

HONG KONG SOCIETY OF ACCOUNTANTS

Auditing and Assurance Standards Committee **Meeting summary – September 2003**

The Society's Auditing and Assurance Standards Committee (Committee) met on 4 September 2003.

Members present at the meeting were: Wong Tak Wai, Alvin (Chairman), Charles Chow (Deputy Chairman), Richard George (Deputy Chairman), Deborah Annells, Albert Au, Andrew Bennett, Patrick Cheng, William Crowe, Charles Grieve, Raymond Li, Man Mo Leung, Phyllis Mo, Paul F. Winkelmann and Desmond Yuen.

Secretariat staff present at the meeting were: Stephen Chan and Steve Ong.

The agenda items were:

1. Minutes of the July 2003 (249th) Meeting
2. Meeting Summary of the July 2003 (249th) Meeting for publication
3. Document for the Committee's ratification
4. IAASB Exposure Draft on Quality Control: Proposed New ISQC 1 "Quality Control for Audit, Assurance and Related Services Practices" and Proposed Revised ISA 220 "Quality Control for Audit Engagements"
5. IFAC Exposure Draft of Proposed Statements of Membership Obligations
6. PN 840 "The audit of solicitors' accounts under the Solicitors' Accounts Rules and the Accountant's Report Rules" – clarification obtained from the Law Society on paragraph 19(b)
7. Corporate Governance Review by The Standing Committee on Company Law Reform – A Consultation Paper on Proposals made in Phase II of the Review – "Corporate Reporting"
8. Government's Proposal on the Monitoring of Charitable Fund-raising Activities
9. Working Group on China audit matters – progress report
10. Date of next meeting

1. Minutes of the July 2003 (249th) Meeting

The Committee approved the Minutes of the 249th Meeting subject to some changes.

2. Meeting Summary of the July 2003 (249th) Meeting for publication

The Committee agreed that meeting summaries should be prepared in such a way that they serve to inform readers of the discussions of the meetings. The Meeting Summary of the 249th Meeting should be revised to meet this objective.

3. Document for the Committee's ratification

The Committee ratified the issuance of the HKSA Invitation to Comment on the IAASB Exposure Draft of Proposed Revised ISA 240 on The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements and Proposed Revised ISA 300 on Planning the Audit, which had been endorsed by the Committee by circulation.

[The HKSA Invitation to Comment is available on-line at: <

http://www.hksa.org.hk/professionaltechnical/assurance/exposedraft/invitation_to_comment1015.pdf >].

4. **IAASB Exposure Draft on Quality Control: Proposed New ISQC 1 “Quality Control for Audit, Assurance and Related Services Practices” and Proposed Revised ISA 220 “Quality Control for Audit Engagements”**

The Committee considered the two submissions of comments received on the Exposure Draft in response to the Committee’s Invitation to Comment.

The Committee discussed the proposed requirements on the rotation of audit partners and senior engagement personnel and had the following comments:

- It would be appropriate to eliminate the flexibility for partner rotation for listed entities due to the size of the firm as set out in paragraph 8.153 of the IFAC Code of Ethics.
- Although the IOSCO Principles for Auditor Independence require that standards of auditors’ independence should address specifically the need to ensure appropriate rotation of the audit engagement team such that *senior members* of a team do not remain in *key decision-making positions* for extended periods, the definitions of *senior members* and *key decision-making positions* must be clearly laid down first before the IOSCO Principles might be considered for adoption.

The Committee considered that the Exposure Draft would lead firms to reflect on whether their quality control policies and procedures are robust and comprehensive, and would help to both clarify and reinforce the roles and responsibilities of engagement partners and teams and engagement quality control reviewers in delivering quality audit, assurance and related services. This is important in strengthening the public’s trust in the profession.

After the meeting, a further review was carried out by the secretariat on the proposed requirements for firms to establish policies and procedures setting out criteria against which audits of non-listed entities, and assurance and related services engagements should be evaluated for the purpose of determining whether the engagement partner is rotated after a specified period (paragraphs 25(b) and (c) of the proposed ISQC 1). In the final submission, the HKSA expressed a few observations and reservations on the proposed requirements.

[The HKSA submission is available on-line at: <
http://www.hksa.org.hk/professionaltechnical/assurance/submission/docs/IAASB_ED_QC.pdf >]

5. **IFAC Exposure Draft of Proposed Statements of Membership Obligations**

The Committee noted that IFAC had released an ED of 7 proposed Statements of Membership Obligations (SMO) for consultation until 30 November 2003.

The Committee considered the proposed SMO 3 on “Auditing Standards and other International Auditing and Assurance Standards Board (IAASB) pronouncements”. It was agreed that further clarifications should be sought from the IAASB on the requirements of paragraph 2(b) of the proposed SMO as to whether the statement would allow member bodies to adopt only the basic principles and essential procedures

(black lettering paragraphs) without the guidance paragraphs and still meet their membership obligations.

