

PN 851 (Revised)
Issued September 2022

Effective for reporting periods ending on or after
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Practice Note 851 (Revised)

Reporting on the Annual Financial Reports of Non- governmental Organisations



Hong Kong Institute of
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香港會計師公會

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PRACTICE NOTE 851 (REVISED)
REPORTING ON THE ANNUAL FINANCIAL REPORTS
OF NON-GOVERNMENTAL ORGANISATIONS

*(Issued September 2022;
 Effective for reporting periods ending on or after 31 March 2023)*

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Practice Note (PN) 851 (Revised), *Reporting on the Annual Financial Reports of Non-governmental Organisations* should be read in the context of the *Preface to the Hong Kong Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* which sets out the application and authority of PNs.

PRACTICE NOTE 851 (REVISED) REPORTING ON THE ANNUAL FINANCIAL REPORTS OF NON-GOVERNMENTAL ORGANISATIONS

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. The purpose of this Practice Note (“PN”) is to provide guidance regarding the reporting requirements in connection with the Annual Financial Reports (“AFRs”) of Non-governmental Organisations (“NGOs”) pursuant to the requirements of the prevailing Lump Sum Grant (“LSG”) Manual published by the Social Welfare Department of the Government of the HKSAR (“SWD”). This PN has been prepared in consultation with the SWD, and it has been agreed that the scope of work and reporting by the auditor of NGOs under this PN would meet the reporting requirements of the LSG Manual.
2. Under the requirements of the LSG Manual, the AFR is required to be reviewed by the auditor of the NGO. Although the LSG Manual refers to a review of the AFR, the guidance contained in this PN contemplates the issuance of an assurance report 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)”) and with reference to this PN. The SWD has agreed that an assurance engagement under HKSAE 3000 (Revised) is acceptable to the SWD for the purpose of satisfying the requirements of the LSG Manual. Accordingly, references to auditor in this PN are not intended to imply that an audit under Hong Kong Standards on Auditing (“HKSAAs”) or a review under Hong Kong Standards on Review Engagements is being or has been undertaken or that an audit opinion or a review conclusion is expressed.

Lump Sum Grant Manual

3. The LSG Manual provides a self-contained and necessary reference for NGOs to operate under the Lump Sum Grant Subvention System, with a view to enhancing accountability, efficiency and cost-effectiveness in the use of public funds for the provision of welfare services.
4. Before accepting the engagement, the auditor would need to be familiar with the provisions of the LSG Manual.
5. The LSG Manual sets out:
 - a. the structure of LSG, the arrangements for Provident Fund (“PF”) provision and other related matters;
 - b. the financial management of NGOs under LSG;
 - c. the respective roles and responsibilities and accountability of SWD and NGOs for the use of public funds; and
 - d. guidance on best management practices and processes.

6. The LSG Manual provides the basic requirements in respect of accounting, financial reporting and internal control, compliance of which by NGOs is a pre-requisite for NGOs receiving LSG and is necessary to support sound financial management. A summary of the relevant requirements as extracted from the LSG Manual is set out in paragraphs 7 to 13 below.

Accounting

7. NGOs must ensure that proper books of account and other accounting records are kept for all transactions, separately identified into Funding and Services Agreement (“FSA”) activities and support services (including central administration and supervisory support), and non-FSA activities.
8. NGOs are required to keep a separate Operating Income and Expenditure Account for each subvented service unit. NGOs are recommended to follow the Chart of Accounts set out in Annex 4 to the LSG Manual in maintaining accounting records.

Financial reporting

9. NGOs must prepare the AFRs in respect of all their FSA activities and support services funded by LSG, other social welfare subventions and other income. The AFR must:
- a. derive its content from and be reconcilable with the Operating Income and Expenditure Account of all the subvented service units under FSAs; and
 - b. show at the NGO level, in respect of:
 - (i) PF subvention received and PF expenditure, the split between Snapshot Staff and 6.8% posts as defined in the LSG Manual;
 - (ii) analysis on the number of posts with annual personal emoluments over \$700,000 each paid under LSG; and
 - (iii) analysis of the LSG Reserve (including holding account), PF Reserves and balances of other SWD subventions.

