



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

Practice Review Committee  
**Activities Report 2007**





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## 1. Introduction

- 1.1 The Hong Kong Institute of CPAs (the Institute) has operated a programme of Practice Review since 1992 with the objective of enhancing the quality of work of Institute members engaged in audit and related assurance activities. In 2004 the Council of the Institute took the decision to revise the Practice Review programme in light of international developments and increasing expectations of regulation and monitoring of auditors.
- 1.2 The revised programme places greater emphasis on addressing areas of significant public interest, such as the audits of public listed companies. While there will be a strengthening of the regulatory effectiveness of Practice Review, the revised programme also retains an educational objective.
- 1.3 During the revisions to the programme the Institute has communicated with members on the content of and progress with developments. Feedback from members has been taken into account in finalizing the launch of the revised programme.
- 1.4 The Institute has kept members informed of the revised programme through the issuance of communication papers, articles in Institute publications, direct correspondence and discussion with interest groups and participation in seminars and forums.
- 1.5 The previous report of the Practice Review Committee was published in November 2006 and focused on the reasons behind the revisions to the Practice Review programme and the principles that were framing the key elements of the revised programme. This report will continue the process of informing members and other stakeholders of the progress that has been made in the development of Practice Review.
- 1.6 The period covered by this report is from January 2006 to December 2007.

## 2. Role of the Practice Review Committee

- 2.1 The Practice Review Committee (the Committee) is a Committee of the Institute with responsibility to Council for exercising the statutory powers and duties given to the Institute as the regulator of auditors in Hong Kong under sections 32A to 32I of the Professional Accountants Ordinance. The Committee is therefore a crucial element in enabling the Institute to operate a robust but fair system of auditor regulation that meets the expectations of local and international stakeholders.
- 2.2 The terms of reference of the Committee are agreed by the Council of the Institute. Council periodically reviews and revises the terms of reference to ensure they remain relevant to current regulatory expectations. The current terms of reference of the Committee are set out in **Annex 1**.
- 2.3 The Committee membership is made up primarily of practising members (by law at least two thirds of the Committee must hold practising certificates). The inclusion of non-practising members demonstrates the Institute's commitment to ensuring the impartiality of Committee decisions on the quality of work carried out by firms subject to Practice Review. The practising members of the Committee are drawn from the full spectrum of audit firms, representing small practices through to the Big 4, ensuring that there is sufficient and relevant knowledge of the auditing profession to be drawn on.
- 2.4 All Committee members are required to give undertakings regarding confidentiality of information that they have access to during the course of Committee work and there is careful monitoring to ensure any potential conflicts of interest are identified and effectively managed.
- 2.5 Membership of the Committee during the period covered by this report is set out in **Annex 2**.
- 2.6 The Committee reaches its own impartial decisions on practices compliance with professional standards and the appropriate follow up action, if any, after fully considering reports by the Quality Assurance Department of the Institute (QAD) on the findings of practice reviews undertaken and the associated submissions and representations by the practices subject to review.
- 2.7 The Committee will always take appropriate actions where necessary to fulfill its statutory role and to protect the public interest.
- 2.7 The activities and operations of the Committee are subject to scrutiny by Council and the Practice Review Oversight Board. The Practice Oversight Board was established in 2005 to oversee the performance of the Institute's Practice Review programme.

### 3. Practice Review Activities

- 3.1 During the period covered by this report the activities of the Committee have been primarily concerned with the continued development and first stages of implementation of the revised Practice Review programme. This has been a time of much activity and transformation, the main features of which are explained in the following pages.
- Electronic self-assessment questionnaire (EQS)*
- 3.2 The revised Practice Review programme has been publicized as being grounded in a risk-based approach to selection of practices for review. To enable this approach to be fully effective it will be necessary to gather information regarding the manner of operation and management, the approach to quality control and the nature of the client base of practices.
- 3.3 Development work on the concept of a self-assessment questionnaire began in 2002. Having settled on the required content of such a questionnaire, resources were then directed to developing the questionnaire into a web based tool that could be accessed, completed and submitted on-line by practices.
- 3.4 By early 2007 QAD had completed development and testing of the EQS and plans were put in place to enable all practices to access the EQS through the Institute's website by using secure and confidential codes and identification numbers.
- 3.5 Many small and medium practices and their representative groups expressed concerns about the EQS. Their first area of concern was that the EQS would be very time consuming and difficult to complete for many practices. A second worry that practices had was that the information supplied in the EQS would be used as evidence of non-compliance with professional standards and could directly lead to disciplinary action being taken against the practice.
- 3.6 To address the first concern, the QAD developed a range of support facilities to assist practices with the task of completing the EQS. These facilities included an EQS user manual accessible through the Institute website, a suite of "frequently asked questions" that was regularly updated as queries were received from practices, dedicated email and telephone helplines and a series of seminars that included guidance on completion and submission of the EQS.
- 3.7 In respect of the second concern senior representatives of the Institute, the Committee and the QAD engaged in dialogue with small practices and their representative groups, wrote letters and articles and spoke at forums and seminars. The purpose of the dialogue was to reinforce the message that Practice Review would retain an educational element and would be sympathetic to the issues facing practices.

