

October 2004
Exposure Draft

Response Due Date
31 December 2004

**Proposed Preface to
Hong Kong Standards on
Quality Control,
Auditing, Assurance
and Related Services**



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

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This Exposure Draft may be filed in the “Exposure Drafts, Invitations to Comment” section of Volume III of the HKICPA Members’ Handbook.

A copy of the Exposure Draft can also be found on the HKICPA’s website at:
<<http://www.hkicpa.org.hk/professionalttechnical/assurance/exposedraft/preface.pdf>>.



INVITATION TO COMMENT

Background

The Exposure Draft is issued as part of the HKICPA's International Standards Convergence Project. The HKICPA Council's objective is to achieve convergence of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services with International Standards on Quality Control, Auditing, Assurance and Related Services issued by the International Auditing and Assurance Standards Board (IAASB).

The proposed Preface seeks to attain convergence with the extant Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services issued by the IAASB (International Preface). As a result, the proposed Preface has not taken into account the proposals in the September 2004 IAASB Exposure Draft on "Proposed Policy Statement, *Clarifying Professional Requirements in International Standards Issued by the IAASB*". The HKICPA's Invitation to Comment on this IAASB Exposure Draft is available at: http://www.hkicpa.org.hk/professionaltechnical/assurance/exposedraft/invitation_to_comment_iaasb.pdf. In finalizing the proposed Preface, the HKICPA will take into account the amendments to the extant International Preface resulting from the adoption of the provisions of the final IAASB Policy Statement, *Clarifying Professional Requirements in International Standards Issued by the IAASB*.

The Exposure Draft will set out the Council's objectives and due process in respect of setting Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services, and explain the scope, authority and timing of application of these Standards. It will also set out the relationship between Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services and International Standards on Quality Control, Auditing, Assurance and Related Services, and the authority of Practice Notes, Auditing Guidelines and Auditing and Assurance Bulletins issued by the HKICPA.

Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services include:

1. Hong Kong Standards on Quality Control (HKSQCs);
2. Hong Kong Framework for Assurance Engagements;
3. Hong Kong Standards on Auditing (HKSAAs);
4. Hong Kong Standards on Review Engagements (HKSREs);
5. Hong Kong Standards on Assurance Engagements (HKSAEs);
6. Hong Kong Standards on Investment Circular Reporting Engagements (HKSIRs); and
7. Hong Kong Standards on Related Services (HKSRSSs).

Categories 1, 2, 4 and 7 are new series of Hong Kong Standards adopting the equivalent International Standards. The extant Statements of Auditing Standards will be replaced by HKASs (Category 3), and the extant Standards on Assurance Engagements will be replaced by HKSAEs (Category 5). Category 6 is a new series of local Standards developed by the HKICPA to be applied by reporting accountants, which were issued in May 2004 for consultation.

Proposals

The more significant new proposals in the proposed Preface are:

- To recognize the HKICPA Council's objective of achieving convergence with International Standards on Quality Control, Auditing, Assurance and Related Services.



- ▶ To recognize that close coordination of the HKICPA's due process with the IAASB's due process is important for the success of achieving convergence of the two sets of Standards.
- ▶ To make clear that in applying the basic principles and essential procedures (identified in bold type lettering) contained in Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services, it is necessary to consider the whole text of a Standard (including the explanatory and other material identified in plain type lettering).

Comments Sought

The HKICPA welcomes comments on the Exposure Draft. In responding to the Exposure Draft, commentators are requested to refer to the relevant paragraphs within the proposed Preface. The responses should include the reasons for the comments, including specific suggestions for any proposed changes to wording.

Comments should be submitted so as to be received by **31 December 2004** and may be sent by mail, fax or email. Comments should be addressed to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

October 2004

PREFACE TO HONG KONG STANDARDS ON QUALITY CONTROL, AUDITING, ASSURANCE AND RELATED SERVICES

This Preface is issued to set out the objectives and due process of the Council of the Hong Kong Institute of Certified Public Accountants (HKICPA) (hereafter referred as the "Council") in respect of setting Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services and to explain the scope, authority and timing of application of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services. For the purpose of this Preface, the term "Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" includes:

- *Hong Kong Standards on Quality Control (HKSQCs);*
- *Hong Kong Framework for Assurance Engagements;*
- *Hong Kong Standards on Auditing (HKSAs);*
- *Hong Kong Standards on Review Engagements (HKSREs);*
- *Hong Kong Standards on Assurance Engagements (HKSAEs);*
- *Hong Kong Standards on Investment Circular Reporting Engagements (HKSIRs); and*
- *Hong Kong Standards on Related Services (HKSRSs).*

It also sets out the relationship between Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services and International Standards on Quality Control, Auditing, Assurance and Related Services issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants, and the authority attaching to Practice Notes (PNs), Auditing Guidelines (AGs) and Auditing and Assurance Bulletins.