A proforma AFR is provided in Annex 5 to the LSG Manual. Any updated version of the proforma AFR will be available at the SWD website <http://www.swd.gov.hk>.

10. The AFR must be an integral part of the NGO’s annual report. If any NGO chooses not to provide the AFR in its annual report, it has to upload the full set of the latest AFR onto its website and specify the website address linking to the AFR in its annual report. For NGOs not publishing an annual report, they have to follow the relevant requirements set out in the LSG Manual in respect of public disclosure of the AFR.
11. NGOs should arrange their AFRs to be reviewed by their external auditors. Such engagement should be conducted in accordance with this PN as explained in paragraph 2 above.
12. NGOs are required to submit two copies of the documents listed below to the SWD not later than 31 October following the end of the financial year, i.e. 31 March:
- a. the AFR together with an assurance report thereon issued by their external auditor; and
 - b. the audited financial statements of the NGO together with the auditor’s management letter in respect of the audit of the annual financial statements of the NGO as a whole.

Internal control

13. Internal control is fundamental to sound and prudent financial management. NGOs should always ensure that adequate internal controls are in place having regard to the nature and size of their organisation and the services provided. Advice on internal control procedures in respect of important financial activities has been provided by the SWD as part of the Subvention Inspection process and is set out in Annex 8 to the LSG Manual.

Objectives of the engagement

14. The objectives of the engagement are for the auditor to report whether:
- a. in the auditor's opinion the AFR for the relevant year ended is properly prepared, in all material respects, in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD; and
 - b. during the reporting period any matter has come to the auditor's attention during the course of the work, which causes the auditor to believe that the use of the funds from the LSG by the NGO has not complied, in all material respects, with the purposes as specified in the LSG Manual and other instructions issued by the SWD.

Planning and performing the engagement

15. The auditor should comply with the requirements of the HKICPA's *Code of Ethics for Professional Accountants*.
16. The auditor should plan and perform the engagement with professional skepticism recognising that circumstances may exist which cause the AFR to be materially misstated and that the use of funds from the LSG by the NGO has not complied, in all material respects, with the purposes as specified in the LSG Manual and other instructions issued by the SWD.
17. For the purpose of expressing conclusions in the assurance report on the AFR, the auditor should obtain sufficient appropriate evidence to be able to draw conclusions.

Terms of engagement

18. The auditor and the NGO should agree on the terms of the engagement. The agreed terms should be recorded in an engagement letter or other suitable form such as a contract. Guidance on engagement letters is set out in paragraphs 27 and 28 of HKSAC 3000 (Revised).
19. An engagement letter will be of assistance in planning the work. It is in the interests of both the auditor and the NGO that the auditor sends an engagement letter before the commencement of the engagement. An engagement letter confirms the auditor's acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objectives and scope of the engagement, the respective management and the auditor's responsibilities and the form of report that is expected to be issued.
20. Matters that should be included in the engagement letter include:
- a. the objective of the engagement;
 - b. management's responsibilities for the preparation of the AFR as required by the LSG Manual and other instructions issued by the SWD;

- c. auditor's responsibilities and the scope of the engagement, including reference to HKSAE 3000 (Revised) and this PN;
- d. unrestricted access to records, documentation and other information requested in connection with the engagement;
- e. a sample or a description of the form of the report expected to be rendered;
- f. the fact that the engagement cannot be relied upon to disclose errors, illegal acts or other irregularities, for example, fraud or defalcations that may exist; and
- g. a statement that an audit is not being performed and that an audit opinion will not be expressed.

An example of an engagement letter for reporting on the AFR is given in Appendix I to this PN.

Planning

- 21. The auditor should plan the engagement so that it will be performed effectively.
- 22. In planning the engagement, the auditor should make use of the knowledge obtained during the course of the audit of the financial statements of the NGO, including consideration of the NGO's organisation, accounting systems, system of internal control, operating characteristics and the nature of its assets, liabilities, revenues and expenses.
- 23. The auditor needs to possess an understanding of such matters and other matters relevant to the AFR, for example, a knowledge of the NGO's services provided, to be able to design appropriate procedures, as well as to assess the responses and other information obtained.

