

Language Fund Notes for Auditors of the Grantees of Sponsorship Projects

These Notes may be revised from time to time. The latest version will be published on the webpage <http://www.scolar.gov.hk> by the Grantor.

Pursuant to the Language Fund (“LF”) Agreement made between the Permanent Secretary for Education Incorporated (“Grantor”) and the Grantee in respect of each LF sponsorship project, the Grantee is required to submit audited project accounts (containing the Income and Expenditure Statement, Balance Sheet and Notes, and an independent auditor’s report on them) with unaudited supplementary information appended to the project accounts and a report of factual findings in connection with the internal controls of the Grantee issued by an auditor in respect of each project within three months upon completion of the project or the date of termination in case of early termination of the project.

Scope

2. The objective of the audit engagement is to express an opinion on whether the project accounts are, in all material respects, prepared in accordance with the LF financial reporting provisions as set out in the “Language Fund Accounting Policies” (**Appendix 1**).
3. The objective of the agreed-upon procedures engagement is to issue a report of factual findings in connection with the internal controls established by the Grantee. The Grantee is required to adhere to the LF General Guidelines and to establish appropriate internal controls for the approved items stipulated in Schedule III to the LF Agreement. The main internal controls are set out in “Summary on Internal Controls for Language Fund Sponsorship Projects” (**Appendix 2**).
4. The project accounts are prepared by the Grantee for meeting the financial information needs of the Grantor and are therefore considered to be special purpose financial statements. When the required financial reporting provision of the LF General Guidelines conflicts with the accounting principles generally accepted in Hong Kong, the former prevails over the latter. The project accounts shall be prepared in accordance with the accounting policies for LF projects.

5. The audit of the project accounts shall be conducted in accordance with the Hong Kong Standards on Auditing (“HKSA”), especially with regard to HKSA 800 (Revised), *Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* issued by The Hong Kong Institute of Certified Public Accountants.

6. The agreed upon procedures engagement shall be conducted in accordance with Hong Kong Standard on Related Services (“HKSRS”) 4400 *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information*.

LF Agreement Documents

7. The terms and conditions of the Grant are contained in the LF Agreement Documents which consist of:

- (a) the LF Agreement (the approved project proposal, the approved budget and the LF General Guidelines are incorporated); and
- (b) all instructions and correspondences issued by the Grantor to the Grantee in respect of the project.

8. In case of any ambiguity regarding the terms and conditions of the grant that has a significant effect upon the auditor’s reporting, the auditor should seek clarification from the Grantor.

Engagement Letters

9. It is in the interest of both the Grantee and the auditor that engagement letters are issued to the Grantee for acceptance before the commencement of the engagements to help avoid misunderstandings. The contents of the engagement letters should include the objective and scope of the audit of the project accounts and the nature, timing and extent of the agreed-upon procedures engagement, including the fact that the procedures performed for the agreed-upon procedures will not constitute an assurance engagement and that accordingly, no assurance will be expressed.

10. Other matters include the respective responsibilities of the Grantee and the auditor, the right of access to records, documentation and other information in connection with the audit, the form of any reports or other

communication of results of the engagements, the audit fee and limitations on distribution of the report of factual findings related to the agreed-upon procedures engagement.

Internal Controls

11. The auditor should obtain a sufficient understanding of the Grantee and its environment, including its internal controls, to assess the risk of misstatement of the subject matters. The auditor shall select the relevant procedures on the internal controls identified in the “Summary on Internal Controls for Language Fund Sponsorship Projects” for testing and agree these with the Grantee. If the auditor identifies any material deficiencies or weaknesses in internal controls, it should draw to the Grantee’s attention in a letter with recommendations for improvement. A copy of such letter should also be forwarded to the LF for reference and action as appropriate.

Fraud and Irregularities

12. The auditor should maintain professional skepticism throughout the engagements, recognising that circumstances including fraud may exist that cause material misstatement to the subject matters. If the auditor finds that a fraud or irregularity has occurred or is likely to have occurred, the auditor should make an immediate written report to the LF. The LF will decide on follow-up actions.

Opinion Provided

13. If the auditor considers that the project accounts are prepared, in all material respects, in accordance with the financial reporting provisions as required by the Grantor, it should issue an unmodified report on the project accounts in accordance with the HKSAs.