Appendix 1 illustrates the structure of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services, PNs and AGs.

1. Pursuant to section 18A of the Professional Accountants Ordinance, Council may, in relation to the practice of accountancy, issue or specify any standards of auditing practices required to be observed, maintained or otherwise applied by members of the HKICPA (members). Approval of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services and related documents, such as exposure drafts, and other discussion documents, is the responsibility of Council.
2. Council has mandated the Auditing and Assurance Standards Committee (AASC) to develop Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services to achieve convergence with International Standards on Quality Control, Auditing, Assurance and Related Services. Within this remit, Council permits the AASC to work in whatever way it considers most effective and efficient and this may include forming advisory working groups or other forms of specialist advisory groups to give advice in preparing new and revised Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services.
3. The HKICPA's Standard-Setting Steering Board (SSSB) is responsible for reviewing and advising on the HKICPA's overall strategy, policies and processes for setting Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services. One of the SSSB's main objectives is to give advice to the AASC on priorities and on

major standard-setting projects.

Objectives of Council

4. In 2001, Council adopted the policy of achieving convergence of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services with International Standards on Quality Control, Auditing, Assurance and Related Services. Council's objectives in this respect are:
 - (a) to establish high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, regulators and other key stakeholders;
 - (b) to establish high quality standards and guidance for other types of assurance services on both financial and non-financial matters;
 - (c) to establish high quality standards and guidance for other related services;
 - (d) to establish high quality standards for quality control covering the scope of services addressed by the AASC;
 - (e) to publish other pronouncements on auditing and assurance matters, thereby advancing public understanding of the roles and responsibility of auditors and assurance service providers; and
 - (f) to bring about convergence of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services with International Standards on Quality Control, Auditing, Assurance and Related Services.

The authority attaching to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services

5. HKSAAs are to be applied in the audit of historical financial information.
6. HKSREs are to be applied in the review of historical financial information.
7. HKSIRs are to be applied in investment circular reporting engagements.
8. HKSAEs are to be applied in assurance engagements dealing with subject matters other than historical financial information.
9. HKSRSs are to be applied to compilation engagements, engagements to apply agreed-upon procedures to information and other related services engagements as specified by the AASC.
10. HKSAAs, HKSREs, HKSIRs, HKSAEs and HKSRSs are collectively referred to as Hong Kong Engagement Standards.
11. HKSQCs are to be applied for all services falling under Hong Kong Engagement Standards.
12. Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services contain basic principles and essential procedures (identified in bold type lettering) together with related guidance in the form of explanatory and other material, including

appendices. The basic principles and essential procedures are to be understood and applied in the context of the explanatory and other material that provides guidance for their application. It is therefore necessary to consider the whole text of a Standard to understand and apply the basic principles and essential procedures.

13. Any limitation of applicability of a specific Hong Kong Standard on Quality Control, Auditing, Assurance and Related Services is made clear in the Standard.

Obligation for members to observe Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services or justify departures

14. Council is committed to promoting and supporting compliance with Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services by members. Council therefore expects members to observe Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services.
15. The nature of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services requires members to exercise professional judgement in applying them. In exceptional circumstances, a member may judge it necessary to depart from a basic principle or essential procedure of a Hong Kong Standard on Quality Control, Auditing, Assurance and Related Services to achieve more effectively the objective of the engagement. When such a situation arises, the member should be prepared to justify the departure.
16. Apparent failures by members to comply with Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services are liable to be enquired into by the appropriate committee established under the authority of the HKICPA, and disciplinary action may result.
17. Members who do not comply with Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services make themselves liable to disciplinary action which may include the withdrawal of a practising certificate and hence of eligibility to perform audits.
18. Relevant Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services are likely to be taken into account when the adequacy of the work of members is being considered in a court of law or in other contested situations.

Compliance with a standard other than Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services

19. Where a member states that he has conducted an engagement in compliance with a standard other than Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services, for example International Standards on Quality Control, Auditing, Assurance and Related Services, the engagement must have in fact been so conducted and the engagement report must in fact have so conformed.