Procedures and evidence

- 24. The auditor should apply judgement in determining the specific nature, timing and extent of procedures to be performed. The auditor will consider matters including:
 - a. any knowledge acquired by carrying out audits of the financial statements of the NGO for the current and prior periods, and reporting on the AFRs for prior periods;
 - b. auditor's knowledge of the services and activities including knowledge of the accounting principles and practices of the sector in which the NGO operates;
 - c. the NGO's accounting systems;
 - d. the extent to which a particular item is affected by management judgement; and
 - e. the materiality of transactions and account balances.
- 25. The auditor should consider materiality when planning and performing an assurance engagement. The auditor should also refer to paragraph 44 of HKSAE 3000 (Revised) for guidance on materiality.
- 26. A list of recommended procedures for reporting on the AFR is set out in Appendix II to this PN.

Documentation

- 27. The auditor should document matters which are important in providing evidence to support the conclusions, and evidence that the engagement was carried out in accordance with HKSAE 3000 (Revised) and this PN.

28. In addition to the above, the auditor should also refer to HKSAE 3000 (Revised) for guidance on procedures and evidence.

Management representations

29. Guidance on management representations is set out in HKSA 580, *Written Representations* and paragraphs 56 to 60 of HKSAE 3000 (Revised).
30. The auditor should obtain appropriate written representations on matters material to the AFR when those representations are necessary to obtaining sufficient appropriate evidence. In addition, the following representations would need to be obtained from management:
- a. the AFR for the relevant year ended is properly prepared in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD; and
 - b. during the reporting period the use of the funds from the LSG by the NGO has complied with the purposes as specified in the LSG Manual and other instructions issued by the SWD.

Conclusions and reporting

31. An example unmodified assurance report on the AFR is given in Appendix III to this PN.
32. The conclusion in the assurance report consists of two parts. The first part is a reasonable assurance opinion on whether the AFR for the relevant year ended is properly prepared, in all material respects, in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD. The second part is a limited assurance conclusion on whether any matters have come to the auditor's attention that causes the auditor to believe that the use of the funds from the LSG by the NGO has not complied, in all material respects, with the purposes as specified in the LSG Manual and other instructions issued by the SWD.
33. The example report in Appendix III to this PN is unmodified. However, circumstances may arise where the auditor believes that unmodified conclusions are not appropriate. Accordingly, this PN does not preclude the auditor from modifying the report including issuing a qualified, adverse, or disclaimer of conclusion or include an emphasis of matter paragraph to draw attention to a specific matter disclosed in the AFR. When issues arise during the course of an engagement, the auditor should consider their impact on the report. The auditor should refer to HKSAE 3000 (Revised) for further guidance.

Appendix I

Example engagement letter for reporting on the annual financial report of a non-governmental organisation

The following engagement letter is to be used as a guide and will need to be adapted according to individual requirements and circumstances.

To the [Management][Trustees][Directors][Council][Committee Members]¹ of [Name of NGO] (“the NGO”)

Objective of services

- 1.1 You have requested that we report on the Annual Financial Report (“AFR”) of the NGO for the year ended 31 March 20XX. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our work will be conducted with the objective of expressing a conclusion on the AFR.

Responsibilities of the [Management][Trustees][Directors][Council][Committee Members]¹

- 2.1 As [management][trustees][directors][council][committee members] of the NGO, you are responsible for ensuring that the AFR of the NGO is properly prepared in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD; and the use of the funds from the LSG by the NGO has complied with the purposes as specified in the LSG Manual and other instructions issued by the SWD.
- 2.2 You are also responsible for making available to us, all records, documents, books, and accounts and to such information and explanations that, in our opinion, are necessary to conduct the engagement.

Responsibilities of the auditor

- 3.1 Our responsibility is to report to you whether for the reporting period:
- a. in our opinion the AFR is properly prepared, in all material respects, in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD; and
 - b. any matters have come to our attention during the course of our work, which cause us to believe that the use of the funds from the LSG by the NGO has not complied, in all material respects, with the purposes as specified in the LSG Manual and other instructions issued by the SWD.

