



18 March 2020

To: **Members of the Hong Kong Institute of CPAs**
All other interested parties

INVITATION TO COMMENT ON EXPOSURE DRAFT TECHNICAL BULLETIN

Technical Bulletin AATB 3 (Revised) *Implementation Guidance on Revised Hong Kong Standard on Investment Circular Reporting Engagements (HKSIR) 400 Comfort Letters and Due Diligence Meetings*

Comments to be received by 20 April 2020

The Hong Kong Institute of Certified Public Accountants' (Institute) Auditing and Assurance Standards Committee is seeking comments on the Exposure Draft which has been posted on the Institute's website at:

<https://www.hkicpa.org.hk/en/Standards-and-regulation/Standards/Open-for-comment-documents/Auditing-and-Assurance>

AATB 3 was issued in 2013 to provide guidance that reporting accountants should be aware of when conducting engagements to issue a comfort letter or to take part in a due diligence meeting under HKSIR 400 (Revised).

Revisions are now proposed to AATB 3 to provide additional guidance when reporting accountants provide change period comfort while there are changes in accounting policies during the change period. Key proposed changes are:

- (a) when the company changes its accounting policies during the change period and the financial statement items requested to be reported on during the change period are impacted by the new accounting standard; and
- (b) sample wordings to the illustrative comfort letter as a result of (a).

In order for readers to easily identify all the changes, a marked-up version of the Exposure Draft is provided.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the Exposure Draft to be considered, comments are requested by the due date shown above.



Hong Kong Institute of
Certified Public Accountants
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Comments may be sent by mail, fax or e-mail to:

Standard Setting Department
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Hong Kong

Fax number (+852) 2865 6776
E-mail: commentletters@hkiipa.org.hk

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

18 March 2020
Invitation to Comment

Response Due Date
20 April 2020

ED of Technical Bulletin AATB 3 (Revised)

Implementation Guidance on Revised Hong Kong Standard on Investment Circular Reporting Engagements (HKSIR) 400 Comfort Letters and Due Diligence Meetings



Hong Kong Institute of
Certified Public Accountants
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Hong Kong Institute of
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Technical Bulletin

Implementation Guidance on Revised Hong Kong Standard on Investment Circular Reporting Engagements (HKSIR) 400 Comfort Letters and Due Diligence Meetings

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* This Technical Bulletin is revised in October 2018 mainly for conforming changes to HKSIR 400 (Revised), *Comfort Letters and Due Diligence Meetings* issued in December 2016 regarding oral due diligence[●] 2020 to provide guidance when the reporting accountants provide a comfort letter in respect of subsequent changes in specified financial statement items during the "change period" and there are changes in accounting policies during the change period.



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HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

TECHNICAL BULLETIN

**IMPLEMENTATION GUIDANCE ON REVISED HONG KONG STANDARD ON
INVESTMENT CIRCULAR REPORTING ENGAGEMENTS (HKSIR) 400
COMFORT LETTERS AND DUE DILIGENCE MEETINGS**

(Issued March 2013, Revised October 2018, ~~2020~~)

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INTRODUCTION

1. On 28 October 2011, the Hong Kong Institute of Certified Public Accountants ("HKICPA") published the revised HKSIR 400 "Comfort Letters and Due Diligence Meetings" ("HKSIR 400 (Revised)"). The revisions were effective for investment circulars or other offering documents dated on or after 1 January 2012. HKSIR 400 was then revised again in December 2012, primarily to update the comfort letter examples. The December 2012 revisions were effective upon issuance. Among other changes, HKSIR 400 (Revised) provides that limited (negative) assurance can now be given by reporting accountants in a comfort letter in respect of subsequent changes in specified financial statement items during the "change period". In addition, HKSIR 400 (Revised) clarifies that reporting accountants should follow HKSIR 400 (Revised) when they are requested to issue a comfort letter for debt offerings. On 29 December 2016, HKSIR 400 (Revised) was further revised to include guidance regarding oral due diligence and the key revisions are set out in Appendices 5A and 5B. The revisions made are effective upon issuance.
2. With the issue of HKSIR 400 (Revised), certain practical issues have arisen in respect of the implementation of the revised standard. This technical bulletin is intended to address, and provide practical guidance on, a few of those issues and serve as a reminder of certain basic principles that reporting accountants (including independent accountants reporting in connection with a debt offering) should keep in mind when conducting their engagement to issue a comfort letter or to take part in a due diligence meeting.