Application of HKSAs to the audits of overseas enterprises

20. Where the financial statements of an overseas enterprise are to be incorporated into Hong Kong financial statements, the audit of the overseas enterprise should conform to HKSAs in so far as this is necessary to ensure that the audit of the Hong Kong financial statements as a whole is in accordance with HKSAs.

21. Where the financial statements of an overseas incorporated enterprise are audited by Hong Kong auditors (as represented by signing the auditor's report in the style "Certified Public Accountants (Practising), Hong Kong") the audit of the enterprise should conform to HKSAs. There may be circumstances, however, where an audit is being carried out of an overseas enterprise for purposes other than Hong Kong reporting. In these cases, the audit should conform to appropriate standards as follows:
- a. where the local audit requirements and standards are properly codified and defined, the audit may conform to those standards; and
 - b. in the absence of such local requirements and standards, the audit should conform to HKSAs or to International Standards on Auditing.

In any event, the auditor's report should specify under which auditing standards the audit has been carried out.

Timing of application of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services

22. Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services apply from a date specified in the Standard.
23. Exposure drafts are issued for comment and their proposals are subject to revision. Until the effective date of a Hong Kong Standard on Quality Control, Auditing, Assurance and Related Services, the requirements of any Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services that would be affected by proposals in an exposure draft remain in force.

Relationship with International Standards on Quality Control, Auditing, Assurance and Related Services

24. Although Council has a policy to achieve convergence of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services with International Standards on Quality Control, Auditing, Assurance and Related Services, Council may consider it appropriate to include additional requirements in a Hong Kong Standard on Quality Control, Auditing, Assurance and Related Services or, in some exceptional cases, to deviate from an International Standard on Quality Control, Auditing, Assurance and Related Services. Each Hong Kong Standard on Quality Control, Auditing, Assurance and Related Services issued by Council contains information about the extent of conformity with the equivalent International Standard on Quality Control, Auditing, Assurance and Related Services.

Due process

25. Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services are developed through a due process that involves members and other interested individuals and organizations.
26. The AASC consults the SSSB on major projects, agenda decisions and work priorities.

27. Appendix 2 illustrates the due process to adopt IAASB Pronouncements including International Standards on Quality Control, Auditing, Assurance and Related Services.

Coordination with International Due Process

28. Council understands that close coordination between the AASC's and IAASB's due processes is important to the success of achieving convergence of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services with International Standards on Quality Control, Auditing, Assurance and Related Services.
29. Council supports the integration of its standard setting process with that of the IAASB as outlined below by adopting the procedures in paragraphs 30 to 32.
30. The IAASB states in its Interim Terms of Reference that it cooperates with national standard setters to link its work with IAASB's own in preparing and issuing Standards with an aim to share resources, minimize duplication of effort and reach consensus and convergence in Standards at an early stage in their development. It also promotes the endorsement of International Standards on Quality Control, Auditing, Assurance and Related Services by national standard setters, legislators and securities exchanges and promotes debate with users, regulators and practitioners throughout the world to identify user needs for new Standards and guidance.
31. The IAASB would continue to publish its own exposure drafts and other documents for public comment and national standard setters would publish their own exposure documents at approximately the same time as IAASB exposure drafts and would seek specific comments on any significant divergences between the two exposure documents. In some instances, national standard setters may include in their exposure documents specific comments on issues of particular relevance to their country or include more detailed guidance than is included in the corresponding IAASB document.
32. National standard setters would follow their own full due process, which they would, ideally, choose to integrate with IAASB's due process. This integration would avoid unnecessary delays in completing standards and would also minimize the likelihood of unnecessary differences between the standards that result.

The authority attaching to Practice Notes and Auditing Guidelines

33. PNs and AGs are issued to provide interpretative guidance and practical assistance to members in implementing Hong Kong Engagement Standards and to promote good practice. PNs and AGs can be local guidance developed by the HKICPA in response to emerging regulatory issues or new reporting requirements, or guidance adopting International Auditing Practice Statements (IAPSSs), International Review Engagement Practice Statements (IREPSs), International Assurance Engagement Practice Statements (IAEPSs) and International Related Services Practice Statements (IRSPSSs) issued by the IAASB.
34. Members should be aware of and consider PNs and AGs applicable to the engagement. A member who does not consider and apply the guidance included in a relevant PN/AG should be prepared to explain how the basic principles and essential procedures in the Hong Kong Engagement Standard(s) addressed by the PN/AG have been complied with.