In particular the Committee would consider relevancy and proportionality in requiring practices to take action or in taking direct action itself, to correct identified weaknesses.

3.8 In August 2007 the first batch of approximately 1500 practices were sent the necessary information to allow them to access their EQS. Before the deadline for submission expired on 14 December 2007 the QAD had run four seminars on completion of the EQS with a total attendance of 1045 delegates and had received and answered more than 1000 enquiries.

3.9 By 14 December 2007 there were only approximately 100 practices that had failed to complete and submit the EQS. These, relatively few, practices were pursued following a programme agreed by the Committee and as a result virtually all practices have completed and submitted the EQS. Given the initial trepidation expressed by many practices this result is a tribute to the commitment of practices and members to the principles of self-regulation and Practice Review and to the effectiveness of the support and encouragement provided by the QAD and the Committee.

#### *Methodology, processes and procedures*

3.10 The revision to the overall Practice Review approach also necessitated a substantial amount of work to be carried out on the development of new ways of applying the revised approach.

3.11 The practical application of Practice Review has been re-examined and new methodologies, procedures and documentation have been developed to assist the QAD reviewers to carry out their work in accordance with the principles of Practice Review. The new procedures and documentation were used on the reviews carried out in the last four months of 2007 and they will be reviewed and amended as necessary in light of the experience of practical application.

3.12 The revised methodology is based around an assessment of how a practice has addressed the implementation of the requirements of HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements*. With a standard now in place that requires all practices to have documented procedures, including internal monitoring, in place to ensure the quality of audit work, it is logical for Practice Review to consider the effectiveness of such controls and procedures. However, reviews of completed audit engagements continue to be an important part of the review process.

3.13 The revised approach to reviews of practices' audit activities also reflects the general overall shift in the principles of the revised Practice Review programme. Whereas the old programme was perceived to be confrontational and fault finding, the revised



programme is intended to be constructive and relevant and to assist practices take appropriate action to rectify any weakness identified.

3.14 However, the use of disciplinary action will be retained where warranted as the Institute is fully committed to and must be able to demonstrate that it is operating an effective self-regulatory regime. There is always the possibility of a serious case when the most effective action a regulator can take is to stop a practice from undertaking any more audit work.

3.15 To facilitate the control and management of the operational workload of the QAD a new database management system is being developed and implemented. This system will interface with other Institute systems and the EQS to allow QAD to plan, monitor and control their workflow and to use the data obtained through the Practice Review programme to produce reports and information. Such information will be of benefit to all practices as it will enable the Institute to identify areas of common concern or potential weakness and provide appropriate assistance or guidance to members. There will of course be no sharing of confidential information and the data obtained will be utilized in a generic and anonymous manner.

3.16 A substantial proportion of the cost of systems and procedures development has been met by a grant received from the

Commerce and Economic Development Bureau of the Government of the Hong Kong Special Administrative Region under the Professional Services Development Assistance Scheme.

#### *Reviews of practices with listed clients*

3.17 In the 2005 Practice Review Committee report, and in subsequent publications, it has been stressed that priority will be given under the revised Practice Review programme to review practices that audit listed companies and a commitment has been made to review all such practices at least every three years. Additionally the Committee and the Council of the institute have decided that in view of the predominantly public interest nature of their client base the Big 4 practices will be subject to an annual review.

3.18 In 2006 all practices (approximately 45) that were identified as having listed clients were required to complete and submit a self-assessment questionnaire. These questionnaires were dealt with in hard copy format as the EQS system was not operational at that time and it was considered important that the reviews of these practices were not delayed while waiting for the system to be fully established. The EQS will be used in future for all practices.

