pursuant to reporting on the licensed insurance broker company's compliance with the Rules, it is recommended that the auditor is guided by HKSAE 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*. In accordance with HKSAE 3000 (Revised), the auditor determines the nature, timing and extent of procedures to be carried out and carry out those procedures so as to ensure sufficient appropriate evidence is obtained on which to base the conclusions, and document matters which are important to providing evidence to support that conclusion. For the purposes of the auditor's reporting on the compliance with the Rules by the licensed insurance broker company, the auditor needs to perform procedures as of 3 dates at the minimum. These 3 dates are as at the end of the company's financial year and 2 such other dates in the company's financial year as the auditor may elect, provided that the intervening period between those 2 dates must not be shorter than 3 months. The auditor may elect more than 2 other dates in the company's financial year if the auditor considers it necessary in order to ensure compliance throughout the financial year.

If, after applying the recommended or other procedures, the auditor becomes aware of non-compliance with the Rules, the auditor's responsibility, after considering the reporting requirements to those charged with governance discussed in paragraph 48 of this PN, extends no further than stating in the report that the auditor is aware of non-compliance by the company with the Rules and reporting the matter to the IA as soon as practicable in accordance with section 53F (further guidance on section 53F can be found in PN 620.2 (Revised), *Communication between the Auditor and the Insurance Authority*). For examples of suggested modified wording for the report by the auditor, refer to Appendix 3 to this PN.

The Rules are in respect of:

1. share capital;
2. net assets;
3. PII;
4. keeping of separate client accounts; and
5. keeping of proper books and accounts.

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**1. Capital and net assets**

<b>Objective</b>	<b>Recommended procedure</b>
i) To establish whether paid-up share capital meets the requirements under the Rules.	Obtain share register, annual return or returns of allotment and inspect whether paid-up share capital met the required amount <sup>3</sup> throughout the reporting period.
ii) To establish whether net assets meet the requirements under the Rules.	a) Obtain the opening and closing balances of net assets in the financial statements and inspect whether the licensed insurance broker company met the required amount <sup>3</sup> throughout the reporting period.
	b) Where either the opening or closing net asset value is close to the minimum required amount, consider checking management accounts during the period to establish whether the licensed insurance broker company has breached the requirements.
	c) Where the management accounts are used as a source of audit evidence as to whether the net assets meet the required amount, consideration should be given to the method of preparation of those accounts and any adjustments necessary to reflect the accounting standards generally accepted in Hong Kong, before deciding to rely on them.

*Guidance on capital and net assets requirements under the Rules is set out in paragraphs 14 and 15 of this PN.*

<sup>3</sup> For the period from the commencement date (i.e. 23 September 2019) to 31 December 2023, a specified insurance broker company (i.e. a company which was immediately before the commencement date, registered with an approved broker body as a member, and regarded as having been granted an insurance broker company licence under section 66 of Schedule 11 to the Ordinance on the commencement date) must maintain at all times the following minimum amount of paid-up share capital and net assets:

- From the commencement date to 31 December 2021: HK\$100,000
- From 1 January 2022 to 31 December 2023: HK\$300,000
- From 1 January 2024 onwards: HK\$500,000

A licensed insurance broker company, other than a specified insurance broker company, is subject to the minimum amount of paid-up share capital and net assets of HK\$500,000 from the commencement date.

## 2. Professional indemnity insurance

<b>Objective</b>	<b>Recommended procedure</b>
i) To establish whether the PII cover meets the requirements under the Rules.	a) Physically inspect the PII policy noting in particular the commencement date of the policy <sup>4</sup> and the limit of cover afforded. Determine whether the policy was in force throughout the period under review.  b) Obtain details of the relevant insurance brokerage income <sup>5</sup> and thereby determine the minimum level of PII required. Compare this with the actual cover to determine whether the level of cover is adequate.  Where only one policy is in effect during the year the procedures need only be carried out once. However, if more than one policy has been in effect during the year, for example where the period of cover does not coincide with the financial year, or where the licensed insurance broker company changes insurer during the financial year, it may be necessary to carry out the recommended procedures more than once, so that evidence is obtained in respect of the adequacy of the PII cover in force throughout the period under review.
ii) To establish whether the policy provides for at least one automatic reinstatement which, in the event of the limit of indemnity under the policy being reduced by losses or claims, operates to reinstate the limit of indemnity not less than the required amount.	Inspect the policy document to establish whether at least one automatic reinstatement is included in the terms of the policy according to the requirements under the Rules. Where there have been any material claims during the year, obtain written evidence of any required reinstatement.
iii) To establish whether the deductible is: <ul style="list-style-type: none"> <li>- not more than 50% of the company's net assets as at the end of its financial year immediately before the commencement date of the policy period under the policy; or</li> <li>- not more than 50% of the company's paid-up share capital as at the commencement date of the policy period under</li> </ul>	Obtain the audited financial statements for the financial year immediately before the commencement date of the policy period under the policy, and determine whether the deductible exceeds the requirements.  If the company's audited financial statements for the financial year immediately before the commencement date of the policy period under the policy are not yet available, obtain the company's management accounts for the financial year immediately before the commencement date of the policy period under the policy, and determine whether the deductible exceeds the requirements. For this purpose, the management accounts should be appropriately adjusted where required in terms of the applicable financial reporting framework.