LENGTH OF CHANGE PERIOD

3. HKSIR 400 (Revised) provides that the period of time since the latest financial information was subject to an audit or review engagement, should be considered by the reporting accountants in determining whether negative assurance should be provided on subsequent changes in specified financial statement items ("change period comfort"). The question has been raised as to whether or not there is a "maximum" change period that reporting accountants should consider when concluding whether negative assurance is appropriate.
4. While each particular engagement circumstance should be considered, providing negative assurance on change period comfort where there has been an extended period of time since the issuer's financial information was last audited or reviewed¹ by the reporting accountants may result in a degree of comfort that is unwarranted given the limited nature of the procedures undertaken by the reporting accountants (i.e. reading of minutes and management accounts, if available, and inquiry of the issuer's management regarding the subsequent changes). For Initial Public Offerings ("IPOs") and other public equity offerings by Hong Kong listed issuers, given that the Hong Kong listing rules generally require that the date of the last audited financial information included in the listing document be not more than six months old as at the date of the listing document, reporting accountants may consider such 6-month period as an appropriate benchmark and should generally refrain from providing negative assurance for an equity offering when the change period (i.e. the period beginning subsequent to the date and period of the last audited or reviewed financial information, and ending at the "cut-off" date for the purpose of the comfort letter) is longer than six months.
5. Such "maximum" change period for the purpose of providing negative assurance comfort may need to be shortened depending on the facts and circumstances. For example, when the equity offering involves a concurrent "Rule 144A" exempt offering in the United States ("U.S."), the reporting accountants are often requested to issue a separate comfort letter to cover the

¹ In most circumstances these latest audited or reviewed financial statements would be included or incorporated in the offering document. If not, the comfort letter should clearly describe these audited or reviewed financial statements (for example, having them included as an appendix to the comfort letter). In these circumstances, the reporting accountants should agree with the addressees of the comfort letter the date from which the change period will be measured (i.e. whether the "change period" being commented on begins on the date subsequent to the audited or reviewed financial statements included/incorporated in the offering document or the date subsequent to the audited/reviewed financial statements not included/incorporated in the offering document). The change period start date should be clearly stated in the comfort letter.

U.S. offering following the guidance set forth in the PCAOB's auditing standard (AS) 6101/ the AICPA Auditing Standards Board's clarified auditing standard AU-C 920, which requires that the negative assurance on subsequent changes cannot be given unless the cut-off date is less than 135 days from the latest balance sheet date upon which the reporting accountants have performed an audit or review. In such circumstance, the reporting accountants are expected to follow the "135-day" rule in their preparation of the HKSIR 400 comfort letter so that the two comfort letters are consistent in respect of the level of change period comfort.

6. For Regulation S debt offerings (including establishments and updates of, and drawdowns under, medium term note programmes) reporting accountants may consider extending the change period for a well established company with a good history of providing reliable financial information. Other factors that the reporting accountants may take into account in evaluating the maximum length of time that is appropriate for the change period comfort may include: whether or not the company is publicly listed (and therefore publishes financial information on a regular basis that is subject to regulatory review and scrutiny), the length of the reporting accountants' relationship with the company and the reporting accountants' assessment of the quality of the company's internal controls over financial reporting. However, in all cases, reporting accountants should generally refrain from providing negative assurance for change period comfort when the cut-off date is more than nine months from the latest balance sheet date upon which the reporting accountants have performed an audit or review.
7. In circumstances in which it is inappropriate to provide negative assurance, whether this is because of the length of the change period or for some other reason such as those described below under "Year-end and post year-end cut-off dates" the reporting accountants may provide "procedures and factual findings comfort" on changes in specified line items, as described in footnotes 33 and 42 of HKSIR 400 (Revised).

