

**STATEMENT OF AUDITING STANDARDS
510
PRINCIPAL AUDITORS AND OTHER AUDITORS**

(Issued July 1997)

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STATEMENT OF AUDITING STANDARDS
510
PRINCIPAL AUDITORS AND OTHER AUDITORS

*Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures, (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

Introduction

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance when the principal auditors, reporting on the financial statements of an entity, use the work of the other auditors on the financial information of one or more components included in the financial statements of the entity. This SAS does not deal with those instances where two or more auditors are appointed as joint auditors nor does it deal with the auditors' relationship with outgoing auditors. Further, when the principal auditors conclude that the financial statements of a component are immaterial, the Auditing Standards in this SAS do not apply. When, however, several components, immaterial in themselves, are together material, the procedures outlined in this SAS would need to be considered.
2. This SAS is written in the context of companies and company legislation, which imposes on the directors of a holding company the responsibility to prepare group financial statements which give a true and fair view so far as concerns the members of the holding company. The auditors of any other form of entity are guided by the terms of their particular appointment and by the relevant legislation, but in the absence of specific provisions to the contrary, the general principles embodied in this SAS are to be followed.
3. ***When the principal auditors use the work of the other auditors, the principal auditors should determine how the work of the other auditors will affect the audit. (SAS 510.1)***
4. "Principal auditors" means auditors with responsibility for reporting on the financial statements of an entity when those financial statements include financial information of one or more components audited by the other auditors.
5. "Other auditors" means auditors, other than the principal auditors, with responsibility for reporting on the financial information of a component which is included in the financial statements audited by the principal auditors. Other auditors include affiliated firms, whether using the same name or not, and correspondents, as well as unrelated auditors.
6. "Component" means a division, branch, subsidiary, joint venture, associated company or other enterprise whose financial information is included in financial statements audited by the principal auditors.

Acceptance as the principal auditors

7. ***The auditors should consider whether their own participation is sufficient to be able to act as the principal auditors. (SAS 510.2)***

8. The principal auditors are required to express an opinion on the group financial statements and have sole responsibility for this opinion even where those group financial statements include amounts derived from accounts which have not been audited by them. As a result, they cannot discharge this responsibility to report on the group financial statements by an uninformed acceptance of components' financial statements, whether audited or not. However, the principal auditors can take account of the extent of work and the report of the other auditors through carrying out certain procedures. The extent of these procedures is determined by the materiality of the amounts derived from financial statements of components and the level of risk that the principal auditors are willing to accept that such statements contain material errors.

The principal auditors' procedures

9. *When planning to use the work of the other auditors, the principal auditors should consider the professional competence of the other auditors in the context of the specific assignment. (SAS 510.3)*
10. Some of the sources of information for this consideration could be common membership of a professional organisation, common membership of, or affiliation with another firm or reference to the professional organisation to which the other auditors belong. These sources can be supplemented when appropriate by enquiries with the other auditors, bankers, etc. and by discussions with the other auditors.
11. *The principal auditors should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditors is adequate for the principal auditors' purposes, in the context of the specific assignment. (SAS 510.4)*
12. The principal auditors would as a matter of courtesy inform the management of the entity which they audit of their intention to communicate with the other auditors.
13. The principal auditors would advise the other auditors of:
- a. the independence requirements regarding both the entity and the component and obtain written representation as to compliance with them;
 - b. the use that is to be made of the other auditors' work and report and make sufficient arrangements for the co-ordination of their efforts at the initial planning stage of the audit. The principal auditors would inform the other auditors of matters such as areas requiring special consideration, procedures for the identification of inter-company transactions that may require disclosure and the timetable for completion of the audit; and
 - c. the accounting, auditing and reporting requirements and obtain written representation as to compliance with them.
14. The principal auditors might also, for example, discuss with the other auditors the audit procedures applied, review a written summary of the other auditors' procedures (which may be in the form of a questionnaire or checklist) or review working papers of the other auditors. The nature, timing and extent of procedures would depend on the circumstances of the engagement and the principal auditors' knowledge of the professional competence of the other auditors. This knowledge may have been enhanced from the review of previous audit work of the other auditors.
15. The principal auditors may conclude that it is not necessary to apply procedures such as those described in paragraph 14 because of sufficient appropriate audit evidence previously obtained that acceptable quality control policies and procedures are complied with in the conduct of the other auditors' practice. For example, when they are affiliated firms the principal auditors and the other auditors may have a continuing formal relationship providing for procedures that give that audit evidence such as periodic inter-firm reviews, tests of operating policies and procedures and review of working papers of selected audits.
16. *The principal auditors should consider the significant findings of the other auditors. (SAS 510.5)*

17. The principal auditors may consider it appropriate to discuss with the other auditors and the management of the component, the audit findings or other matters affecting the financial information of the component and may also decide that supplementary tests of the records or the financial information of the component are necessary. Such tests may, depending on the circumstances, be performed by the principal auditors or the other auditors.
18. The principal auditors would document in their audit working papers the components whose financial information was audited by the other auditors, their significance to the financial statements of the entity as a whole, the names of the other auditors and any conclusions reached that individual components are immaterial. The principal auditors would also document the procedures performed and the conclusions reached. For example, working papers of the other auditors that have been reviewed would be identified and the results of discussions with the other auditors would be recorded. However, the principal auditors may decide not to document the reasons for limiting the procedures in the circumstances described in paragraph 15, provided those reasons are summarised elsewhere in documentation maintained by the principal auditors' firm.