3.19 The reviews of the Big 4 commenced in late 2006 with a series of introductory and information gathering interviews. As a

result of significant changes in the staffing of QAD and a need to concentrate resources on development of procedures and the roll out of the EQS, further work was postponed until the second half of 2007 to enable the reviews to be carried out using the revised Practice Review methodology. Reviews of all of the Big 4 were completed in the final quarter of 2007. The reviews included assessment of the practices systems of quality control and reviews of completed audit engagement files. Reports based on the outcome of these reviews will be presented to the Committee for consideration in the first quarter of 2008.

3.20 The focus and extent of the work undertaken during the Big 4 reviews in 2007 was agreed by the Committee. In future the QAD will make proposals on the nature and extent of review work for the annual reviews of the Big 4. Reports to the Committee will be produced based on the outcome of each annual visit.

3.21 From 1 July 2007 the QAD started to arrange and carry out reviews of practices with listed company audit clients other than the Big 4 at a rate designed to review all such practices within a three year period. Five reviews had been completed by the end of 2007 and will be reported to the Committee in due course. Plans are in hand for a full year's programme of reviews in 2008.

#### *Clearance of outstanding Practice Review cases*

3.22 In early 2007 an exercise was carried out to identify all cases that had been presented to the Committee under the old Practice Review programme and that had not yet been concluded. Twenty-one such cases were identified, the two most recent coming from reviews carried out in 2004.

3.23 In nine cases the Committee had not finalised a decision; in four cases the Committee had concluded that a complaint should be raised but this had not been referred to Council for confirmation; in three cases Council had confirmed the Committee decision to raise a complaint but there had not yet been a referral to a Disciplinary Committee convenor; and in five cases an agreed complaint had been referred to a Disciplinary Committee convenor.

3.24 The Committee was concerned that the age of these cases meant that the Disciplinary Proceedings rules and also the nature of evidence necessary to support a complaint had changed significantly since the cases arose. The QAD undertook to review of all the identified cases and to present a proposal to the Committee for the completion of each case.

3.25 QAD completed the reviews and presented proposals for the completion of all of the cases to the Committee during 2007 as planned. The Committee reached a decision

on the conclusion of each case before the end of 2007. A number of the practices involved will be included in the 2008 programme of Practice Review to follow up on issues identified in the original cases.

### *Communications*

3.26 Throughout the development and the implementation of the revised Practice Review programme the Committee and the QAD have been committed to ongoing and open dialogue with practices, members and other interested parties concerning the aims, principles and issues arising out of the revision exercise.

3.27 In addition to the publication of this report there have been a number of significant initiatives to ensure that practices have been kept informed of and engaged in the development of matters that could have an impact on their activities such as the EQS. These have included:

- The participation of the Chairman of the Committee and the Director, Quality Assurance in various small and medium practitioner forums to engage directly with practices on the issues concerning them around Practice Review.
- The hosting of four (another three planned for 2008) seminars on the revised Practice Review programme and completion of the EQS attended by 1045 members.

- A letter from the President of the Institute to all practices explaining the reasons behind the revised Practice Review programme and the development of the EQS.
- An article by the Director, Quality Assurance in APlus addressing some of the concerns that had been raised by practices concerning the EQS.
- More than one thousand queries dealt with on the QAD telephone and email helplines.
- The Chief Executive & Registrar of the Institute, the Chairman of the Committee and the Director, Quality Assurance have engaged in meetings and correspondence with groups representing small and medium practitioners to directly address the concerns of that particular sector of the membership.

3.28 As has been the practice with previous operations reports the Committee has included (at **Annex 3**) some examples of issues facing practices that have come to light through the Practice Review programme. By highlighting such issues practices will have the opportunity to consider whether there is relevance to their own circumstances and therefore lessons that they could learn.

### *The Practice Review team*

3.29 To ensure that the aims and intentions of the revised Practice Review programme are effectively delivered requires not just revised procedures and new systems but a commitment to and belief in the revised approach by the team responsible for the delivery.

3.30 The Council of the Institute and the Committee have consistently confirmed their commitment to and support of the revisions being carried out to Practice Review. Such views have been communicated to members through many channels.