YEAR-END AND POST YEAR-END CUT-OFF DATES

8. Reporting accountants should exercise caution when considering providing comfort on financial information as of a company's year-end date or on subsequent changes in financial statement items where the cut-off date is at or within a few days of the year end. Year-end information generally is, or will be, the subject of audit procedures and may change once the year-end financial statements are published. Although HKSIR 400 (Revised) does not specifically preclude reporting accountants from giving comfort in such circumstances, unless the audit is substantially complete at the cut-off date, reporting accountants should exercise extreme caution before agreeing to:
 - Provide "tick-mark" comfort on information as at or ending on a year-end date;
 - Read management accounts ending on the financial year end date in order to provide change period comfort; or
 - Enquire of management and provide negative assurance with respect to change period comfort using a cut-off date on, or within a few days before or after, the financial year end. For example, enquiring of management and providing negative assurance with respect to changes in financial statement amounts as at a cut-off date of 29 December for a calendar year end company.
9. In terms of exercising caution, reporting accountants should provide comfort in the above circumstances **only** after the year-end audit fieldwork² is substantially complete and the reporting accountants are satisfied that there are no other significant matters that would cause a material change to the numbers on which comfort is being given. Where the audit fieldwork is not substantially complete, reporting accountants may agree to provide "bifurcated comfort" on changes in financial statement items with a cut-off date on, or within a few days before or after, the financial year end, as described more fully below (negative

² The reference to year-end audit fieldwork in this context refers to the entire audit, not those specific procedures related to the identified line items.

assurance based on reading pre year-end management accounts and procedures and factual findings comfort to the cut-off date).

10. Reporting accountants should also be cautious when considering providing negative assurance on changes to a cut-off date ending after the year-end date. When the cut-off date extends beyond the year-end, the reporting accountants may wish to wait until the audit fieldwork is substantially complete or, alternatively, restrict comments to reporting factual findings in the form illustrated in footnotes 33 and 42 HKSIR 400 (Revised), provided that there is an adequate basis to do so (see paragraph 45 of HKSIR 400 (Revised)). In this situation, where the cut-off date extends beyond the company's financial year end, the reporting accountants may provide bifurcated comfort (negative assurance based on reading pre year-end management accounts and procedures and factual findings comfort to the cut-off date) provided that the overall change period does not exceed the parameters discussed in the section "Length of change period" above. For example, an offering memorandum for a calendar year company issued in January 20X3, may contain 30 June 20X2 or 30 September 20X2 interim financial statements that have been reviewed by the reporting accountants. In connection with the HKSIR 400 comfort letter, the reporting accountants may be requested to read unaudited management accounts for the period up to the end of November of 20X2 and to enquire of company officials about changes in specified financial statement items as of 25 January 20X3 and for the period from 1 October 20X2 to 25 January 20X3. Assuming that there are no factors that would render negative assurance inappropriate based on the specific facts of the transaction (including the overall length of the change period and the time since the last audit or review as described under "Length of change period" above), even though the audit procedures and related fieldwork on the year-end financial statements may not be substantially complete, the reporting accountants may provide negative assurance with respect to changes in specified financial statement items as of 30 November 20X2 and for the period from 1 October 20X2 to 30 November 20X2 (based on reading management accounts for the months of October and November 20X2) and report procedures and factual findings comfort with respect to changes in specified financial statements items as of 25 January 20X3 and for the period from 1 October 20X2 to 25 January 20X3 consistent with footnotes 33 and 42 of HKSIR 400 (Revised).
11. Similar considerations (potentially implying a level of comfort that is not warranted by the level of work performed as at the date of the comfort letter) apply in the following circumstances:
 - Reading (for the purpose of providing change period comfort) interim financial information for a period included in the prospectus or offering circular, where no audit or review of those financial statements has been undertaken by the reporting accountants³. It should be noted, however, that although the reporting accountants will not agree to read (for the purpose of providing change period comfort) the interim financial information included in a prospectus or offering memorandum, reporting accountants will ordinarily agree to provide "tick mark" comfort on the information, by agreeing the numbers in the interim financial statements to the company's books and records; and
 - Providing negative assurance using a cut-off date within a few days before or on or subsequent to an interim period end, or reading management accounts for an interim period, when the financial statements for that interim period will be subject to a review to be performed in accordance with Hong Kong Standard on Review Engagements 2410 (or an equivalent standard) but that review is not substantially complete at the date of the comfort letter. In these circumstances reporting accountants may, however, provide "bifurcated comfort", similar to that described in paragraph 10 above, by agreeing to read management accounts for a period ending before the end of the interim period that will be subject to the review.