<sup>4</sup> The commencement date of the policy includes the annual renewal of the PII cover maintained by the licensed insurance broker company.

<sup>5</sup> Under Rule 2 of the Rules, insurance brokerage income in relation to a licensed insurance broker company means the gross income derived from the business of carrying on regulated activities by the company.



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the policy if the company is in its first 12 months of operation as a licensed insurance broker company.	
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*Guidance on PII requirements under the Rules is set out in paragraphs 16 to 22 of this PN.*

### 3. Keeping of separate client accounts

Procedures (ii) to (vi) apply to licensed insurance broker companies that are required to maintain at least one separate client account under Rule 6(1).

<b>Objective</b>	<b>Recommended procedure</b>
<p>i) To establish whether the licensed insurance broker company must maintain at least one "client account" with an authorised institution in the name of the licensed insurance broker company in the title of which the word "client" appears.</p>	<p>Where management represents that no separate client account is kept because the licensed insurance broker company did not receive or hold client monies during the reporting period,</p> <p>(a) perform necessary procedures to corroborate management's representation (e.g. for contracts of insurance arranged by the company, obtain understanding over the settlement of insurance premiums to insurers and reinsurers, and the settlement of claims, refunds and other monies to policy holders; scan records of receipts and/or payments to determine whether the company received or held client monies during the reporting period); and</p> <p>(b) seek management's confirmation that the licensed insurance broker company did not receive or hold client monies during the reporting period. This may be achieved by way of a written representation from management included in the management representation letter in relation to the engagement. General guidance on management's representations is set out in paragraphs 56 to 60 and A137 to A140 of HKSAE 3000 (Revised).</p>
<p>ii) To establish whether the licensed insurance broker company maintained at least one "client account" with an authorized institution in the name of the licensed insurance broker company in the title of which the word "client" appears.</p>	<p>Obtain documentary evidence such as bank statements to determine whether there is in existence at least one "client account" in accordance with the requirements under the Rules.</p>
<p>iii) To establish whether the provisions of section 71 of the Ordinance have been notified to an authorized institution with which the "client account" is maintained.</p>	<p>Obtain documentary evidence of the notification to determine whether it is sufficient for the provisions of section 71 of the Ordinance.</p>
<p>iv) To establish whether the licensed insurance broker company keeps client monies in a separate account from his own monies, performs reconciliations with sufficient</p>	<p>a) Enquire with management procedures in place to ensure that client monies are kept separately from the licensed insurance broker company's own monies and client monies relating to a client are used only for the purposes of that client. Perform sample testing to establish whether the controls and procedures are operating effectively and consider the adequacy of such procedures and controls.</p>