Scope and limitations of our work

- 4.1 Our work will be carried out 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 851 (Revised), *Reporting on the Annual Financial Reports of Non-governmental Organisations* issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”). We will perform such procedures as we considered necessary for the purpose of reporting on the matters as stated in paragraph 3.1.
- 4.2 Our work undertaken is less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we

¹ The addressee of the engagement letter should be consistent with that of the report in Appendix III to this PN.

would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

- 4.3 As part of our procedures, we will request you to provide written confirmation concerning representations which we have received from you during the course of the engagement on matters having a material effect.
- 4.4 The responsibility for safeguarding the assets of the NGO and for the prevention and detection of fraud, errors and non-compliance with law or regulations rests with yourselves. Our engagement cannot be relied upon to disclose whether fraud or errors, or illegal acts exist. However, we shall inform you of any material matters that come to our attention.

Reporting and distribution

- 5.1 Our report is intended solely for submission by the NGO to the SWD and is not intended to be, and should not be, used by anyone for any other purpose.
- 5.2 We will agree that a copy of the report once issued may be provided to the SWD without further comment from us.

Fees

6. Our fees are computed on the basis of the time spent on your affairs by the partners and our staff and on the levels of skill and responsibility involved plus out-of-pocket expenses. Fees will be due and payable on presentation.

Agreement of terms

7. Once it has been agreed, this letter will remain effective, from one appointment to another, until it is replaced. Please sign and return the enclosed copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our report on the AFR including our respective responsibilities.

Yours faithfully

ABC & Co.

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

Date

We agree to the terms of this letter.

[Manager][Trustee][Director][Council member][Committee Member], for and on behalf of the
[Management][Trustees][Directors][Council][Committee Members] of [Name of NGO]

Date

Appendix II**Recommended procedures for reporting on the annual financial report of a non-governmental organisation**

The nature and extent of procedures to be carried out for the purposes of reporting on the AFR of a non-governmental organisation 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 AFR of a non-governmental organisation, 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 carries out those procedures so as to ensure sufficient appropriate evidence is obtained on which to base the conclusions, and documents matters which are important to providing evidence to support that conclusion.

1. AFR

Objective	Recommended procedures
To establish the AFR is properly prepared in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD.	a) Obtain an understanding of the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD.
	b) Obtain an understanding of the NGO's activities and the basis of preparation of the AFR to identify and assess the risks of material misstatement in the AFR.
	c) Review the policies and control procedures set up by the NGO over the preparation of the AFR to assess whether these policies and procedures would be adequate to ensure all transactions have been recorded and the AFR is properly prepared in accordance with the format and requirements.
	d) Perform tests on controls implemented by the NGO, in particular, the auditor considers whether those suggested control procedures over the preparation of the AFR as set out in Annex 8 to the LSG Manual have been properly implemented by the NGO.

	<p>e) Perform analytical procedures to identify relationships and individual items that appear unusual. Such procedures would include:</p> <ul style="list-style-type: none"> - compare the AFR with AFRs for prior periods; - compare the AFR with anticipated results and financial position; - study the relationships of the elements of the AFR that would be expected to conform to a predictable pattern based on NGO's experience or industry norm.
	<p>f) Reconcile the AFR with the Operating Income and Expenditure Account of all the subvented service units under Funding and Services Agreements.</p>
	<p>g) Check the payroll records to ensure the correct split between Snapshot Staff and 6.8% posts as defined in the LSG Manual. Test check the amount of PF subvention received and PF expenditure for these staff/ posts to the supporting document.</p>
	<p>h) Check the payroll records for posts with annual personal emoluments over \$700,000 each paid under LSG.</p>
	<p>i) For the analysis of LSG Reserve and balances of other SWD subventions, agree the balances to the underlying records.</p>
	<p>j) Enquire concerning actions taken at meetings of the Management Board and other meetings, and correspondence between the SWD and NGO that may affect the AFR and LSG.</p>
	<p>k) Perform substantive procedures, where appropriate, to assess whether the AFR has been prepared in accordance with the format and requirements set out in the LSG Manual.</p>