3.31 The QAD team responsible for systems and procedures development and implementation and the conduct of on-site reviews of practices has undergone significant changes. A new Director, with extensive hands-on experience of quality assurance of auditors, joined the Institute in April 2007 and five new reviewers have subsequently been added to the team.

3.32 The new team has been engaged in learning and development activities designed to ensure that all team members are familiar with the revised procedures and documentation and how the materials reflect and implement the aims and principles of the revised programme. All members of the team are fully committed to the revised Practice Review programme

and have been heavily involved in all of the activities set out above.

3.33 The market for well qualified and experienced individuals of the caliber required to carry out practice reviews has been very competitive. However, the Institute remains committed to resourcing the QAD to the level necessary to deliver a robust and effective programme of Practice Review.

## 4 The Future

- 4.1 The revised Practice Review programme will, throughout 2008, begin to encompass reviews of practices other than those that audit listed companies. The information obtained from the EQS submitted by practices will be assessed and will be used to determine the practices that are included in the review sample.
- 4.2 The Committee has already made it clear that the selection of practices for review will be governed by risk factors including the public interest profile of audit clients. Accordingly the initial focus of reviews, other than on listed company auditors, will be on practices that do not audit listed companies but do have other audit clients that are deemed to be of significant public interest.
- 4.3 The debate that is currently in progress, in the context of professional ethics, on what constitutes an entity of significant public interest (ESPI) will ultimately influence what Practice Review considers to be of public interest. In the meantime Council has issued guidance that has been adopted by Practice Review and is included in the glossary of terms attached to the EQS.
- 4.4 The Committee and Council are considering what volume of reviews will be necessary to demonstrate that the Institute can operate a credible and effective self-regulatory monitoring function. A conclusion is yet to be reached on this but it is anticipated that the number of reviews carried out annually will, over the next two to three years, rise significantly from the levels achieved under the old programme to well over one hundred.
- 4.5 The QAD team will continue to review and improve procedures and documentation to ensure that the process of review and reporting is as efficient as possible while retaining the clear need to maintain sufficient record of work carried out and conclusions reached. Attention will also be given to the way that reviews are conducted to minimize the disruption caused to busy practices.
- 4.6 When the first year's experience of the EQS is fully assimilated, attention will be given to revising both the content and the process of completing and submitting the EQS. Serious thought is already being given to producing a simpler version that can be used in future by practices that have already submitted the full initial version of the EQS.
- 4.7 Given that the first round of EQS submissions will not be completed until well into 2008 there is no current intention of requiring all practices to submit another EQS in 2008, although it may become an annual exercise in the future.
- 4.8 The Institute and the Committee recognize the potential conflicts in exercising an

effective and robust regulatory regime over members while also seeking to support members in achieving their professional and business objectives. However, the belief is strongly held that Practice Review can be an effective regulatory mechanism while also contributing to the overall raising of standards and quality in the work carried out by members.



## Practice Review Committee

### Terms of Reference

#### (A) Statutory duty

To discharge responsibilities and powers vested in the HKICPA and the Committee by the Professional Accountants Ordinance Sections 32A to 32H. In this respect particular regard shall be had to the need for the Committee to:

- (a) determine the practice and procedures to be observed in relation to practice reviews (PAO Section 32D(1)(a)) having regard to instructions issued by Council under PAO Section 32B (1);
- (b) receive and consider reports made by reviewers at the conclusion of a practice review and having had regard to that report and submissions and representations attached to it make such recommendations, instructions or complaint as considered appropriate (PAO Sections 32D(2), (3) and (5)); and
- (c) consider and determine disputes over the exercise of a power or powers of reviewers referred by either a reviewer or a practice unit and communicate the determination of the dispute to the appropriate parties (PAO Section 35F(2) (a) and (b)).

#### (B) General duties

- (a) To report to Council on the progress and outcomes of the practice review programme including observations on the application of professional standards by practice units.
- (b) To recommend to Council amendments to the scope and procedures of practice review or updates necessary to manuals or material issued in connection with practice review arising from experience.
- (c) To provide all information, reports and assistance required by the Practice Review Oversight Board that is required by that Board in the discharge of its own responsibilities and duties.
- (d) To liaise with other Committees and contribute to activities of the Institute that assist practising certificate holders in understanding the requirements of and latest developments in practice review and to promote the full application of professional standards and the highest quality in audit work.