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<p>regularity and whether client monies relating to a client are used only for the purposes of that client.</p>	<p>While it is management's responsibility to ensure that balances due from/to individual clients are reconciled sufficiently regularly, the auditor should base on the size and complexity of the broker's operations and use professional judgement when assessing this.</p> <p>In a situation where the management represents that there is no insurance brokerage activity in the reporting period, perform necessary procedures to corroborate management's representation (e.g. scan records of receipts and/or payments; obtain understanding of client's business).</p> <p>b) On a sample basis, test reconciliations between the monies in the client account and the insurance broking debtors and creditors (at an individual client level) to determine whether there is any deficiency in the client account which would indicate that client monies relating to a client are not used only for the purposes of that client.</p> <p>c) For a sample of transactions selected both from the bank statements and from the insurance broking ledgers, check to establish whether those transactions made through the client account fall within the scope of the permitted deposits and withdrawals and whether transactions recorded in the insurance broking ledgers, which relate to client monies and should be reflected in the client account, are included therein. Refer to paragraphs 27 to 32 of the PN for additional guidance.</p> <p>d) Scan client accounts for the whole period for potentially unusual items, e.g. round sum transfers, regular frequent transfers and individually large deposits or transfers. Where unusual items are detected, perform follow up procedures as deemed necessary to determine whether a breach of the requirements has occurred.</p>
<p>v) To establish whether the licensed insurance broker company deposits monies received or held on behalf of his clients in relation to insurance broking business into the client account as soon as practicable after its receipt.</p>	<p>For a sample of transactions selected both from the bank statements and from the insurance broking ledgers, check to determine whether monies received or held on behalf of clients in relation to insurance broking business are being deposited into the client account as soon as practicable after its receipt.</p>
<p>vi) To establish whether the licensed insurance broker company which holds or receives client monies:</p> <p>(a) at least once a calendar month compare the total</p>	<p>a) On a sample basis, test the reconciliation statements and relevant supporting documents to determine whether comparison and reconciliation of client monies were performed in accordance with the requirements.</p> <p>b) For the samples selected, evaluate causes of the differences stated in the reconciliation statements to</p>

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<p>of the ledger balances of client monies with the total of (i) the balances shown on the bank statements and passbooks (after allowing for all unrepresented items) of all client accounts; and (ii) any client monies held by the company that have not been deposited into a client account; and</p> <p>(b) as at the same date when a comparison is made, prepare a reconciliation statement which must show the cause of the difference, if any.</p>	<p>determine whether client monies were deposited, used or withdrawn in accordance with the requirements.</p> <p>c) If the management represents that there is no insurance brokerage activity in the reporting period, perform necessary procedures to corroborate management's representation (e.g. scan records of receipts and/or payments; obtain understanding of client's business).</p>
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*Guidance on keeping of separate client accounts under the Rules is set out in paragraphs 23 to 35 of this PN.*

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**4. Keeping proper books and accounts**

<b>Objective</b>	<b>Recommended procedure</b>
<p>i) To establish whether the licensed insurance broker company maintains sufficient and proper accounting and other records which:</p> <ul style="list-style-type: none"> <li>• explain, and reflect the financial position and operation of, such business;</li> <li>• enable financial statements that give a true and fair view of its financial position and financial performance to be prepared from time to time;</li> <li>• account for all client monies that it receives or holds;</li> <li>• demonstrate compliance by it with the Rules; and</li> <li>• demonstrate there is no contravention of sections 71(1), (3), (4), (5) and (6) of the Ordinance;</li> <li>• are kept in such a manner as will enable an audit to be conveniently and properly carried out;</li> <li>• entries are made in those records in accordance with applicable accounting standards; and</li> <li>• are kept in writing in the Chinese or English language or in such a manner as to enable them to be readily accessible and readily converted into written form in the Chinese or English language.</li> </ul>	<p>In planning and performing the audit of the licensed insurance broker company's financial statements, the auditor should be aware of the requirements for the licensed insurance broker company to maintain, and the auditor to give an opinion on whether the licensed insurance broker company has maintained, adequate books and records during the year.</p> <p>In general, the auditor, on the basis of the audit of the licensed insurance broker company's financial statements, should be able to reach a conclusion in respect of whether proper accounting and other records have been maintained. Therefore further checking in this respect should not normally be necessary.</p>
<p>ii) To establish whether the licensed insurance broker company retains the books and records for at least 7 years.</p>	<p>Enquire with the client the procedures in place for safeguarding the books and records for at least 7 years and consider these for adequacy.</p> <p>Validate the physical existence for a sample of items.</p>

*Guidance on keeping of proper books and accounts under the Rules is set out in paragraphs 36 to 39 of this PN.*

## Appendix 2

### Examples of unmodified limited assurance report for a licensed insurance broker company on compliance with the Rules

#### Illustration 1

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

- The reporting period began before 23 September 2019 and ended on or after 23 September 2019; and
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the evidence obtained.

