AUDITING GUIDELINE

FINANCIAL INFORMATION ISSUED WITH AUDITED FINANCIAL STATEMENTS

Introduction

1. This guideline is intended to offer guidance on the auditor's responsibilities in relation to financial information contained in a company's annual report when that information does not form part of the audited financial statements. The guideline is supplementary to, and should be read in conjunction with, Auditing Standards and related Auditing Guidelines and the Explanatory Foreword to Auditing Standards and Guidelines.

2. This guideline is written in the context of the audit of companies incorporated under the Companies Ordinance. The auditor of an enterprise other than such a company will be guided by the terms of his particular appointment or by relevant legislation or other requirements. However, in the absence of specific provisions to the contrary, the general principles embodied in this guideline should be followed.

3. Financial information contained in a company's annual report is not confined to the statements encompassed by the auditor's report. Other financial information may be included in the statutory directors' report or in other unaudited statements such as a chairman's statement, a report on operations or a summary of past results. In this guideline the term "other financial information" is used to refer to all such unaudited financial information.

4. In performing the procedures outlined here, the auditor's main aim is to ensure that the other financial information does not detract from or cast doubt upon the view of the company's state of affairs and its profit or loss given by the audited financial statements.

Auditor's Responsibilities

5. The auditor has no statutory responsibility in respect of other financial information except insofar as the company has exercised its right under section 141C of the Companies Ordinance to show an item in the directors' report rather than in the accounts. In that event, section 141C obliges the auditor to report on that item as if it appeared in the financial statements.

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6. Where other financial information is published, the auditor should review it. The purpose of the review is to ascertain

   (i) whether the other financial information is consistent with the audited financial statements, and

   (ii) whether, though consistent with the audited financial statements, it is nevertheless misleading in some other respect.

7. Matters which may give rise to an inconsistency include the following:

   (a) an inconsistency between figures or narrative appearing in, respectively, the audited financial statements and other financial information;

   (b) an inconsistency between the bases of preparation of related items appearing in the audited financial statements and other financial information, where the figures themselves are not directly comparable and the different bases are not disclosed;

   (c) an inconsistency between figures contained in the audited financial statements and a narrative interpretation of the effect of those figures in the other financial information.

   This list is not intended to be exhaustive. Care needs to be exercised in identifying inconsistencies in each particular case.

8. Where the auditor considers that there is an inconsistency between the audited financial statements and other financial information or that an item of other financial information is misleading in some other respect, he should, if he considers that the inconsistency or misleading item is material, consider its implications and hold discussions with directors, or other senior members of management of the company with a view to achieving its elimination. It may also be desirable, depending upon the circumstances to make his views known in writing to the directors.

9. In the case of a material inconsistency, the auditor should consider whether it is the other financial information or the audited financial statements themselves which require amendment. If he considers that it is the audited financial statements which require amendment, and if the statements are not amended, he will need to consider qualifying his report on them. In these circumstances, the auditor should refer to Statement 3.320 ("Forms of Qualifications in Auditors' Report") and Statement 3.330 ("Audit Report Examples"). He will also need to consider whether further action should be taken in respect of the inconsistency itself, which will still exist.

10. If it is not the audited financial statements which require amendment, the auditor should consider the following possible courses of action:

    (i) writing a letter to the directors of the company advising them that, in the auditor's opinion, an inconsistent or otherwise misleading item of other financial information requires amendment;

    (ii) using his right under section 141(7) of the Companies Ordinance to be heard at any general meeting of the members on any business of the meeting which concerns him as auditor;

    (iii) referring to, and if necessary explaining, the inconsistent or otherwise misleadig item in his audit report;

    (iv) withdrawing from the engagement.

    Choice between these courses of action will depend in part upon the auditor's perception of the seriousness of the inconsistent or misleading item.

11. As a matter of law it is the third and fourth of these courses of action which are likely to offer the auditor the greatest protection from claims that he has failed to discharge his responsibilities. However, the auditor who is considering the course of referring to the matter in his audit report is advised that the qualified privilege (i.e. the defence to an action for defamation) which an audit report normally enjoys may not extend to comments on items of other financial information which appear to be inconsistent with the audited financial statements or otherwise misleading. Similarly, no qualified privilege may attach to statements made by him on such matters at a general meeting pursuant to his right under section 141(7) of the Companies Ordinance. The auditor should also bear in mind the provisions of section 140A of the Companies Ordinance, and in particular the obligation imposed by subsection (2) thereof, before deciding whether resignation from the engagement would be likely to resolve the problem. The auditor should consider seeking legal advice both as to which of the four courses of action he should adopt and as to the precise form of any wording to be used.

Other Considerations

12. The auditor should urge the company not to publish its annual report until after he has completed his review of the other financial information and he should make arrangements to see, prior to publication, any documents in which the financial statements are to be included. The auditor should deal with these procedures in the audit engagement letter. Where, notwithstanding this, the auditor is not given an opportunity to complete his review before the date of issue, he should complete it before the general meeting at which the financial statements are laid before the members. In the event that there is something with which he disagrees, the auditor should take legal and other professional advice and consider taking the course of action set out in paragraph 10(ii).