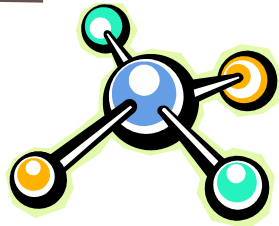


Sample Financial Statements and Sample Audit Documents (Part 3) 5 July 2007



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CPA (US) FCCA FCPA (Practising) MSCA

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1

Recap of 17.10.06 and 13.02.07

Previous Sessions

- Illustrated the application of HKSQC 1 and **HKSA 300, 315 and 330** (together with HKSA 200, 210, 220, 230, 240, 250, 260 and 402) through a set of sample documents
 - **Sample Planning and Control Document**
 - **Sample Audit Programme (SME-FRS) on PPE**
- **Template on Linking**
 - **An Understanding of An Entity → Risk of Material Misstatement → Audit Procedures** (HKSA 315 and 330)
- **Sample Audit Programme (SME-FRS) on Selected Sections**
- **Sample Audit Programme on**
 - **Accounting Estimates and Fair Value Measurement** (HKSA 540 and 545)
 - **Subsequent Events** (HKSA 560)
 - **Going Concern** (HKSA 570)



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2

Scope of Today

Today, we complete our sharing on sample documentation on an audit by illustrating

- **An update set of Sample Financial Statements**
(for year ended on or after 31 December 2006)

In addition, we revisit the Sample Audit Documentation by illustrating

- **A Set of Sample Audit Documentation** with
- **A Set of Sample Audit Programme under SME-FRS with all Relevant Cycles**
 - 6 more Sample Audit Programmes are enclosed