#### INDEPENDENT AUDITOR'S ASSURANCE REPORT

To the Director[s] of XYZ Insurance Brokers Limited

We have been engaged:

- Pursuant to the Membership Regulations of [the Hong Kong Confederation of Insurance Brokers ("HKCIB") / Professional Insurance Brokers Association ("PIBA")] to perform a limited assurance engagement on the compliance of XYZ Insurance Brokers Limited ("the Company") with the requirements for capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts specified in section 70(2) of the pre-amended Ordinance as defined in section 2(1) of the Insurance Ordinance (Cap. 41) ("the Pre-Amended Ordinance") and the "Guideline on Minimum Requirements for Insurance Brokers" ("the Guideline") issued by the Insurance Authority ("IA") under section 133 of the Pre-Amended Ordinance from [Date] to 22 September 2019; and
- Pursuant to section 73(1)(e)<sup>6</sup> of the Insurance Ordinance (Cap. 41) ("the Ordinance") to perform a limited assurance engagement on the compliance of the Company with the requirements for capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts specified in the "Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules" ("the Rules") issued by the IA under section 129 of the Ordinance from 23 September 2019 to [Date].

#### *Director[s]' Responsibilities*

The director[s] are responsible for the Company's compliance with the requirements specified under section 70(2) of the Pre-Amended Ordinance and the Guideline from [Date] to 22 September 2019; and the Rules from 23 September 2019 to [Date].

#### *Our Independence and Quality Control*

We have complied with the independence and other ethical requirement 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>7</sup> and accordingly maintains a comprehensive

<sup>6</sup> In case a licensed insurance broker company ceases to carry on regulated activities, the applicable reference of auditor's reporting requirement should be section 64T(2)(b).

<sup>7</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

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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, pursuant to the Membership Regulations of [HKCIB / PIBA] and section 73(1)(e)<sup>6</sup> of the Ordinance, is to evaluate information from the Company and report whether we are aware of any non-compliance with the requirements for (a) capital and net assets, (b) professional indemnity insurance, (c) keeping of separate client accounts and (d) keeping of proper books and accounts specified in section 70(2) of the Pre-Amended Ordinance and the Guideline from [Date] to 22 September 2019; and the Rules from 23 September 2019 to [Date].

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 810.1 (Revised), *Insurance Brokers – Compliance with the Minimum Requirements Specified by the Insurance Authority Under Sections 69(2) and 70(2) of the Insurance Ordinance* ("pre-amended PN 810.1 (Revised)") issued by the HKICPA for the reporting period from [Date] to 22 September 2019; and Practice Note 810.1 (Revised), *Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules* ("PN 810.1 (Revised)") issued by the HKICPA for the reporting period from 23 September 2019 to [Date]. We have planned and performed our work to obtain limited assurance for giving our conclusion below.

We have planned and performed such procedures as we considered necessary with reference to the procedures recommended in pre-amended PN 810.1 (Revised) and PN 810.1 (Revised) as appropriate, which included reviewing, on a test basis, evidence obtained from the Company regarding the Company's compliance with the requirements specified under section 70(2) of the Pre-Amended Ordinance and the Guideline from [Date] to 22 September 2019; and the Rules from 23 September 2019 to [Date]. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material non-compliance of capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts with section 70(2) of the Pre-Amended Ordinance and the Guideline, and the Rules as appropriate.

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.

#### *Conclusion*

Based on the foregoing,

- a. nothing has come to our attention that causes us to believe that the Company has failed to maintain paid-up share capital not less than HK\$[insert amount]<sup>8</sup> from [Date] to [Date] specified under section 70(2) of the Pre-Amended Ordinance and the Guideline, and the Rules as appropriate;

---

<sup>8</sup> For the period from the commencement date (i.e. 23 September 2019) to 31 December 2023, a specified insurance broker company (i.e. a company which was immediately before the commencement date registered with an approved broker body as a member, and regarded as having been granted an insurance broker company licence under section 66 of Schedule 11 to the Ordinance on the commencement date) must maintain at all times the following minimum amount of paid-up share capital and net assets:

- From the commencement date to 31 December 2021: HK\$100,000
- From 1 January 2022 to 31 December 2023: HK\$300,000
- From 1 January 2024 onwards: HK\$500,000

A licensed insurance broker company, other than a specified insurance broker company, is subject to the minimum amount of paid-up share capital and net assets of HK\$500,000 from the commencement date.

