



Issue 18 (April 2013)

Dear practising members,

Documentation requirements for group auditors and practical implications for auditor regulation in Hong Kong

Background

The Practice Review Committee is a statutory committee responsible for exercising the powers and duties given to the Institute as the regulator of auditors in Hong Kong under the Professional Accountants Ordinance. From time to time the Committee becomes aware of matters arising from the practice review programme carried out by the quality assurance department of the Institute that warrant further communication with members. This Alert sets out some matters concerning documentation requirements for group auditors.

In Hong Kong, it is very common for Hong Kong companies to have major operating subsidiaries (components) located outside of Hong Kong and for Hong Kong auditors to rely on their local network firms to carry out the audit of component financial statements.

This type of group structure is often found when a Hong Kong listed holding company has a significant component located in mainland China. As a result of Hong Kong audit firms' concern over mainland China restriction on transmittal of audit documents outside of China and on disclosure of information to outside authorities, Hong Kong audit firms do not always maintain in Hong Kong copies of working papers relating to the audit of the component located in mainland China, whether generated by the component auditor or by the Hong Kong audit firms themselves and access to the documentation by practice review teams is sometimes not possible, in particular when substantially all audit work was performed in mainland China.

Regulatory approach and expectations

Practice reviewers would normally expect to see the documentation set out below on audit files kept by the Hong Kong audit firm in Hong Kong to demonstrate the firm had met its responsibilities as group auditor and complied with HKSA 600 *Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors)*. This applies even when the group audit partner is based in mainland China and substantially all audit work is carried out in mainland China.

1. *Evidence of the group auditors understanding of the component auditor and client*, analysis and identification of significant components and the decision to rely on work of component auditors.
2. *Directions to the component auditor* on the scope and timing of the component auditors work and reporting on financial information of the component and other specific requirements of the group auditor.
3. *Communication from the component auditor on the work carried out*, conclusions reached and other specific information requested by the group auditor. This would typically take the form of a reporting pack or memo that includes the following information:
 - a. Financial information about the component;
 - b. Summary of adjusted and unadjusted misstatements;
 - c. Significant audit findings and problem areas;
 - d. Significant matters to be communicated to those charged with governance of the group;
 - e. Letter of representation from component management; and
 - f. Component auditor conclusion and opinion on the component financial information.
4. *Evidence of group auditor review* of the reporting pack submitted by the component auditor and any subsequent correspondence between group and component auditors arising from that review.
5. *The nature, timing and extent of group auditor's involvement in the work performed by the component auditor* that might include review of relevant parts of the component auditor's audit documentation and conclusions thereon.
6. *The extent, nature and results of any work the group auditor considered necessary to carry out directly* on financial information of the component.
7. *Overall conclusion and opinion* on group financial statements and appropriate consolidation working papers.

The exact content and wording of these documents will depend to some degree on the judgment of the group auditor and direct participation of the group audit partner. The presence of some of these documents will also depend on the extent of involvement of the group auditor in the work of the component auditor. The more significant the component is to the audit of the group financial statements, the more direct involvement is expected from the group auditor in the work of the component auditor and thus the more documentation would be prepared by the group auditor itself.

In 2009 the Institute signed a memorandum of understanding with the Supervision and Inspection Bureau of the Ministry of Finance (SIB) to facilitate co-operation between both parties in fulfilling their respective regulatory responsibilities. This might include the Institute seeking SIB's assistance in carrying out reviews of audit engagements carried out by Mainland audit firms that are part of group audits selected for review as part of the Institute's practice review programme.

The quality assurance department monitors the application of HKSA 600 through the practice review programme and will report any significant potential non-compliance to the Practice Review Committee.

Sincere regards,

Chris Joy
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