Today's Agenda

Overview

Sample Financial Statement 2006/07

Sample Audit Documentation



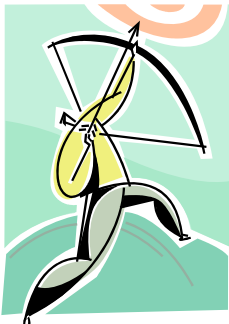
Recap

Revisit

Update

Today's Agenda

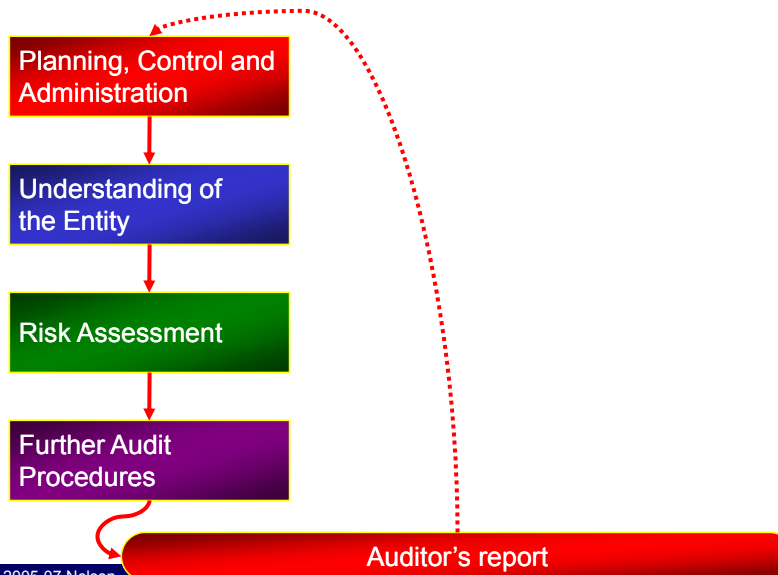
Overview



Audit Process



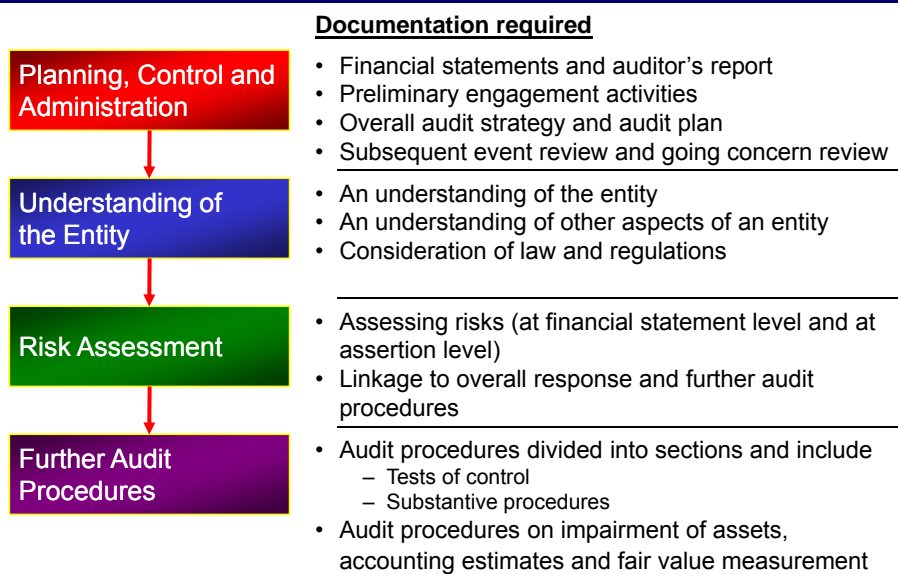
Sample Audit File Structure



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7

Sample Audit File Structure



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8

Sample Audit File Structure

E.g. for a single entity

- Sample fin. statements
- P. 5
- P. 6 – 11
- P. 25 – 30

- P. 13 – 15
- P. 15
- P. 16 – 18

- P. 19 – 21

- P. 19 – 21

- P. 31 – 69
Sample SME-FRS Audit Programme
- P. 22 – 24 (if any)

Documentation required

- Financial statements and auditor's report
- Preliminary engagement activities
- Overall audit strategy and audit plan
- Subsequent event review and going concern review

- An understanding of the entity
- An understanding of other aspects of an entity
- Consideration of law and regulations

- Assessing risks (at financial statement level and at assertion level)
- Linkage to overall response and further audit procedures

- Audit procedures divided into sections and include
 - Tests of control
 - Substantive procedures
- Audit procedures on impairment of assets, accounting estimates and fair value measurement

Today's Agenda

Sample Financial Statement 2006/07



Sample Financial Statements

E.g. for a single entity

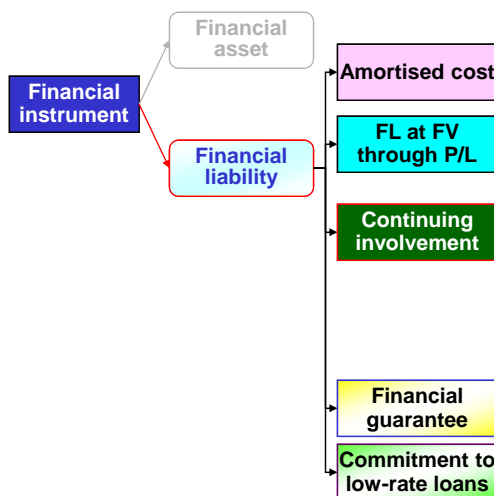
Documentation required

- **Sample fin. statements**
- Financial statements and auditor's report

Sample Financial Statements 2006/07

- Based on Sample Financial Statements 2005 (of 12 April 2006)
- Updated with
 - New and amended HKFRSs
 - Amendments to HKAS 39 and HKFRS 4 *Financial guarantee contracts*
 - HK(IFRIC) Interpretation 4 *Determine whether an arrangement contains a lease*
 - HKSA 700
 - Fine-tuning on certain areas, incl. fair value of financial instruments

Sample Policy on Guarantee



After initial recognition, an entity shall measure all financial liabilities at **amortised cost** using the effective interest method, except for:

- financial liabilities at fair value through profit or loss
- financial liabilities that arise
 - when a transfer of a financial asset does not qualify for derecognition, or
 - when the continuing involvement approach applies.
- Financial guarantee contracts
- Commitments to provide a loan at a below-market interest rate.