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- b. nothing has come to our attention that causes us to believe that the Company has failed to maintain net assets not less than HK\$*[insert amount]*<sup>8</sup> from [Date] to [Date] specified under section 70(2) of the Pre-Amended Ordinance and the Guideline, and the Rules as appropriate;
- c. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the professional indemnity insurance specified under section 70(2) of the Pre-Amended Ordinance and the Guideline, and the Rules as appropriate;
- d. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the keeping of separate client accounts specified under section 70(2) of the Pre-Amended Ordinance and the Guideline, and the Rules as appropriate; and
- e. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the keeping of proper books and accounts specified under section 70(2) of the Pre-Amended Ordinance and the Guideline, and the Rules as appropriate.

*Intended Users and Purpose*

Our report is intended solely for the use of the Company in connection with the requirements for filing with the IA under section 73(2) of the Pre-Amended Ordinance from [Date] to 22 September 2019 and section 73(1)(e)<sup>6</sup> of the Ordinance from 23 September 2019 to [Date] and may not be suitable for any other purpose. This report is not intended to be, and should not be distributed to or used for any other purpose except a copy of this report may be provided to the IA without further comment from us.

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



Illustration 2

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

- The reporting period begins on or after 23 September 2019; and
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the evidence obtained.

## INDEPENDENT AUDITOR'S ASSURANCE REPORT

To the Director[s] of XYZ Insurance Brokers Limited

Pursuant to section 73(1)(e)<sup>9</sup> of the Insurance Ordinance (Cap. 41) (the "Ordinance"), we have been engaged to perform a limited assurance engagement on the compliance of XYZ Insurance Brokers Limited ("the Company") with the requirements for capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts specified in the "Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules" ("Rules") issued by the insurance Authority ("the IA") under section 129 of the Ordinance for the [year ended [Date]/ period from [Date] to [Date]].

### *Director[s]' Responsibilities*

The director[s] [is][are] responsible for the Company's compliance with the requirements specified under the Rules.

### *Our Independence and Quality Control*

We have complied with the independence and other ethical requirement 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>10</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, pursuant to section 73(1)(e)<sup>9</sup> of the Ordinance, is to evaluate information from the Company and report whether we are aware of any non-compliance with the requirements for (a) capital and net assets, (b) professional indemnity insurance, (c) keeping of separate client accounts and (d) keeping of proper books and accounts specified in the Rules.

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 810.1 (Revised), *Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules* ("PN 810.1 (Revised)") issued by the HKICPA. We have planned and performed our work to obtain limited assurance for giving our conclusion below.

<sup>9</sup> In case a licensed insurance broker company ceases to carry on regulated activities, the applicable reference of auditor's reporting requirement should be section 64T(2)(b).

<sup>10</sup> HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

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We have planned and performed such procedures as we considered necessary, with reference to the procedures recommended in PN 810.1 (Revised), which included reviewing, on a test basis, evidence obtained from the Company regarding the Company's compliance with the requirements specified under the Rules for the [year ended [Date]/ period from [Date] to [Date]]. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material non-compliance of capital and net assets, professional indemnity insurance, keeping of separate client accounts and keeping of proper books and accounts with the Rules.

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.

*Conclusion*

Based on the foregoing,

- a. nothing has come to our attention that causes us to believe that the Company has failed to maintain paid-up share capital not less than HK\$[insert amount]<sup>11</sup> for the [year ended [Date] / period from [Date] to [Date]] specified under the Rules;
- b. nothing has come to our attention that causes us to believe that the Company has failed to maintain net assets not less than HK\$[insert amount]<sup>11</sup> for the [year ended [Date] / period from [Date] to [Date]] specified under the Rules;
- c. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the professional indemnity insurance specified under the Rules;
- d. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the keeping of separate client accounts specified under the Rules; and
- e. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the keeping of proper books and accounts specified under the Rules.

*Intended Users and Purpose*

Our report is intended solely for the use of the Company in connection with the requirements for filing with the IA under section 73(1)(e)<sup>9</sup> of the Ordinance and may not be suitable for any other purpose. This report is not intended to be, and should not be distributed to or used for any other purpose except a copy of this report may be provided to the IA without further comment from us.

ABC & Co.

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

[Auditor's Address]

Date

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<sup>11</sup> For the period from the commencement date (i.e. 23 September 2019) to 31 December 2023, a specified insurance broker company (i.e. a company which was immediately before the commencement date registered with an approved broker body as a member, and regarded as having been granted an insurance broker company licence under section 66 of Schedule 11 to the Ordinance on the commencement date) must maintain at all times the following minimum amount of paid-up share capital and net assets:

- From the commencement date to 31 December 2021: HK\$100,000
- From 1 January 2022 to 31 December 2023: HK\$300,000
- From 1 January 2024 onwards: HK\$500,000

A licensed insurance broker company, other than a specified insurance broker company, is subject to the minimum amount of paid-up share capital and net assets of HK\$500,000 from the commencement date.

