

How to deal with special purpose reports

By Steve Ong

The Institute's Auditing and Assurance Standards Committee (AASC) has issued an exposure draft of discussion paper, "Requests For Special Purpose Reports," for consultation until 31 October 2006. The exposure draft aims to clarify to practitioners and users of their reports the principal types of special purpose engagements and the form and contents of the related reports. In the exposure draft, a "special purpose report" refers to a report on an engagement other than an audit or review of a set of financial statements.

Background

In 2001, the Hong Kong Institute of CPAs adopted the policy of converging Hong Kong standards on quality control, auditing, assurance and related services with international standards on these areas developed by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The convergence aims to establish high quality standards and guidance for financial statement audits, other types of assurance services and other related services (special purpose engagements) that are accepted locally

and internationally by investors, auditors, governments, regulators and other key stakeholders.

As part of the convergence programme, the AASC has issued a range of standards on different reporting engagements typically undertaken by accountants in public practice in Hong Kong. These standards set out key principles, required procedures and the appropriate form a report should take when the engagement falls within the scope of the applicable standards. The effect of this standards development is that practices, procedures and requests for reports by practitioners that have developed in the past may no longer be appropriate. This exposure draft addresses the discrepancies between existing practices and the requirements of recently released standards.

Special purpose engagements

The exposure draft focuses on "special purpose" engagements primarily because issues relating to audits or reviews of financial statements are

generally better understood compared to those that arise in other types of reporting. The key issue being addressed is how to fit all the existing "special purpose" reporting requirements in Hong Kong into the new framework and how to apply the new standards.

The relevant parties (the practitioner, his client and, where appropriate, relevant users of the intended report) would need to discuss and agree on the scope of work and nature of report that is best suited to the circumstances. Typically the first issue to determine is whether the practitioner is to undertake an assurance engagement or an agreed-upon procedures engagement.

The final decision may depend on a number of factors including the reasons for the requested report, the main concerns of the intended user that prompted the request, and the client's and the user's expectations as to the work that they expect the practitioner to perform. Once a particular reporting requirement is covered by a specific Institute pronouncement, that pronouncement should be followed.

Assurance or agreed-upon procedures engagement

The key difference between an assurance engagement and an agreed-upon procedures engagement is that with an "assurance engagement," the practitioner provides an opinion based on testing and evaluating the information provided by the client to see if it meets agreed standards or benchmarks. In contrast, in an agreed-upon procedures engagement the practitioner is only performing specific procedures that have been agreed beforehand by the practitioner and the client and any appropriate third parties and to report on factual findings.

In an agreed-upon procedures engagement, the nature of the work is such that the practitioner does not provide an opinion, but instead

provides a report of factual findings. The client will have to draw his or her own conclusions from the work of the practitioner, who will not interpret the results. This is one of the key distinctions between those reports and an "assurance" report. Nevertheless, it should be noted that the scope of work undertaken and the report setting out the practitioner's factual findings under an agreed-upon procedures engagement provides comfort, as well as some degree of credibility, to the client on the information reported upon.

Factors to consider when determining whether an assurance engagement or an agreed-upon procedures engagement should be conducted include:

- (i) the subject matter to be reported on (that is, the matters that need to be reported on or regulated)
- (ii) the nature of evidence that may be available (that is, the information available to the practitioner to carry out the work expected)
- (iii) whether an assurance report is required (that is, does the practitioner need to give an opinion or would a report of factual findings meet the client's needs)
- (iv) if an assurance report is required, the nature of any suitable criteria to evaluate the findings (a benchmark should be available such as Hong Kong Financial Reporting Standards or the Small and Medium Sized Entity Financial Reporting Standard or a recognised internal control framework such as that developed by The Committee of Sponsoring Organisations of the

Treadway Commission)

- (v) the level of procedures that may need to be undertaken (that is, in accordance with the relevant auditing and assurance or related services standards)
- (vi) costs and benefits of the different types of engagements