### Members of the Practice Review Committee 2006 - 2007

Name	Position	Company
Mr. AU, Siu Cheung, Albert	Chairman (from February 2007)	BDO McCabe Lo Ltd
Mr. CHAN, Kam Wing, Clement	Deputy Chairman (from February 2007)	Shu Lun Pan Horwath Hong Kong CPA Ltd
Mr. CROWE, William Andrew	Deputy Chairman (from February 2007) Member (to January 2007)	KPMG
Ms. CHEUNG, Yuk Ting, Mabel	Member (from February 2007)	PricewaterhouseCoopers
Ms. CHUA, Suk Lin, Ivy	Member	PCP CPA Ltd
Ms. FUNG, Yee, Pammy	Member	CCIF CPA Ltd
Ms. KWOK, Yuen Man, Eunice	Member (from February 2007)	Mazars CPA Ltd
Mr. LAM, Chi Yuen, Nelson	Member (from February 2007)	Nelson and Company
Ms. LAM, Oi Yan, Fiona	Member (from February 2007)	H.H. Lam & Company
Mr. MOK, Yun Lee, Paul	Member	Orient Overseas Container Line Ltd
Mr. TAM, King Ching, Kenny	Member (from February 2007)	Kenny Tam & Co
Mr. TAM, Kwok Yiu, Eric	Member	BDO McCabe Lo Ltd
Ms. YEN, Sau Yin, Emily	Member	Deloitte Touche Tohmatsu
Mr. MORRISON, Kenneth Graeme	Chairman (to January 2007)	Mazars CPA Ltd
Mr. LAM, Hon Ming	Deputy Chairman (to December 2006)	Ernst & Young
Ms. YUNG, Wing Sheung, Amy	Deputy Chairman (to January 2007)	Amy Yung & Co
Mr. CHAN, Kwok Wai, Patrick	Member (to January 2007)	Hang Seng Bank Ltd
Mr. CHOW, Chan Lum, Charles	Member (to January 2007)	Wong Brothers & Co
Mr. FUNG, Lak, Philip	Member (to January 2007)	Lak & Associates CPA Ltd
Ms. LAW, Elizabeth	Member (to January 2007)	Stephen Law & Co
Mr. PANG, Tsun Loy, Michael	Member (to January 2007)	M.T.L. Pang & Co
Mr. RADCLIFFE, Robin Frederick Keppel	Member (to October 2006)	Baker Tilly Hong Kong Ltd
Mr. WONG, Kar Yung, Wilfred	Member (to January 2007)	PricewaterhouseCoopers
Mr. WONG, Wing Cheong, Dennis	Member (to January 2007)	Dennis Wong & Co



## Matters for the attention of all practices

### Introduction

1. In previous Operations reports a section has been included on common matters identified during the course of reviews carried out in the period covered by the report. This has generally been well received as a useful pointer to practices in respect of areas that should be given special attention in learning and development plans.
2. For the purposes of this report a similar summary of potential issues has been compiled from a variety of sources including:
  - Reviews of practices carried out during the report period
  - Matters identified in the twenty-one old cases cleared by the Committee during 2007
  - Questions raised at seminars by practices and members
  - Questions raised with the QAD hotline
3. The majority of questions raised under the last bullet were quite specific and to do with completion of the EQS. These points have generally been incorporated into the “frequently asked questions” section of the EQS website and have not been repeated here.
4. The following matters should be of interest to all practices involved in auditing and may assist them in revising their audit approach and procedures where they recognize the situations as potentially applying to them.

*HKSQC 1 Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.*

5. HKSQC 1 was introduced with effect from 15 June 2005. In March 2006 the Institute published “A guide to Quality Control”, a manual to assist practices in the implementation of HKSQC 1. The introduction of the guide was supported by a series of eight seminars presented by the author of the guide. The guide has proved popular in that many practices have purchased copies and the introductory seminars were very well attended. However, there is evidence that few practices have taken the time to use the guide, or tailor the standard documentation included with it to their practices, and to introduce the necessary policies and procedures to address the requirements of HKSQC 1.
6. QAD reviews have identified practices adopting the guide wholesale without considering how it should be specifically applied to their circumstances. It has also been noted that the adoption of policies, procedures and documentation from the guide was delayed until well into 2007 with the result that very little of the theory has actually been implemented. From discussions with practices it seems that there

is still a widespread lack of understanding of the requirements of HKSQC 1 and that practices are assuming that adopting the guide will be sufficient. This is not the case as HKSQC 1 does not have a single solution and needs to be considered in the context of the organizational model and client base of each practice.