### Appendix 3

#### Examples of suggested modified wording for a report by an auditor where a licensed insurance broker company has not complied with the Rules

If any breaches of the requirements are noted by the auditor, either on the dates chosen for testing or on other dates, the wording of the report by the auditor would be modified to give a specific report on whether or not they complied on the dates tested, and a statement that based on information given to the auditor he/she is aware of breaches on other dates during the year.

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), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* ("HKSAE 3000 (Revised)"). Further guidance is set out in paragraphs 74 to 77, A183, A189 to A192 of HKSAE 3000 (Revised).

Examples:

1. The licensed insurance broker company met the requirements on at least one date tested in the sample, but not for the whole period:

.....

#### *Basis for Qualified Conclusion*

- a. The net assets held by the Company enabled the Company to meet the net assets requirements of HK\$[insert amount]<sup>12</sup> specified by the Rules as at [the year-end date] [and] [one][some]\* of the dates selected by us but not as at the other dates selected by us in our sample. From information and explanations supplied to us we are aware that the Company failed to maintain net assets of HK\$[insert amount]<sup>12</sup> specified under the Rules at other times during the period;
- b. as at [the year-end date] [and] [one][some]\* of the dates selected by us but not as at the other dates selected by us in our sample the Company complied with the requirements in relation to the keeping of separate client accounts specified under the Rules. From information and explanations supplied to us we are aware that the Company failed to comply with the requirements in relation to the keeping of separate client accounts specified under the Rules at other times during the period. [Describe details of the non-compliance against the Rules.]

#### *Qualified Conclusion*

Based on the foregoing, except for the effects of the matters described in the Basis for Qualified Conclusion paragraph:

---

<sup>12</sup> For the period from the commencement date (i.e. 23 September 2019) to 31 December 2023, a specified insurance broker company (i.e. a company which was immediately before the commencement date registered with an approved broker body as a member, and regarded as having been granted an insurance broker company licence under section 66 of Schedule 11 to the Ordinance on the commencement date) must maintain at all times the following minimum amount of paid-up share capital and net assets:

- From the commencement date to 31 December 2021: HK\$100,000
- From 1 January 2022 to 31 December 2023: HK\$300,000
- From 1 January 2024 onwards: HK\$500,000

A licensed insurance broker company, other than a specified insurance broker company, is subject to the minimum amount of paid-up share capital and net assets of HK\$500,000 from the commencement date.

LICENSED INSURANCE BROKER COMPANIES –  
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- a. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the professional indemnity insurance specified under the Rules;
  - b. nothing has come to our attention that causes us to believe that the Company has failed to comply with the requirements in relation to the keeping of proper books and accounts specified under the Rules.
2. The Company did not meet the requirements on any of the dates tested in the sample:

.....

*Basis for Adverse Conclusion*

- a. the net assets held by the Company did not enable the Company to meet the net assets requirements of HK\$*[insert amount]*<sup>12</sup> specified by the Rules as at the year-end date nor as at the other date[s] selected by us in our sample. From information and explanations supplied to us we are aware that the Company failed to maintain net assets of HK\$*[insert amount]*<sup>12</sup> specified by the Rules at other times during the period;
  - .
  - .
  - .
- d. the Company did not maintain client accounts in accordance with the requirements in relation to the keeping of separate client accounts specified under the Rules as at the year-end date nor as at the other date[s] selected by us in our sample. From information and explanations supplied to us we are aware that the Company failed to comply with the requirements in relation to the keeping of separate client accounts specified under the Rules at other times during the period. [Describe details of the non-compliance against the Rules.]

*Adverse Conclusion*

Based on the foregoing, due to the significance of the matters discussed in the Basis for Adverse Conclusion paragraph, the Company has failed to comply with the requirements specified under the Rules as at the year-end date and at the other date[s] selected by us.