Sample Policy on Guarantee

Financial guarantee

- **Financial guarantee contract** is defined in HKAS 39 as a contract that:
 - requires the issuer to make specified payments to reimburse the holder for a loss it incurs
 - because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

- Financial guarantee contracts may have various legal forms, such as
 - a guarantee
 - some types of letter of credit
 - a credit default contract or
 - an insurance contract

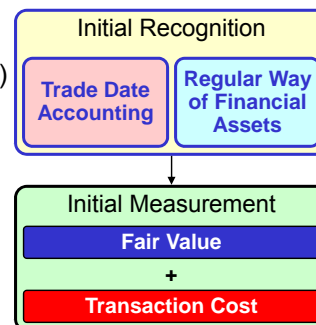


Sample Policy on Guarantee

Financial guarantee

- Financial guarantee contracts
 - are within the scope of HKAS 39.
- In consequence, the issuer shall initially recognise and measure it as other financial assets and liabilities and at
 - its fair value
 - plus transaction costs (unless classified as fair value through profit or loss)

- If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction,
 - its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary.



Sample Policy on Guarantee

Financial guarantee

Commitment to low-rate loans

After initial recognition,

- An issuer of such contract and such guarantee shall measure it at the higher of:
 - i) the amount determined in accordance with HKAS 37 Provisions, Contingent Liabilities and Contingent Assets; and
 - ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 Revenue.



Sample Policy on Guarantee

Financial guarantee

Asserted Explicitly

Used Insurance Accounting

- However, for financial guarantee contracts alone, such contracts may be excluded from the scope of HKAS 39
- HKAS 39.2e states that:

“if an issuer of financial guarantee contracts

- has previously asserted explicitly that it regards such contracts as insurance contracts and
- has used accounting applicable to insurance contracts,

- the issuer may elect to apply either
 - HKAS 39 or
 - HKFRS 4

to such financial guarantee contracts (see paragraphs AG4 and AG4A).

The issuer may make that election contract by contract, but the election for each contract is irrevocable.

Sample Policy on Guarantee

Financial guarantee

Asserted Explicitly

Used Insurance Accounting

Assertions that an issuer regards contracts as insurance contracts are typically found throughout the issuer's

- communications with customers and regulators,
- contracts,
- business documentation and
- financial statements.

- KPMG (FRU Issue 28, Jan. 2006):
 - This election applies to previously existing contracts as well as to similar contracts that an entity may enter into in the future.
- Ernst & Young (Sep. 2005):
 - The amendment applies to all existing contracts and any new contracts issued by an entity.

Sample Policy on Guarantee

Financial guarantee

Asserted Explicitly

Used Insurance Accounting

- KPMG Singapore (Aug. 2006):
 - If a guarantee arrangement is accounted for under FRS 104 (which is based on IFRS 4 without modification) by a non-insurance entity,
 - the guarantee arrangement should be disclosed as a contingent liability.
 - A liability is only recognised
 - if payment become probable.
 - This treatment is consistent with the current position in accounting for financial guarantees by non insurance entities.

Sample Policy on Guarantee

Case

Financial guarantee

Jardine Matheson



- 2006 Annual Report
 - Financial guarantee contracts under which the Group accepts significant risk from a third party by agreeing to compensate that party on the occurrence of a specified uncertain future event
 - are accounted for in a manner similar to insurance contracts.
 - Provisions are recognized when
 - it is probable that the Group has obligations under such guarantees and
 - an outflow of resources embodying economic benefits will be required to settle the obligations.

Sample Policy on Guarantee

Case

Financial guarantee

Tristate Holdings Limited

- 2006 Annual Report
 - For guarantees provided by the Company for banking facilities granted to subsidiaries, the Company
 - regards such guarantees as insurance contracts and does not recognise liabilities for financial guarantees at inception,
 - but performs a liability adequacy test at each reporting date and recognise any deficiency in the liabilities in the income statement.

Sample Policy on Guarantee

Financial guarantee

- HKFRS 4 *Insurance Contracts*:

Liability adequacy test (HKFRS 4.15)

- An insurer shall assess at each reporting date whether its recognised insurance liabilities are adequate,
 - using current estimates of future cash flows under its insurance contracts.
- If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows,
 - the entire deficiency shall be recognised in profit or loss.