14. If the auditor cannot express an unmodified opinion on the project accounts, it should give a qualified opinion, an adverse opinion or a disclaimer of opinion in accordance with the relevant HKSAs as appropriate.

Language Fund Accounting Policies

These accounting policies are the principles that the Grantee shall follow in preparing the Language Fund (LF) project accounts.

Reporting Entity

2. The LF provides funding for the Grantee to undertake a one-off project for the promotion of biliteracy and trilingualism in Hong Kong. For projects which are sponsored¹ by LF, the Grantee is required to submit audited project accounts together with unaudited supplementary information appended to the project accounts and a report of factual findings issued by the auditor to the Grantor within three months after completion of the project. For the purpose of these project accounts, the reporting entity is the Grantee. If a Grantee receives the LF grants under more than one LF Agreement, a separate set of project accounts (including the report of factual findings) shall be prepared for each project. The “project accounts” mean the Income and Expenditure Statement, Balance Sheet and Notes (comprising a summary of significant accounting policies and other explanatory notes) of a project.

Basis of Presentation

3. The Grantee is responsible for proper use of the Grant in conformity with the approved budget. To demonstrate compliance with budgetary constraints, the project accounts shall present a comparison of budget and actual amounts. The LF requires the presentation of final budget figures in the Income and Expenditure Statement for budget-to-actual comparison on the same classification basis.

Basis of Accounting

4. Costs under the “Actual” column of the project accounts are the

¹ For each sponsored project, the amount of sponsorship shall not exceed 40% of the total estimated or actual expenditure of the project whichever is the lesser. The maximum amount of sponsorship for each sponsored project is capped at HK\$1,000,000.

actual amount for allowable items incurred by the Grantee and funded by the Grant. It should be noted that the Grantee shall ensure that the project expenditure approved by LF will not exceed the amount of the Grant (i.e. no overspending) and the amount of sponsorship shall not exceed 40% of the total estimated or actual expenditure whichever is the lesser. The maximum amount of sponsorship for each project is capped at HK\$1,000,000. When there is overspending upon completion of the project, the Grantee is responsible for the deficit and shall cover the shortfall by non-LF sources of funding.

5. The measurement focus is concerned with the inflow and outflow of the Grant on the project. The primary focus is on the receipt and use of the Grant, and assets and liabilities reported on the Balance Sheet are current in nature. The project accounts shall also report the balance of the Grant which cannot be negative. Balance of the Grant, if any, represents the unused Grant and must be returned to the Grantor within three months after completion of the project.

6. Incomes are recognised when they become measurable and available. Incomes are considered “measurable” if a reasonable estimate can be provided and “available” if they are collectible within the project period or within three months after completion of the project.

7. Expenditures are recognised when the related liability is incurred and measurable. In addition, the liability shall be paid no later than three months after completion of the project. The liability is incurred when the goods or services have been received with the exception of audit service which is engaged during the project period and performed after project completion. Goods and services are expensed when acquired. No capitalisation of expense is required for durable goods or products acquired from the project (i.e. the item(s) shall be reported in the Income and Expenditure Statement rather than the Balance Sheet).

Reporting Framework

8. The project accounts shall be prepared using a special purpose financial reporting framework designed to meet the LF Grantor’s needs. These accounts are primarily used to assist the Grantor in monitoring and reviewing the Grantee’s use of budgetary grant resources. They are, therefore, different from general propose accounts reports prepared pursuant to the Hong Kong Financial Reporting Standards (HKFRSs). When the LF financial reporting framework conflicts with the HKFRSs, the former prevails over the latter.

Foreign Currency Translation

9. Where the project has entered into a transaction denominated in a foreign currency, the transaction shall be deemed to have been converted into Hong Kong dollar at the exchange rate applicable on the date on which the transaction becomes effective. Where the transaction payment/receipt is not paid/received at the project completion date, the value of the transaction in Hong Kong dollar shall be deemed to have been reconverted using the spot exchange rate at the completion date of the project. Resulting gains and losses shall be recognised in the Income and Expenditure Statement.

Components of Project Accounts

10. The fundamental components of project accounts are:

- (a) an Income and Expenditure Statement (**Annex A**);
- (b) a Balance Sheet (**Annex B**); and
- (c) Notes, comprising a summary of significant accounting policies and other explanatory notes.

The components set out in (a) to (c) above shall be presented with equal prominence.