Co-operation between auditors

19. *The other auditors, knowing the context in which the principal auditors will use their work, should co-operate, subject to the necessary consent of the client, with the principal auditors. (SAS 510.6)*
20. The other auditors have sole responsibility for the audit opinion on the financial statements of the component which they audit. Accordingly, they plan and execute their audit in a manner which enables them to report on the component without placing reliance on the principal auditors necessarily informing them of matters which have come to their attention and which may have an important bearing on the financial statements of the component. This may involve the other auditors seeking representations directly from the management of the entity audited by the principal auditors.
21. The other auditors need to appreciate that the financial information which they report on is to be included within the financial statements which are reported on by the principal auditors. In principle, the other auditors would therefore be prepared to co-operate with the principal auditors and make available such information as the principal auditors may require in order to discharge their duties as auditors of the financial statements audited by them. In many circumstances when the component is a subsidiary, there is a statutory obligation on the other auditors, and the component which they audit, to give the principal auditors such information and explanations as they may reasonably request for the purpose of their audit.
22. This is the case in Hong Kong where, if a holding company and its subsidiary are incorporated in Hong Kong, section 133(1)(a) of the Companies Ordinance imposes a duty on the subsidiary and its auditors to give to the auditors of the holding company such information and explanation as those auditors may reasonably require for the purposes of their duties as auditors of the holding company.
23. Where a holding company is incorporated in Hong Kong, but its subsidiary is not, section 133(1)(b) of the Companies Ordinance imposes a duty on the holding company, if required by its auditors to do so, to take all such steps as are reasonably open to it to obtain from the subsidiary such information and explanation as the principal auditors may reasonably require for the purpose of their duty as the principal auditors.
24. Where the principal auditors have no statutory right to approach the other auditors, they would normally arrange, through management, for the other auditors to be instructed to co-operate by the component, in order to ensure that the duty of confidentiality owed by the other auditors to their client is maintained. This may not be possible where the component is an associated company, as the directors of the holding company may have less control than in the case of a subsidiary. If the component's management refuses such permission, the principal auditors would normally discuss and agree an appropriate course of action with the management of the entity which they audit.

25. If in carrying out their audit procedures the other auditors identify matters which they consider likely to be relevant to the principal auditors' work, they would normally consider the most appropriate means of bringing the matter to the attention of the principal auditors. This may be achieved through the other auditors' direct communication with the principal auditors, providing consent is granted by the component's management or there exists a statutory obligation. In any event, the other auditors would normally inform the principal auditors of any aspect of their work that cannot be carried out as requested.
26. There is no obligation, statutory or otherwise, on the principal auditors to provide information to the other auditors. However, in carrying out their work the principal auditors may identify matters which they assess to be relevant to the other auditors' work. In these circumstances, the principal auditors would normally discuss and agree an appropriate course of action with management of the entity which they audit.
27. The course of action agreed with management may involve the principal auditors communicating directly with the other auditors, or management informing the component's management or the other auditors. However, there may be circumstances where sensitive commercial considerations dictate that information cannot be passed on to the component's management or the other auditors. In this event, the principal auditors would not take further action as to do so would be in breach of the principle of client confidentiality.

Reporting considerations

28. The principal auditors have sole responsibility for their audit opinion and a reference to the other auditors in the principal auditors' report may be misunderstood and interpreted as a qualification of their opinion or a division of responsibility, neither of which is appropriate. However, where there are material components not audited by the principal auditors an indication of this may be given in a note to the group financial statements.
29. *When the principal auditors conclude that the work of the other auditors cannot be used and the principal auditors have not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditors, the principal auditors should consider expressing a qualified opinion or disclaimer of opinion because there is a limitation of scope in accordance with SAS 600 "Auditors' reports on financial statements". (SAS 510.7)*
30. If the other auditors issue, or intend to issue, a qualified auditors' report or an auditors' report containing a fundamental uncertainty paragraph, the principal auditors would consider whether the subject of the qualification or fundamental uncertainty paragraph is of such a nature and significance, in relation to the financial statements of the entity on which they are reporting, that it needs to be reflected in their report. In all circumstances, no reference to the other auditors is required in the principal auditors' report.

Compliance with International Standards on Auditing

31. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 600 "Using the Work of Another Auditor".

Effective date

32. Auditors are required to comply with the requirements of this SAS in respect of audits of financial statements for periods ending on or after 30 September 1997.