³ Where an interim review of such interim financial information has in fact been undertaken by the reporting accountants, the reporting accountants should generally agree to the reproduction of the review report in the offering circular or to provide comfort in accordance with footnotes 34 or 43 of HKSIR 400 (Revised).

In each of the above cases, the reporting accountants should be cautious so as not to inadvertently imply a higher level of comfort on interim or annual financial statements than can be justified by the work completed as of the date of the comfort letter. In particular, where interim or year-end information is still subject to change, it is important that reporting accountants do not give the impression that such change is unlikely by agreeing to give an inappropriate level of assurance or comfort.

CHANGES IN ACCOUNTING POLICIES DURING THE CHANGE PERIOD

12. Reporting accountants should also exercise caution when considering providing change period comfort where there are changes in accounting policies during the change period.
13. In general, the procedures in relation to subsequent changes referred to in paragraphs (1) to (7) of the standard comfort letter should be performed on financial information that was prepared in accordance with generally accepted accounting principles (“GAAP”) and prepared and presented on a basis consistent with the accounting policies normally adopted by the company and applied in preparing the historical financial information.
14. If the company changes its accounting policies (e.g. due to introduction of a new accounting standard (“New Accounting Standard”)) during the change period and the financial statement items requested to be reported on by the reporting accountants during the change period (the “Reported Items”) are impacted⁴ by the New Accounting Standard, the reporting accountants should pay attention to the following when providing the change period comfort:
- a) If the management accounts for the current period referred to in paragraph (1)(b) of the standard comfort letter are not prepared in accordance with the New Accounting Standard, the reporting accountants generally should not agree to read the managements accounts because such management accounts are not prepared in accordance with GAAP.
- b) If the management accounts for the current period referred to in paragraph (1)(b) of the standard comfort letter are prepared in accordance with the New Accounting Standard, consideration needs to be given as to whether the New Accounting Standard would be applied prospectively or retrospectively by the issuer in its annual accounts covering the change period.
- (i) If the New Accounting Standard will be applied retrospectively in the annual accounts covering the change period and the company has not yet restated⁵ the comparative financial information used for providing the change period comfort (the “Comparatives”) to reflect the retrospective application of the New Accounting Standard, the reporting accountants can only provide procedures and factual findings comfort on the subsequent changes because the Comparatives are different from those to be presented in the company’s annual accounts covering the change period.
- (ii) If the New Accounting Standard will be applied prospectively in the subsequent annual accounts, the issue mentioned in (i) above does not exist and the reporting accountants can provide negative assurance on the subsequent changes provided that the other criteria for providing negative assurance on the subsequent changes set out in HKSIR 400 and this implementation guidance are met.

⁴ If the Reported Items are not impacted by the New Accounting Standard, the guidance in this section is generally not applicable to the case and the reporting accountants should refer to the requirements and guidance set out in HKSIR 400 and other sections of AATB 3 when providing the change period comfort.

⁵ If the company has restated the Comparatives, the guidance in this section is generally not applicable to the case as there will not be changes in accounting policies during the change period. The reporting accountants should refer to the requirements and guidance set out in HKSIR 400 and other sections of AATB 3 when providing the change period comfort.

For both (i) and (ii) above, the comfort letter should indicate that the results set out in paragraph (5) of the standard comfort letter should be considered in light of the fact that the financial information for the current period has been prepared in accordance with the New Accounting Standard while the comparative financial information is not prepared on that basis. In addition, for (i) above, the comfort letter should further indicate that the findings might have been different from those that are reported in the comfort letter if the company had restated the comparative financial information to reflect the retrospective application of the New Accounting Standard.