11. Each component shall be clearly identified. The following information shall be displayed prominently and repeated when necessary for a proper understanding of the information presented:

- (a) the name of the reporting entity;
- (b) the project title;
- (c) the project reference number;
- (d) the reporting period end date (i.e. completion date of the project) or the period covered (i.e. project period); and
- (e) the presentation currency.

Income and Expenditure Statement

12. The Income and Expenditure Statement is a statement of the LF Grant and other income earned or received on the project as well as the project-related expenditure eligible for the Grant and funded by non-LF sources of funding. Income and expenditure shall not be offset in the statement.

Income

13. Income from the LF Grant is based on the LF Agreement. Payments of the Grant will be arranged by Language Education and SCOLAR Section of the Education Bureau. The amount of the LF Grant shall be disclosed in the Income and Expenditure Statement.

14. Other Incomes of the project shall include all revenue generated (if any) from the project and income received from non-LF sources of funding for the project. Incomes from LF source shall be deposited into the designated bank account or kept under a separate ledger in the Grantee's finance system from other monies belonging to the Grantee, and to apply such income to be used exclusively for the purpose of the project in accordance with the terms of the LF Agreement.

15. The type and amount of Other Incomes shall be disclosed separately in the Income and Expenditure Statement. Interest which is earned on the LF Grant maintained in bank account shall be accounted for "Interest Earned" in the Income and Expenditure Statement. If the LF Grant for the project is maintained in a commingled bank account, the interests earned on the Grant and other funds shall be apportioned based upon their respective average monthly proportionate balances during the period when such interest is earned. The average monthly balance of the funds shall be calculated by summing up their respective beginning and ending balances and then divided by two. Alternatively, they shall be calculated by summing up the daily or weekly balances in respect of each fund and then divided by the total number of days or weeks in the month.

Expenditure

16. The budget of the LF Agreement has identified the types of expenditures and the estimated amounts that the LF will fund for the project. This budget shall be the basis for the Grantee to charge expenditures to the Income and Expenditure Statement of the project.

17. The Grantee shall disclose the amount of each category of all the expenditure items of the project. For budgetary line items funded by the LF Grant, Grantee shall disclose the expenditure amount in accordance with the items stipulated in Schedule III to the LF Agreement.

Balance Sheet

Items of the Balance Sheet

18. Balance sheet is a statement of financial position as at project completion exhibiting the project's assets, liabilities and project balance at their respective values. Given the basis of accounting and the fact that the LF Grant is one off in nature for the Grantee to carry out a non-recurrent project, assets are current in nature and are expected to be realised, redeployed or disposed of within three months from completion of the project. Liabilities are also current in nature and are expected to be settled within three months from completion of the project. Project balance is the difference between assets and liabilities. As the project accounts show the application of the LF Grant and non-LF sources of funding, the ending project balance shall not be negative (i.e. a deficit balance). As mentioned in paragraph 4 above, the Grantee shall cover the shortfall by non-LF sources of funding when there is overspending.

LF Assets

19. The term "assets" used in the LF refers to goods or products such as fixture or equipment approved by the Grantor. They are durable and/or tangible (i.e. non-financial) in nature. For the purpose of LF financial reporting, the costs of these goods or products are expensed and not capitalised in the Balance Sheet (see paragraph 7 above). Grantee is required to deliver, upon demand, to the Grantor all machinery and equipment purchased or acquired with the Grant within three months after completion of the project or upon termination of the project by the Grantor.

Notes to the Project Accounts

20. The Grantee shall make use of the explanatory notes accompanying the project accounts in order to provide further financial information.

21. All significant accounting policies adopted in the preparation and presentation of project accounts shall be disclosed. Such disclosure shall form

part of the project accounts and the significant accounting policies shall normally be disclosed in the first paragraph of the Notes.

22. The Grantee shall report the balance of the LF Grant, which cannot be negative, in the notes.

23. For items listed in the Balance Sheet, the Grantee is required to provide a breakdown of each item showing the portions that are related to LF Grant and non-LF sources of funding.

24. Information to be disclosed shall include:

(a) For income:

(i) The type and amount of other incomes if not yet disclosed separately in the Income and Expenditure Statement;

(ii) If there is interest earned that is apportioned to the project based upon average monthly proportionate balances, the calculation method of the average monthly balance shall be disclosed; and

(iii) While project income collectible after three months from completion of the project is not to be included in the Income and Expenditure Statement, the nature, amount and expected date of receipt of such income as identified up to the date of sign-off the accounts, if any, shall be disclosed in the explanatory notes.