2. Use of Funds

Objective	Recommended procedures
<p>To establish the use of funds from the LSG by the NGO has complied with the purposes as specified in the LSG Manual and other instructions issued by the SWD.</p>	<p>a) Obtain an understanding in respect of the purposes of the use of the funds as specified in the LSG Manual and other instructions issued by the SWD.</p>
	<p>b) Understand the policies and control procedures set up by the NGO over the use of funds.</p>
	<p>c) One of the objectives of the engagement is for the auditor to state whether any matter has come to the auditor's attention which causes the auditor to believe that the use of the funds from the LSG by the NGO has not been complied, in all material respects, with the purposes as specified in the LSG Manual and other instructions issued by the SWD. However, the auditor is not required to perform any procedures to search for instances of the use of fund being non-complied with the specified purposes. The work of auditor is limited to reporting non-compliances identified during the normal course of the engagement.</p>
	<p>d) If the auditor noted that the NGO did not use the funds on the services specified in the FSA, this may lead to the auditor deciding to test a larger sample of expenditure throughout the year. The auditor should also inquire the NGO to understand the reason for such non-compliance.</p>

Appendix III

Example unmodified assurance report on the annual financial report of a non-governmental organisation

INDEPENDENT AUDITOR'S ASSURANCE REPORT

To the [Management][Trustees][Directors][Council][Committee Members] of [Name of NGO] ("the NGO")

We have audited the financial statements of the NGO for the year ended 31 March 20XX in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and have issued [an unmodified/ a modified] auditor's report thereon dated [insert date here].

Pursuant to the Lump Sum Grant ("LSG") Manual issued by the Social Welfare Department of the Government of the Hong Kong Special Administrative Region ("SWD"), we have been requested to issue this assurance report in connection with the Annual Financial Report ("AFR") of the NGO for the year ended 31 March 20XX.

Responsibilities of the [Management][Trustees][Directors][Council][Committee Members]

In relation to this report, the [Management][Trustees][Directors][Council][Committee Members] are responsible for ensuring the AFR of the NGO for the year ended 31 March 20XX is properly prepared in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD; and the use of the funds from the LSG by the NGO has complied with the purposes as specified in the LSG Manual and other instructions issued by the SWD.

Our Independence and Quality Management

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

The firm applies Hong Kong Standard on Quality Management 1², which requires the firm to design, implement and operate a system of quality management including policies or procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Auditor's Responsibility

Our responsibility is to form a conclusion, based on our engagement, and to report our conclusion to you.³

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 851 (Revised), *Reporting on the Annual Financial Reports of Non-governmental Organisations* issued by the HKICPA. We have planned and performed our work to obtain reasonable assurance for giving conclusion 1 and obtain limited assurance for giving conclusion 2 below.

² HKSQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

³ Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 *Auditors' Duty of Care To Third Parties and The Audit Report*.

The work undertaken in connection with this engagement is less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

In relation to our conclusion 1 below, we have planned and performed such procedures as we considered necessary with reference to the procedures recommended in PN 851 (Revised), to satisfy ourselves that the AFR has been properly prepared, in all material respects, in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD.

In relation to our conclusion 2 below, we have obtained an understanding in respect of the purposes of the use of the funds as specified in the LSG Manual and other instructions issued by the SWD and obtaining an understanding of the control procedures. We are not required to perform any procedures to search for instances of the use of funds from the LSG by the NGO being non-complied with the specified purposes. Our work was limited to reporting non-compliances identified as a result of the procedures performed in relation to conclusion 2 and during the normal course of our work relating to conclusion 1. 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

1. In our opinion, the AFR of the NGO for the year ended 31 March 20XX is properly prepared, in all material respects, in accordance with the relevant accounting and financial reporting requirements set out in the LSG Manual and other instructions issued by the SWD.
2. Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that the use of the funds from the LSG by the NGO has not complied, in all material respects, with the purposes as specified in the LSG Manual and other instructions issued by the SWD.

Intended Users and Purpose

This report is intended solely for submission by the NGO to the SWD and is not intended to be, and should not be, used for any other purpose. We agree that a copy of this report may be provided to the SWD without further comment from us.

[Name of firm]

[* Certified Public Accountants (Practising)/Certified Public Accountants]

[Auditor's Address]

Hong Kong

[Date]

* Delete as appropriate