7. One element of HKSQC 1 that some practices do seem to have addressed is the requirement to set up a mechanism to review the practices' own policies, procedures and audit engagement files. However, QAD have noted two shortcomings in the manner in which this requirement is being implemented. Firstly, although the plans for monitoring may have been documented no monitoring activity had taken place. Secondly, very few of the planned monitoring programmes extended beyond the cold review of engagement files to cover reviews of all other elements of HKSQC 1. As the revised Practice Review approach focuses on a practice's own approach to quality control, it is important that practices ensure that their monitoring programmes are both fully comprehensive and active.
8. On a positive note the requirements in HKSQC 1 relating to the Engagement Quality Control Review (EQCR) do seem to have been largely understood and implemented. This is probably a reflection of the fact that practices have always recognized the need

for additional partner input in the audit of listed entities.

### **Audit methodology and procedures**

9. In respect of some practices it has been observed that audit procedures have been developed "in-house" over a period of time but that the current versions of their procedures do not appear to fully embrace the changes that came in with the adoption of International Standards on Auditing as Hong Kong Standards on Auditing (HKSA) with effect for accounting periods beginning on or after 15 December 2004. There were a number of standards that introduced requirements that would mean that many practices would need to rethink and revise their approach to auditing.

*HKSA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement and HKSA 330 The Auditor's Procedures in Response to Assessed Risks*

10. These standards impose an obligation on auditors to carry out procedures that enable them to understand the entity and its environment, to assess the risk of material misstatement and to design and apply procedures to respond to those assessed risks. Among the requirements of HKSA 315 is the need to understand how the client assesses and controls risk and to assess the design and implementation of significant controls. Although some methodologies in use, primarily among the larger firms, already

took this approach it was not something that was demanded by standard. Some smaller practices do not appear to have noticed the change in approach required by the new standards and QAD have noted examples of established audit approaches continuing to be applied with no recognition of the more specific steps now required.

*HKSA 240 The Auditor's Responsibilities to Consider Fraud in an Audit of Financial Statements*

11. As a topic of general interest to auditors and the business community this matter has been widely debated over many years. HKSA 240 addresses the reality that there are now far higher expectations among audit clients, investors, regulators and other stakeholders that auditors should be more alert to the possibility of fraud. The standard makes it clear that heightened skepticism is expected of the auditor and that there should be more overt and documented information sharing within the audit team and between auditor and client on the consideration of the possibility of fraud. Very much as for the two standards referred to above where practices have continued to use the same audit approach over many years, there is little to show that the heightened alertness and additional procedures required by HKSA 240 have been recognized.

Audit procedures manuals and standard documentation

12. Where a practice has acquired a commercially available audit procedures manual, such as the Institute's Audit Practice Manual, it is important that the practice reviews the manual and tailors it to suit the circumstances of the practice. The practice must then ensure that the adopted procedures are actually applied in carrying out audits. QAD reviewers have observed a practice's formally adopted audit manual sitting on a library shelf while audits are being carried out using entirely different procedures and documentation. In practices with more than one principal this can result in the practice actually having more than one audit approach as each principal has developed procedures (old or new) in a different manner.
13. It is also important that all principals and audit staff are properly trained in the use and application of any procedure that is adopted by the practice as part of a standard audit approach. Failure to take this basic step may result again in inconsistency of application of procedures and also in a checklist or form-filling driven approach that does not result in relevant and appropriate audit work being undertaken.

#### **Audit Documentation**

14. From the evidence of past practice reviews, such as the cases cleared in 2007 and the reviews being carried out under the current programme, it appears that a constant

theme is for auditors to ensure that they have sufficient relevant documentation to evidence the work carried out and conclusions reached. The relevant standard is HKSA 230 *Audit Documentation* which was updated in 2006 to bring in even more stringent requirements concerning the nature and extent of audit documentation.