(b) For expenditure:

(i) The amount of sponsorship does not exceed 40% of the total estimated or actual expenditure whichever is the lesser; and the maximum amount of sponsorship for each project is capped at HK\$1,000,000;

(ii) Staff Cost shall consist of two sub-items of basic salary/wage and the corresponding employer's contribution to the Mandatory Provident Fund, and the amounts of these two sub-items shall be disclosed;

(iii) General Expenses shall include the sub-item of professional

fees to the auditor. The budget and actual professional fees to the auditor² funded by the LF Grant shall be disclosed. As the audit of the project accounts is performed after project completion, for the purpose of charging the professional fees to the project accounts, the Grantee shall:

- enter a written service contract with the external auditor within the project period; and
- settle the audit fee after completion of the engagement.

The fact that the above two conditions are met shall also be disclosed in the explanatory notes.

² Starting from the 2015/16 school year, the Grantees of the Sponsorship projects are required to submit auditor's reports upon project completion. A maximum of \$10,000 of audit fee may be charged for each sponsored project.

**[Name of the Grantee]
Language Fund
Sponsorship Projects
Income and Expenditure Statement**

For the Period from _____ to _____

Name of Project: _____

Project Reference No.: _____

	Final Budget (unaudited)	Actual	Variance with Final Budget (unaudited)
	i	ii	iii = ii – i
	HK\$	HK\$	HK\$
Income			
- LF Grant	\$0.00	\$0.00	\$0.00
- Interest Earned	\$0.00	\$0.00	\$0.00
- Other Income	\$0.00	\$0.00	\$0.00
Total Income:	\$0.00	\$0.00	\$0.00
Less: Expenditure			
<i>[Items specified in the approved budget stipulated in Schedule III to the LF Agreement]</i>	\$0.00	\$0.00	\$0.00
	\$0.00	\$0.00	\$0.00
	\$0.00	\$0.00	\$0.00
Other Expenditure	\$0.00	\$0.00	\$0.00
<i>[Items not included in Schedule III to the LF Agreement]</i>			
Total Expenditure:	\$0.00	\$0.00	\$0.00
Excess of Income over Expenditure	\$0.00	\$0.00	\$0.00

Notes are an integral part of the project accounts

[Name of the Grantee]
**Language Fund
 Sponsorship Projects
 Balance Sheet**

As at _____

Name of Project: _____

Project Reference No.: _____

HK\$

Current Assets

Account receivables \$0.00

Other current assets \$0.00

Cash and cash equivalents \$0.00

\$0.00

Current Liabilities

Accounts payables \$0.00

Amount due to Grantor \$0.00

Other current liabilities \$0.00

\$0.00

Net Assets

\$0.00

Project Balance

\$0.00

Notes are an integral part of the project accounts

 Signature of Authorised Person

 Name of Authorised Person

Date:

 (dd/mm/yyyy)

Remarks: Grantees may include item(s) which is deemed necessary and appropriate.

Supplementary Information

24. The schedule of budgetary information is supplementary information to the basic part of the project accounts. The Grantee shall prepare the unaudited information and append them to the project accounts.

Schedule of Budgetary Information

25. Spending of the LF Grant shall be made in accordance with the approved budget. The budget is a key tool for financial management and control of the use of the LF Grant by the Grantee. If the figures in the original budget have been revised, the Grantee shall present the adjustments and the final budget in the following format:

	Original Budget	Adjustments	Final Approved Budget in the Income and Expenditure Statement
Incomes:			
<i>[List by Items]</i>	\$	\$	\$
	\$	\$	\$
	<hr/>	<hr/>	<hr/>
	<hr/>	<hr/>	<hr/>
Expenditures:			
<i>[List by Items]</i>	\$	\$	\$
	\$	\$	\$
	<hr/>	<hr/>	<hr/>
	<hr/>	<hr/>	<hr/>

26. The fundamental principle is that adjustments in budget shall not increase the amount of the LF Grant for project. Any budget adjustments shall require prior written approval by the Grantor.

27. All project personnel shall be remunerated on a fixed salary point during the entire project period. In normal circumstances, salary increment is not permitted.

**Summary on Internal Controls
for Language Fund Sponsorship Projects**

Introduction

The Grantee shall observe the following guidelines and establish appropriate internal controls accordingly.