Overview of relevant reporting standards

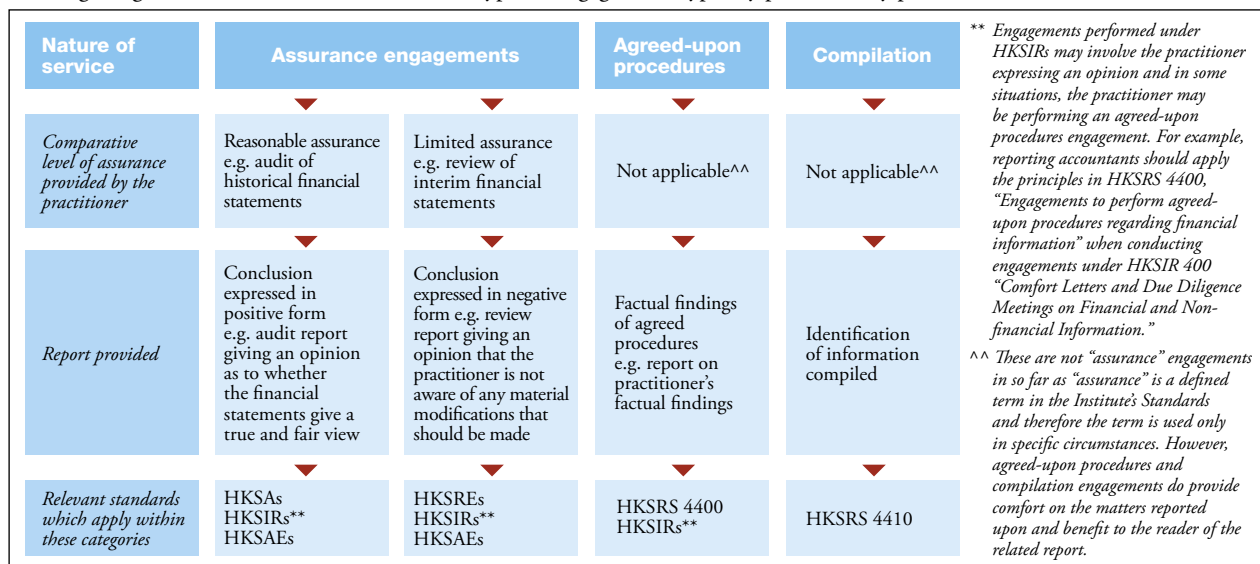
The discussion paper provides a background summary and overview of the relevant reporting standards that apply to different types of engagements:

- Hong Kong Standards on Auditing (HKSAAs) are applied in the audit of historical financial information
- Hong Kong Standards on Review Engagements (HKSREs) are applied in the review of historical financial information
- Hong Kong Standards on Investment Circular (HKSIRs) are applied in investment circular reporting engagements
- Hong Kong Standards on Assurance Engagements (HKSAEs) are applied in assurance engagements dealing with subject matters other than historical financial information
- Hong Kong Standards on Related Services (HKSRs) are applied to compilation engagements, engagements to apply agreed-upon procedures to information and other related services engagements as specified by the AASC.

In addition, Hong Kong Standards on Quality Control (HKSQCs) are applied at the practitioner or accounting firm level rather than the engagement level, for all services falling under the above engagement standards.

Standard setting feature

The diagram gives a brief overview of the different types of engagements typically performed by practitioners:



Discussion of issues

Appendix 2 of the exposure draft explains in detail the common issues arising from requests to undertake the various types of special purpose engagements and some suggested approaches addressing the issues. This is the first time that such issues have been documented in a discussion paper in Hong Kong.

Appendix 2 is divided into three parts and some of the key findings are:

(a) Engagement acceptance and scoping

This part addresses the appropriateness of the work the practitioner is asked to perform. Examples of issues are:

- It is common for a requestor to request the practitioner to undertake an assurance engagement when an agreed-upon procedures engagement may better suit their needs. An agreed-upon procedures engagement, where it is scoped appropriately, could be more effective in meeting the client's needs than an assurance engagement
- The practitioner should decline engagements to report on matters that are not within his professional competence, such as giving an opinion of an actuarial nature or a property valuation where the practitioner is not appropriately qualified or experienced
- Practitioners are required to be independent when performing an

assurance engagement. Where a practitioner carries out an agreed-upon procedures engagement or compilation engagement and where he or she is not independent, the report on the engagement should include a statement to that effect.

(b) Reporting issues

This part addresses the report the practitioner is asked to provide. Examples of issues are:

- Financial statements may be prepared in accordance with a set of accounting instructions that are not in full compliance with a recognised financial reporting framework, such as HKFRSs. It is generally not appropriate for the auditors to provide a "true and fair view" type of opinion on those financial statements even though the financial statements may fully comply with the relevant accounting instructions
- The opinion "properly prepared in accordance with" is used in reporting on reasonable assurance reports. It is not appropriate for an agreed-upon procedures reports as it is an expression of the auditor's opinion
- When the financial information has been prepared on a basis other than a recognised financial reporting framework for general purpose financial statements, the practitioner should consider whether

the information upon which he is being asked to report is appropriate in the particular circumstances for which it is intended. Where this is not the case, the practitioner should consider whether it is appropriate to accept such an engagement.