15. Areas where recent QAD reviews across a range of practices have identified weakness in documentation include:

- Consultation – the detail of consultation has not always been adequately documented when principals and audit teams have consulted technical teams or other specialists in respect of significant and difficult audit issues
- Discussions with management, often on difficult or contentious issues are not always well recorded
- Conclusions – final conclusions on significant audit areas, including decisions on the need for or the type of audit qualification, that may have involved extensive consultation, discussions with management, audit principal input or additional audit work are not always fully documented

16. Additionally, there has been evidence that some areas where poor documentation has been historically been identified and reported continue to give cause for concern. Examples of these that practices may like to

consider in the context of their own client base and audit approach include:

- Recurring “limitation of scope” audit opinions

Instances were noted where practices had issued limitation of scope opinions on the basis of not attending client stock takes because they were not invited by the clients and have because directors estimates or valuations in respect of significant account balances were the only practical measure and no other audit procedures could be applied. Typically these practices have been the auditors of their clients for a number of years and have qualified their reports on the same basis for a number of times.

Practices are reminded that they should consider the implication for retaining the appointment as auditor with an ongoing imposed limitation of scope on the audit. Attention is drawn to paragraph 16 of HKSA 701 *Modifications to the Independent Auditor’s Report* which states that when the proposed terms of an audit engagement include a scope limitation such that the auditors believe the need to issue a disclaimer of opinion, they would normally not accept such a limited engagement unless required by statute to do so; and statutory auditors would not accept such an audit engagement when the limitation

infringes on their statutory duties. Failure to demonstrate the evidence of giving consideration to the impact of a limitation of scope on the ability to continue as auditor over a period of time could amount to non-compliance with the Code of Ethics.

Practices are also reminded that they should plan for attendance at physical inventory count instead of relying on receiving invitations from clients. In this regard, practice units should refer to HKSA 300 *Planning an Audit of Financial Statements for guidance*. If the practices are unable to attend the physical inventory count on the date planned due to unforeseen circumstances, HKSA 501 Audit Evidence – *Additional Consideration for Specific Items* requires the practice units to take or observe some physical counts on an alternative date and, when necessary, perform audit procedures on intervening transactions. In general, when a practice is claiming for a number of years that there are no suitable alternative audit procedures other than accepting figures generated by management, it is possible that the auditor is simply repeating the previous year's approach and is not actively seeking an alternative solution.

- Related party transactions

In some cases, practices relied primarily representations by management that

there were no related party transactions during the period except for those disclosed in the financial statements as the sole evidence that there were no undisclosed related parties transactions. Practices should refer to HKSA 550 *Related Parties* for guidance on additional audit procedures regarding related parties and transactions.

- Assets - valuation and impairment

In this particular area examples were noted where audit documentation was insufficient to clearly demonstrate the work undertaken in respect of verification of valuation of assets and/or assessment of impairment of assets under HKAS 36 *Impairment of Assets* for investments in subsidiaries, property, plant and equipment, and investment properties. In some instances the practice relied solely on management's representations without documenting an assessment of the reasonableness of the directors' valuation. HKAS 16 *Property, Plant and Equipment*, HKAS 27 *Consolidated and Separate Financial Statements* and HKAS 40 *Investment Property* have specific guidance on valuation of specific assets. HKAS 36 contains specific guidance on identifying an asset that may be impaired and measuring recoverable amount of an asset. Practices should obtain sufficient appropriate audit evidence as to whether the valuation and the

impairment assessment made/obtained by management are reasonable in the circumstances and comply with the relevant accounting framework.

- Going concern

In some cases where there were signs in the financial statements of events or conditions which might cast significant doubt on an entity's ability to continue as a going concern, there was not always sufficient audit documentation to demonstrate that the practice had carried out the procedures required under paragraph 26 of HKSA 570 *Going Concern*.

In other cases where the financial statements were prepared on a going concern basis as the directors/shareholders had agreed to provide the financial support to the company; there was sometimes inadequate audit documentation of the assessment of the existence of the financial support and the capability of the directors/shareholders in providing the financial support, if called upon to do so.

Practices are reminded that they should pay more attention to the guidance in HKSA 570 when assessing the going concern of an entity.

- Subsequent events

Reviewers noted that in some cases practices had relied on representations from management, usually in a document titled "letter of representations", as the only evidence of the verification of subsequent events. Paragraph 7 of HKSA 580 *Management Representations* states that representations by management cannot be a substitute for other audit evidence that the auditors could reasonably expect to be available. Practices should always consider the effect of subsequent events on the financial statements and on the auditor's report and refer to HKSA 560 s for the relevant guidance.