- “General Guidelines on Procurement”
- “General Guidelines on Staff Administration”
- “General Guidelines on Management and Monitoring of Sponsorship Projects”

2. This document lists the main internal controls in paragraphs 3 to 8 below that should be established by the Grantee with a view to following the financial requirements of the Language Fund (LF) such as ensuring the proper use of the LF Grant and maintaining books and records. The document serves as a summary for reference of the auditor when reporting factual findings on the internal controls of the Grantee. To have a full understanding of the financial requirements, reference should be made to the full text of the above LF General Guidelines.

3. Internal controls on expenditure

- (a) Processes are established to review that expenditures have only been made in accordance with the approved budget.
- (b) Any internal virement between budget items should only be between approved items (except audit fee) of the budget and must not exceed 5% of the original budgeted expenditure for that particular item or HK\$100,000, whichever is the lesser. The Grantee shall immediately disclose the justifications for such reallocation of funds to the Grantor and any other information relating thereto as the Grantor may require. Should circumstances warrant reallocation of funds in excess of the above-stated amount, the Grantee must seek prior written approval from the Grantor by applying to the Grantor not less than one month in advance. The Grantor may in its sole discretion determine whether or not to grant its approval, and approval will only be granted in

exceptional circumstances where there is no mismanagement or change in the objectives of the project as stated in the approved project proposal.

[See Clause 6.4 in the LF Agreement]

- (c) Procedures to check the quality of goods/services received before making payments are established.
- (d) There are measures to properly record expenditures in ledger, and maintain the relevant accounting and financial documents.

4. Internal controls on cash and bank

- (a) The Grantee shall keep a designated bank account or a separate ledger in the Grantee's finance system and keep separate the Grant from other monies belonging to the Grantee (the designated bank account).
- (b) Processes are established to reconcile bank statements relating to the designated bank account against the ledger of income and expenditure on a monthly basis.
- (c) There are measures to monitor that no cash payment out of the LF Grant in excess of \$5,000 for each payment.

5. Internal controls on procurement

- (a) Procedures are in place for:
 - (i) segregation of duties in procurement processes.
 - (ii) providing potential suppliers identified in a purchase with clear information.
 - (iii) maintaining the confidentiality of the information from potential suppliers.

[See the General Guidelines on Procurement]

- (b) There are procedures to select the appropriate procurement method based on the value of the purchases. The summary is:

Value of Purchases	Procurement Method
Over \$5,000 but not exceeding \$50,000	A minimum of two quotations should be obtained
Over \$50,000 but not exceeding \$1,400,000	At least five quotations should be obtained
Over \$1,400,000	A competitive tendering procedure should be adopted

[See the General Guidelines on Procurement]

- (c) Procedures are established to properly maintain procurement documentation such as quotation records, tendering documents, signed contracts, etc.

6. Internal controls on staff administration

- (a) There are measures to adopt open recruitment process when filling in staff position.
- (b) There are measures to ensure that staff are aware of the situations where conflict of interest may arise.

[See the General Guidelines on Staff Administration]

7. Internal controls on non-financial assets handling

- (a) Processes are in place to identify non-financial assets purchased for the project.
- (b) Procedures are established to properly record acquisitions of non-financial assets and to deliver, upon demand, to the Grantor all non-financial assets purchased or acquired with the Grant.
- (c) There are processes to properly maintain accounting records and supporting documents for acquisitions of non-financial assets.

8. Other internal controls

- (a) There are procedures to identify and disclose real or perceived conflicts of interest of the Grantee in administering the LF Grant and implementing the project.
- (b) Measures are in place for adherence to the LF financial reporting submission requirements as stipulated in the LF General Guidelines:

- To submit Income/Expenditure Accounts Report(s) and Progress Report(s) in accordance with the report submission date(s) stipulated in Clause 7.2 in the LF Agreement.

[See paragraphs 10 – 12 of the General Guidelines on Management and Monitoring Sponsorship Projects]

- To submit Final Financial Report and End-of-Project Report within three months after completion of the project or the date of termination in case of early termination of the project.
- To prepare the project accounts and supplementary information of the project together with an auditor's report on the project accounts, and to provide a report of factual findings prepared by the auditor in connection with the internal controls.
- To return any unused fund to the Grantor by cheque.

[See paragraphs 13 – 16 of the General Guidelines on Management and Monitoring Sponsorship Projects]