*\*Delete as appropriate*

PN 810.2 (Revised)  
Issued February 2015; revised February 2016, October 2016,  
September 2017, January 2018, September 2019

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Effective upon issue

*Practice Note 810.2 (Revised)*

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



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 ORDINANCE**

*(Issued February 2015; revised February 2016, October 2016, January 2018, September 2019  
Effective upon issue)*

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

*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 Ordinance (Cap.41) ("the Ordinance") unless otherwise stated. The Insurance Companies Ordinance (Cap. 41) has been renamed as the "Insurance Ordinance" since section 4 of the Insurance Companies (Amendment) Ordinance 2015 came into operation on 26 June 2017.
2. This PN is intended to give guidance to members on the duties of the auditor of an authorized insurer appointed under section 15 (see paragraphs 21 and 22) or paragraph 4(1A) of Part 1 of Schedule 3 to the Ordinance ("Schedule 3"). In addition, guidance on the duties of the auditor of a licensed insurance broker company appointed under section 72 is also included (see paragraphs 56 to 58). 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, the Terrorism scheme for Employee Compensation and the annual remittance report on the levy to the Insurance Authority ("IA"). 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.

An auditor should refer to the guidance in paragraph 52 of PN 620.2 *Communication between the Auditor and the Insurance Authority* on sending a written request to the Insurance Authority to confirm whether it has any matter to report to the auditor.

3. The PN has been prepared following discussions with the IA.
4. This is a guide to the provisions in the Ordinance which were effective as at 26 June 2017 (i.e. including the amendments introduced by the Insurance Companies (Amendment) Ordinance 2015), 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 ORDINANCE**

**Scope of the Ordinance**

5. The Ordinance is applicable to all persons (companies or individuals) carrying on insurance business in Hong Kong (including licensed insurance broker companies) other than those persons noted in paragraph 7 and those specifically exempted by section 51 (see paragraph 8).

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

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 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
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);



the nature of the contingency, the uncertainties which are expected to affect the ultimate outcome and a prudent estimate of the financial effect.

### **Liabilities Rules 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 (Determination of Long Term Liabilities) Rules ("Liabilities Rules").
50. The general principles and certain specific factors underlying the determination of long term liabilities are laid down in rule 4 of the Liabilities Rules. 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 Rules, and the sections of those Rules in which they are covered, are made in respect of options and guarantees (rule 10), expenses (rule 12), valuation of future premiums (rule 14) and acquisition expenses (rule 15). Rule 5 of the Liabilities Rules 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 authorized 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.
55. The Insurance Authority may, by serving a notice in writing on an authorized insurer, require the insurer to provide to the Insurance Authority, within the period specified in the notice, any books of account that are required to be kept by section 16 and by the Insurance Authority for performing its functions.

### **Licensed insurance broker companies**

56. Section 64N states that an authorized insurer must not enter into a contract of insurance through another person in Hong Kong or accept a referral of insurance business from another person in Hong Kong unless:
  - a. that person is (i) a licensed insurance agency or a licensed individual insurance agent appointed by the insurer; or (ii) a licensed insurance broker company; or
  - b. that person's duties only involve clerical or administrative duties.

Sections 64U, 64W and 64ZA, among others, set out the Insurance Authority's requirements for an insurance agency, individual insurance agent and insurance broker company to obtain the relevant licence.

57. Under section 72, a licensed insurance broker company 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 licensed insurance broker company 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.
58. The auditor of a licensed insurance broker company is required to report on the company's financial statements to its shareholders. The auditor is also required to report on a licensed insurance broker company's compliance with the requirements stipulated by the Insurance Authority. For further guidance on this area, members may refer to PN 810.1 (Revised), *Licensed Insurance Broker Companies - Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules* issued by the HKICPA.

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

59. 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**

60. 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**

61. 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**

62. 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.

## **Annual remittance report on levy to the IA**

63. On 6 June 2017, the Insurance (Levy) Order ("Order") and the Insurance (Levy) Regulation ("Regulation") were issued. The Order specifies the prescribed classes of insurance business and types of insurance contract that a levy is payable by policy holders and the rates of such levy. The Regulation sets out the manner in which the payment of levies must be made. The Order and the Regulation come into operation on 1 January 2018. According to the Regulation, an authorized insurer must lodge with the IA an annual remittance report. The annual remittance report must cover the remittances made in respect of the two remittance periods immediately preceding the date of the report unless otherwise approved by the IA. The annual remittance report is subject to examination by an auditor appointed by the insurer at its expense.
64. The auditor is required to opine on whether the insurer has maintained proper records in accordance with section 16 of the Ordinance for the purpose of preparing the annual remittance report and whether such report has been properly prepared, in all material respects, from the records of the insurer. A practitioner should conduct such an engagement in accordance with HKSAE 3000 (Revised). An example report is set out in Example 4 in Appendix 4.