For example, the following paragraphs should be added to the standard comfort letter:

For situation (i):

Insert the following paragraph after paragraph (2)(b) of the standard comfort letter:

“The Persons Responsible for Financial and Accounting Matters advised us that the April 20X5 Management Accounts have been prepared and presented on a basis consistent with the accounting policies normally adopted by the Group and applied in preparing the Historical Financial Information except that the Group has applied HKFRS XXX (the “New Accounting Standard”) to the April 20X5 Management Accounts with effect from 1 January 20X5 and has not restated the comparative financial information to reflect the retrospective application of the New Accounting Standard. The Persons Responsible for Financial and Accounting Matters advised us that, for the annual financial statements for the year ended 31 December 20X5, they will apply HKFRS XXX from 1 January 20X5 using the retrospective approach (with certain practical expedients selected), and will restate the comparative financial information.”

Insert the following paragraph after paragraph (5)(b) of the standard comfort letter:

“The above results should be considered in light of the fact as noted in paragraph (2)(b) above that the Group has applied the New Accounting Standard to the April 20X5 Management Accounts with effect from 1 January 20X5 and has not restated the 31 December 20X4 historical financial information and the April 20X4 Management Accounts to reflect the retrospective application of the New Accounting Standard. If the Group had restated the 31 December 20X4 historical financial information and the April 20X4 Management Accounts to reflect the retrospective application of the New Accounting Standard, [for cases without exceptions : increases or decreases in the balances or amounts referred to above might have been reported to you.] / [for cases with exceptions : the amounts of increases or decreases reported to you might have been different from the above and other increases or decreases in the balances or amounts referred to above might have been reported to you.]”

For situation (ii):

Insert the following paragraph after paragraph (2)(b) of the standard comfort letter:

“The Persons Responsible for Financial and Accounting Matters advised us that the April 20X5 Management Accounts have been prepared and presented on a basis consistent with the accounting policies normally adopted by the Group and applied in preparing the Historical Financial Information except that the Group has applied HKFRS XXX (the “New Accounting Standard”) to the April 20X5 Management Accounts with effect from 1 January 20X5 and has not restated the comparative financial information to reflect the retrospective application of the New Accounting Standard as [permitted/provided] by the New Accounting Standard. The Persons Responsible for Financial and Accounting Matters advised us that, for the annual financial statements for the year ended 31 December 20X5, they will apply the HKFRS XXX from 1 January 20X5, and will not restate the comparative financial information as [permitted/provided] by the New Accounting Standard.”

Insert the following paragraph after paragraph (5)(b) of the standard comfort letter:

“The above results should be considered in light of the fact as noted in paragraph (2)(b) above that the Group has applied the New Accounting Standard to the April 20X5 Management Accounts with effect from 1 January 20X5 and has not restated the 31 December 20X4 historical financial information and the April 20X4 Management Accounts to reflect the retrospective application of the New Accounting Standard as [permitted/provided] by the New Accounting Standard.

15. Similar considerations apply when providing change period comfort for the period immediately preceding the cut-off date for which complete accounting information is not yet available (i.e. the procedures referred to in paragraphs (6) and (7) of the standard comfort letter).