6. **PN 840 “The audit of solicitors’ accounts under the Solicitors’ Accounts Rules and the Accountant’s Report Rules” – clarification obtained from the Law Society on paragraph 19(b)**

The Committee noted that the Law Society in its letter dated 15 July 2003 clarified that it takes the view that whilst contraventions of Practice Direction J “Interest on Clients’ Account” (which provides for the payment of interest on client account) are regarded as matters which adversely affect any client account or any trust money held by the firm, those providing the accountant’s report should exercise common sense and apply the “de minimis” rule particularly if the contravention is less than a realistic administration fee which could have been charged under the same Practice Direction.

A further clarification was obtained from the Law Society on 13 August 2003 that it would not envisage reports or qualifications of accountant’s report merely on a failure to account for very small amounts of interest particularly if those amounts of interest are less than a realistic administration fee. It went on to say that the purpose of the accountant’s report is to identify breaches of the Solicitors’ Accounts Rules or Practice Directions that adversely affect any client account or trust money.

The Committee agreed that in view of the clarifications obtained from the Law Society, paragraph 19(b) of PN 840 would need to be amended.

7. **Corporate Governance Review by The Standing Committee on Company Law Reform – A Consultation Paper on Proposals made in Phase II of the Review – “Corporate Reporting”**

The Committee considered Chapter 5 of the Consultation Paper on “Corporate Reporting” and supported the proposals on auditors’ functions and auditing standards, auditors’ remuneration, outgoing auditors, auditors’ independence, rotation of audit firms and auditors’ duties.

The majority view of the Committee did not support the proposal to widen the duty of the auditors of a subsidiary undertaking of a company so as to require them to volunteer information to the auditors of the holding company for the following reasons:

- the proposal contains elements of uncertainty and ambiguity which would cause practical difficulties for the auditors of a subsidiary undertaking to comply with, in particular it is not clear what is the intended threshold of the criteria of “*where the normal standards of auditors’ care and skill require them to recognize that such information is needed*” and “*information material to the audit (of the holding company)*”;
- in performing an audit of the subsidiary undertaking, the auditors would consider materiality at the subsidiary undertaking level, but such materiality level would not be appropriate for the audit of the holding company or group accounts. It would be impossible for the auditors of a subsidiary undertaking to determine what is considered material to the audit of the holding company or the group; and
- the auditors of the holding company at present already have an effective channel to receive material information on a subsidiary undertaking through any

qualifications/modifications in the audit report of the subsidiary undertaking.

The Committee considered that the current requirements were adequate and recommended that further research should be carried out before reaching a conclusion on the proposal to widen the duty of the auditors of a subsidiary undertaking.

The Committee supported the proposal of mandatory rotation of both lead and concurring audit partners every five years for audits of listed entities, as this seemed to be the international trend. However, it did not support the proposal of a “time-out” period of five years as it was considered too long. The Committee considered that a shorter “time-out” period would be more appropriate given that a period of five years could prove challenging not only for small and medium-sized firms, but also for larger firms in the case of audits of specialized industries. Accordingly, the Committee recommended that the “time-out” period of two years mentioned in the IFAC Code of Ethics should be adopted.

The Committee also supported the SCCLR’s recommendation of a detailed review of the final rules of the Sarbanes-Oxley model with regard to other partners to determine their relevance and applicability in Hong Kong.

The Committee’s comments were incorporated into the HKSA submission dated 17 October 2003. It is stated in the HKSA submission that the current requirements under the IFAC Code of Ethics may be a more appropriate starting point for Hong Kong (i.e. a rotation period of no more than 7 years) subject to review in 2-3 years’ time to see if it is necessary to shorten the maximum period to 5 years or some other duration.

[The HKSA submission is available on-line at: <
http://www.hksa.org.hk/professionaltechnical/corporategov/SCCLR_II.pdf >]

8. Government’s Proposal on the Monitoring of Charitable Fund-raising Activities

The Committee noted from the Social Welfare Department’s (SWD) letter to the Society that the Government had decided not to pursue legislative changes for the purpose of expanding the Permit System under the Summary Offences Ordinance to cover all types of fund-raising activities. The Government would instead be working on a voluntary system to monitor charitable fund raising activities.

The Committee reviewed the draft “Reference Guide for Charities on Best Practice for Fund-raising Activities” and was concerned that the proposed audit requirement for individual events or drives involving appeal to the public as set out in the draft Reference Guide would not be consistent with the current practice in PN 850 “Review of flag day accounts”, which was agreed between the HKSA and the SWD in 1999. It was agreed that a meeting should be arranged to meet with the SWD to discuss this concern.

9. Working Group on China audit matters – progress report

The Committee endorsed the Working Group’s recommendations that the proposed guidance is to be issued in the form of Questions and Answers in The Hong Kong Accountant and the topics of sales, off-book transactions and debtors should form the first series of the Questions and Answers.

10. Date of next meeting

The next Committee meeting would be held on 28 October 2003.

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This meeting summary is provided for the information and convenience of those who wish to follow the Committee's deliberations. Decisions reported are tentative and may be changed or modified by the Committee at a later date. Decisions become final only after completion of the formal due process required to finalize and release documents. No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this meeting summary, or for any errors or omissions in it.