Sample Financial Statements

E.g. for a single entity

Documentation required

- **Sample fin. statements**
- Financial statements and auditor's report

Let's look at :

Sample Financial Statements 2006/07

Today's Agenda



Sample Audit Documentation

Sample Audit Documentation

E.g. for a single entity

Documentation required

- P. 5
- P. 6 – 11

- Preliminary engagement activities
- Overall audit strategy and audit plan

**Sample
Planning and
Control
Document**

Sample Audit Documentation

E.g. for a single entity

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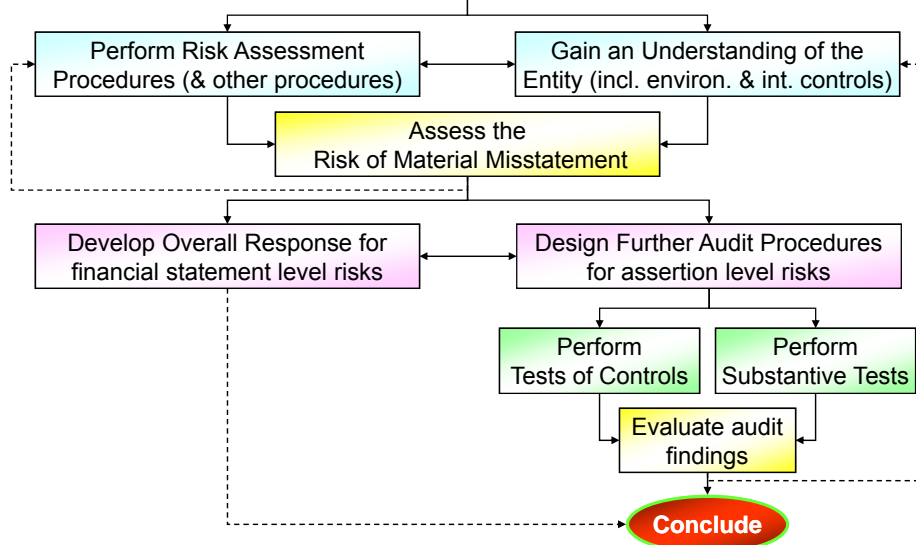
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Template on Understanding an Entity

Linkage of Understanding with Risk

Sample Audit Documentation

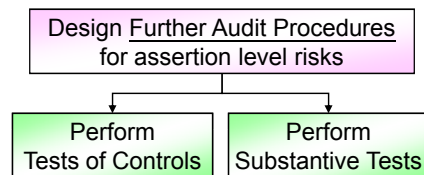
Start



Sample Audit Documentation

E.g. for a single entity

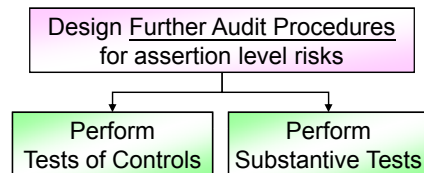
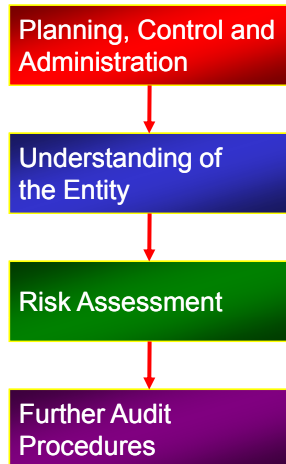
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Sample Audit Documentation



Sample SME-FRS Audit Programme

Sample Audit File Structure

Planning, Control and Administration

Understanding of the Entity

Risk Assessment

Further Audit Procedures

Documentation required

- Financial statements and auditor's report
- Subsequent event review and going concern review

P. 25 – 30

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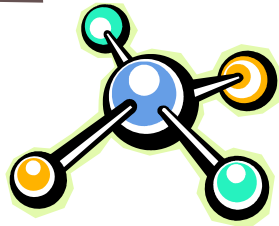
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Full set of slides can be found in
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Financial Liabilities: Current or Not

- Before discuss one of the latest observations on financial liabilities, think about what current liabilities are
- A liability shall be classified as **current** when it satisfies any of the following criteria:
 - a) it is expected to be settled in the entity's normal operating cycle;
 - b) it is held primarily for the purpose of being traded;
 - c) it is due to be settled within 12 months after the balance sheet date; or
 - d) the entity does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.
- All other liabilities shall be classified as **non-current**.



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Any implication on loans from shareholders or other similar parties?

Any implication on fair value or valuation techniques?

New requirements