FORM OF COMFORT LETTER

16. An issue frequently encountered by practitioners is whether or not the example comfort letters included in the appendices to HKSIR 400 (Revised) are intended to be "standard" forms that reporting accountants must follow without substantive modifications. The example comfort letters included in Appendix 2 and Appendix 3 to HKSIR 400 (Revised) are intended to be used as examples only and are not intended as illustrations of the form and content of comfort letters issued under HKSIR 400 (Revised) that would be appropriate in every situation. Those example comfort letters should be distinguished from the example arrangement letters included in Appendix 1 to HKSIR 400 (Revised), which should generally be followed without substantive modifications as the terms and conditions set forth in the example arrangement letters were largely agreed by the major investment banks and accounting firms as part of the revisions made to HKSIR 400 (Revised).
17. Reporting accountants should appropriately modify the example comfort letters to suit the particular engagement specific facts and circumstances (for example, when it is determined that negative assurance for change period comfort is not appropriate). Also, reporting accountants should not be restricted from including matters of emphasis in the comfort letters as they deem necessary as long as they do not contradict or otherwise supersede the agreed terms and conditions set forth in the HKSIR 400 arrangement letter.
18. Other common issues that may require the comfort letter to be updated to reflect actual facts and circumstances include:
- a) The absence of management accounts subsequent to the latest financial statements included or referenced in an offering circular. In this case, references to subsequent management accounts would be removed, along with the concluding sentence in paragraph 1 and the whole of paragraphs 2, 3 and 5 under the section headed "Changes in Financial Position" of the standard comfort letter and as set out in Appendix 2 to HKSIR 400 (Revised). In addition, the introductory sentence of Paragraph 6 would be updated, for example, as follows:
- "Since the directors have advised us that no management accounts have been prepared to any date subsequent to [date of latest financial statements included or referred to in an offering circular], the procedures carried out by us with respect to changes in financial statement items of the [Issuer/Group] after [date of latest financial statements included or referred to in an offering circular] have of necessity been limited."*
- b) In some circumstances, notably when issuing comfort letters in relation to updates of medium term note programmes and when providing comfort on repeat transactions where previous arrangement and comfort letters have been expressed to be governed by the laws of a country other than Hong Kong and/or in relation to which the parties to the arrangement letter submit to the jurisdiction of that other country's courts, reporting accountants may wish to consider adopting a continuation of this approach.
- c) Certain sponsor(s), manager(s) or, as the case may be, arranger(s)/dealer(s) have a preference for alternative language in standard paragraphs 5 and 7, when setting out exceptions noted in respect of changes in specified financial statement items. If requested to do so, reporting accountants may consider replacing the phrase "*except that the [July 20X5 management accounts showed a decrease....]*" with the alternative "*however the [July 20X5 management accounts showed a decrease....]*"
19. Reporting accountants should also note that the list of procedures to be conducted with reference to the provision of "tick mark" comfort in HKSIR 400 (Revised) is not intended to be exhaustive and that different or additional procedures may be required and appropriate in

some cases, subject to the general considerations set out in paragraphs 28 to 40 of HKSIR 400 (Revised).

AUDITED/ REVIEWED FINANCIAL STATEMENTS REPRODUCED IN AN OFFERING CIRCULAR

20. The fourth paragraph of Example 2, Appendix 2 (example comfort letter for a debt offering in reliance on Regulation S) states:

"On pages [x to x], the offering circular of the Company with respect to the Notes dated 20[x] (the "Offering Circular") sets out certain financial statements as at and for the [three] years ended 31 December 20X2, 20X3 and 20X4 (the "Historical Financial Statements") [and the [six] months ended 30 June 20X4 and 20X5] (the "Interim Financial Statements") of the [Company/Guarantor] and its subsidiaries (the "Group"). We have read this information and have compared it with that shown in the published audited consolidated financial statements as at and for the [three] years ended 31 December 20X2, 20X3 and 20X4 [and the published unaudited consolidated interim financial statements as at and for the [six] months ended 30 June 20X4 and 20X5] of the [Company/Guarantor]. We confirm that these financial statements have been found to be in agreement with the published audited consolidated financial statements for the relevant years [or, as the case may be, the published unaudited consolidated interim financial statements for such period]. [We did not conduct a review of such interim financial statements in accordance with the standards and guidance issued by the [HKICPA] or any professional body in any other jurisdiction]."

Prior to the issuance of HKSIR 400 (Revised) there were inconsistent views on whether the procedures outlined above could include comparing the full financial statements reproduced in an offering circular back to the original financial statements on which the reporting accountants have opined. Although this procedure is not generally necessary or required for an equity transaction in respect of which the reporting accountants' generally issue a signed accountants report and consent, for a debt transaction the arrangers or dealers may request that such comfort be provided. If so requested, reporting accountants may include the full financial statements (frequently referred to as the "F-pages") within the scope of the above paragraph.