(c) Problematic words

This part addresses words that practitioners should generally avoid as they are potentially confusing or misleading:

- Words such as "certify," "confirm," "verify" and "check" should be avoided as such words are not defined in the auditing standards. They usually suggest "complete accuracy." This is usually inappropriate, as the practitioner usually uses judgement in forming his opinion by examining samples rather than all items
- Also avoid words like "examine," "correct" and "audit in full" as they are likely to mislead users of the practitioners report as to the extent of the work performed.

The exposure draft can be accessed directly at www.hkicpa.org.hk/professionalttechnical/assurance/exposedraft/led_sp_reports.pdf

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Standard setting

This column is dedicated to answering questions submitted by members regarding Institute standards. You can submit questions on technical issues by sending an email to hkipca@hkipca.org.hk. We will answer these questions in accordance with the policy on handling members' technical questions on our website.

Q. A prospective new client has recently asked me to consider accepting an appointment as its auditor. Since it is a listed issuer, are there any additional steps that I need to do prior to accepting the engagement apart from obtaining a professional clearance letter?

A. In addition to Section 210 "Professional Appointment" (paragraphs 210.10-210.18) and Section 440 "Changes in a Professional Appointment" of the Code of Ethics for Professional Accountants (the code) which apply to all types of engagements and can be found in the July 2006 edition of *A Plus*, you are also required to follow Section 441 "Change of Auditor of a Listed Issuer of the Stock Exchange of Hong Kong."

In accordance with Section 441 of the code, the outgoing auditors should prepare a letter to the audit committee and the board of directors of the listed issuer whenever:

- (a) The outgoing auditors resign or decline to stand for re-appointment; or
- (b) The listed issuer decides to propose to its shareholders that the outgoing auditors be removed from office during the auditors' term of office, or

there is a proposal or intention not to re-appoint the auditors on the expiry of their term of office.

The outgoing auditors' letter to the audit committee and the board of directors should set out the circumstances leading to their resignation or termination. The circumstances to be disclosed in the letter are all occurrences that, in the opinion of the outgoing auditors, affect the relationship between the listed issuer and the outgoing auditors.

Paragraph 441.17 of the code requires incoming auditors to request a copy of the letter and any correspondence referred to in the letter directly from the listed issuer for consideration, in addition to requesting professional clearance from the outgoing auditors, before accepting the appointment.

If the listed issuer refuses to provide the incoming auditors with a copy of the letter, paragraph 441.18 of the code requires that the incoming auditors decline the nomination.

Q. As a practitioner, I have been following the recent auditing and assurance pronouncements issued by the Institute, like HKSAs, HKSREs, HKSIRs, HKSAEs and HKSRSSs. I have



answers

been asked by an audit client to provide an auditors' certificate in respect of the gross receipts generated from the client's business at one of their leased premises. The certificate is to state that the gross receipts are accurately reported. Am I permitted to sign such a certificate?

A. The Institute's Auditing and Assurance Standards Committee has recently issued a draft discussion paper, "Requests For Special Purpose Reports," to help clarify to members and users of their reports the principal types of special purpose engagements and the form and content of the related reports.

This paper sets out some of the practical issues and addresses the problems in the report you are being asked to prepare, including problems with the engagement you have described. For example, the draft discussion paper notes that the user of the report (the landlord) may interpret terms such as "certificate" and "accurate" as being potentially misleading because these terms may be interpreted as implying complete accuracy when you have only sampled the available data. The paper suggests that practitioners should generally seek to avoid reporting in such terms and instead use a form of wording that describes more precisely the scope of work done with reference to relevant standards (for example, assurance or agreed-upon procedures engagement standards, depending on the scope of work).

The draft discussion paper also suggests that it may be more appropriate for you to conduct an agreed-upon procedures engagement that

consists in checking that the reported receipts have been agreed with the information in your client's books and records. You should consider discussing the engagement with your audit client to ensure that the work you can do meets your client's needs and that your report is appropriate for the engagement. You can find the draft discussion paper on the Institute's website: www.hkicpa.org.hk/professionaltechnical/assurance/exposedraft/ed_sp_reports.pdf.

Please note that the answers only address general issues and provide general guidance. The answers do not constitute professional or legal advice. You need to base your decisions on Frameworks, Standards and other documents approved by the Council of the Institute, after taking account of your specific circumstances.

Members helping members

Do you want to help your fellow members? Try answering this question from a member and send an email to hkicpa@hkicpa.org.hk. Answers received by 20 August will be considered for inclusion in the October issue of A Plus.

Since Hong Kong has no requirement to file financial statements with a regulator, does it mean that the "available for public use" condition in HKAS 27 paragraph 10 that permits a parent not to prepare consolidated financial statements can never be met as far as the ultimate Hong Kong parent or any intermediate Hong Kong parent of the parent that produces consolidated financial statements is concerned?