HKAPG 1000  
Issued July 2012; revised December 2012, September 2019

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Effective upon issue

*Hong Kong Auditing Practice Guidance 1000*

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# Special Considerations in Auditing Financial Instruments



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

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- Management's and, where appropriate, those charged with governance's understanding of the financial instruments, their use and the accounting requirements.
- Their exact terms and characteristics so that their implications can be fully understood and, in particular where transactions are linked, the overall impact of the financial instrument transactions.
- How they fit into the entity's overall risk management strategy.

Inquiries of the internal audit function, the risk management function, if such functions exist, and discussions with those charged with governance may inform the auditor's understanding.

77. In some cases, a contract, including a contract for a non-financial instrument may contain a derivative. Some financial reporting frameworks permit or require such "embedded" derivatives to be separated from the host contract in some circumstances. Understanding management's process for identifying, and accounting for, embedded derivatives will assist the auditor in understanding the risks to which the entity is exposed.

*Using Those with Specialized Skills and Knowledge in the Audit*<sup>14</sup>

78. A key consideration in audits involving financial instruments, particularly complex financial instruments, is the competence of the auditor. HKSA 220<sup>15</sup> requires the engagement partner to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements and to enable an auditor's report that is appropriate in the circumstances to be issued. Further, relevant ethical requirements<sup>16</sup> require the auditor to determine whether acceptance of the engagement would create any threats to compliance with the fundamental principles, including the professional competence and due care. Paragraph 79 below provides examples of the types of matters that may be relevant to the auditor's considerations in the context of financial instruments.
79. Accordingly, auditing financial instruments may require the involvement of one or more experts or specialists, for example, in the areas of:
- Understanding the financial instruments used by the entity and their characteristics, including their level of complexity. Using specialized skills and knowledge may be needed in checking whether all aspects of the financial instrument and related considerations have been captured in the financial statements, and evaluating whether adequate disclosure in accordance with the applicable financial reporting framework has been made where disclosure of risks is required.
  - Understanding the applicable financial reporting framework, especially when there are areas known to be subject to differing interpretations, or practice is inconsistent or developing.

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<sup>14</sup> When such a person's expertise is in auditing and accounting, regardless of whether the person is from within or external to the firm, this person is considered to be part of the engagement team and is subject to the requirements of HKSA 220, *Quality Control for an Audit of Financial Statements*. When such a person's expertise is in a field other than accounting or auditing, such person is considered to be an auditor's expert, and the provisions of HKSA 620, *Using the Work of an Auditor's Expert*, apply. HKSA 620 explains that distinguishing between specialized areas of accounting or auditing, and expertise in another field, will be a matter of professional judgment, but notes the distinction may be made between expertise in methods of accounting for financial instruments (accounting and auditing expertise) and expertise in complex valuation techniques for financial instruments (expertise in a field other than accounting or auditing).

<sup>15</sup> HKSA 220, paragraph 14

<sup>16</sup> The *Code of Ethics for Professional Accountants*, Chapter A, Part 3, paragraphs 320.2, 320.3 A1, 320.3 A4 and 320.3 A5

### Communications with Regulators and Others

145. In some cases, auditors may be required,<sup>45</sup> or may consider it appropriate, to communicate directly with regulators or prudential supervisors, in addition to those charged with governance, regarding matters relating to financial instruments. Such communication may be useful throughout the audit. For example, in some jurisdictions, banking regulators seek to cooperate with auditors to share information about the operation and application of controls over financial instrument activities, challenges in valuing financial instruments in inactive markets, and compliance with regulations. This coordination may be helpful to the auditor in identifying risks of material misstatement.

### Conformity and Compliance with International Auditing Practice Notes

146. As of September 2019, this HKAPG is, in all material respects, in accordance with International Auditing Practice Note (IAPN) 1000, “Special Considerations in Auditing Financial Instruments” except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKAPG ensures compliance with IAPN 1000.

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<sup>45</sup> For example, HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, requires auditors to determine whether there is a responsibility to report identified or suspected non-compliance with laws and regulations to parties outside the entity. In addition, requirements concerning the auditor's communication to banking supervisors and others may be established in many countries either by law, by supervisory requirement or by formal agreement or protocol.