ED/Auditing Preface (October 2004)

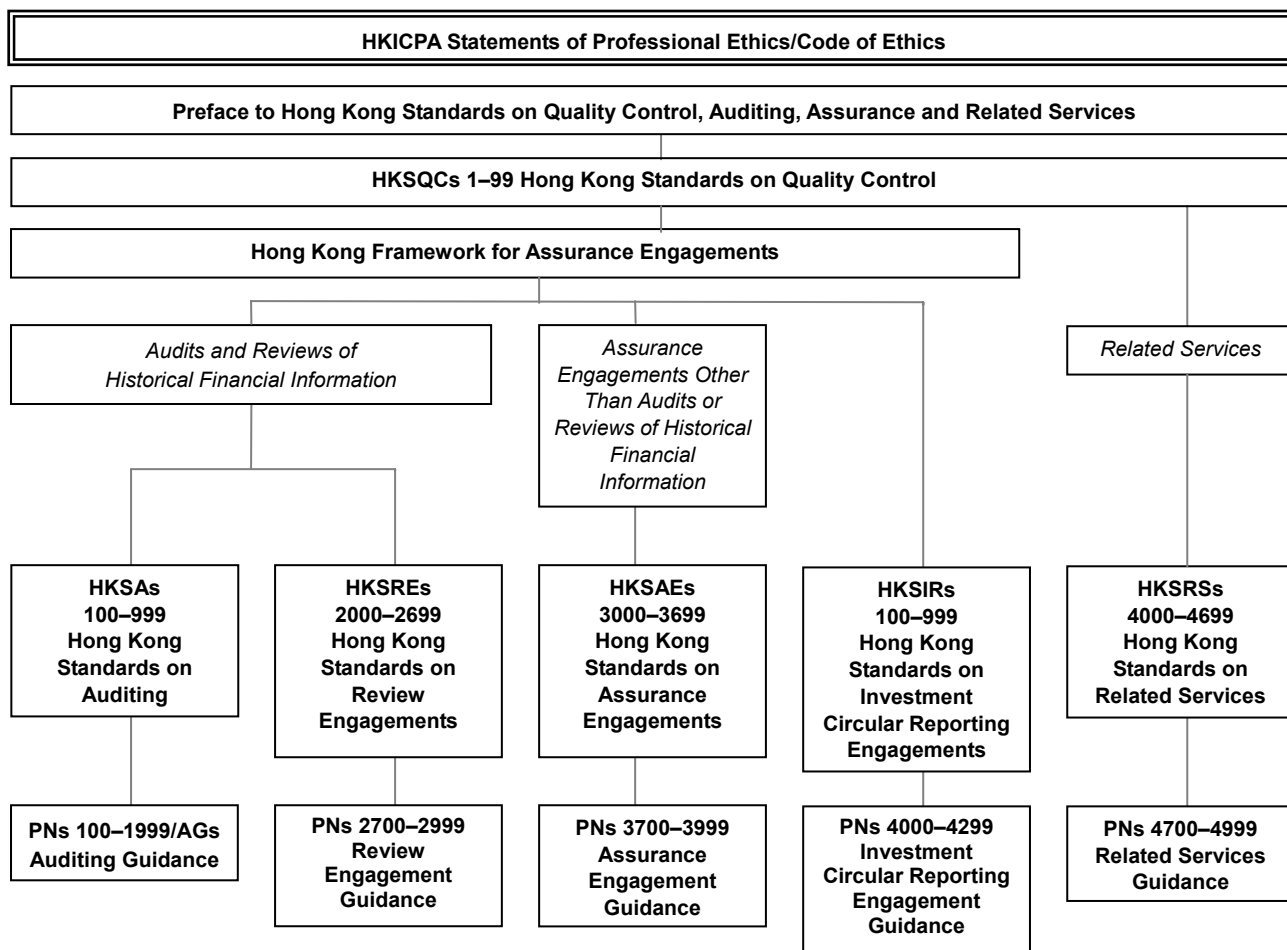
35. Appendix 3 illustrates the due process for the development of local PNs. Appendix 2 is equally applicable to the due process to adopt IAPs, IREPs, IAEPs and IRSPs.

The authority attaching to Auditing and Assurance Bulletins

36. Auditing and Assurance Bulletins are informative publications issued by the AASC on subjects of topical interest and are intended to assist members or to stimulate debate on auditing and assurance issues. They do not require the approval of Council and they do not have the same authority as Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services.

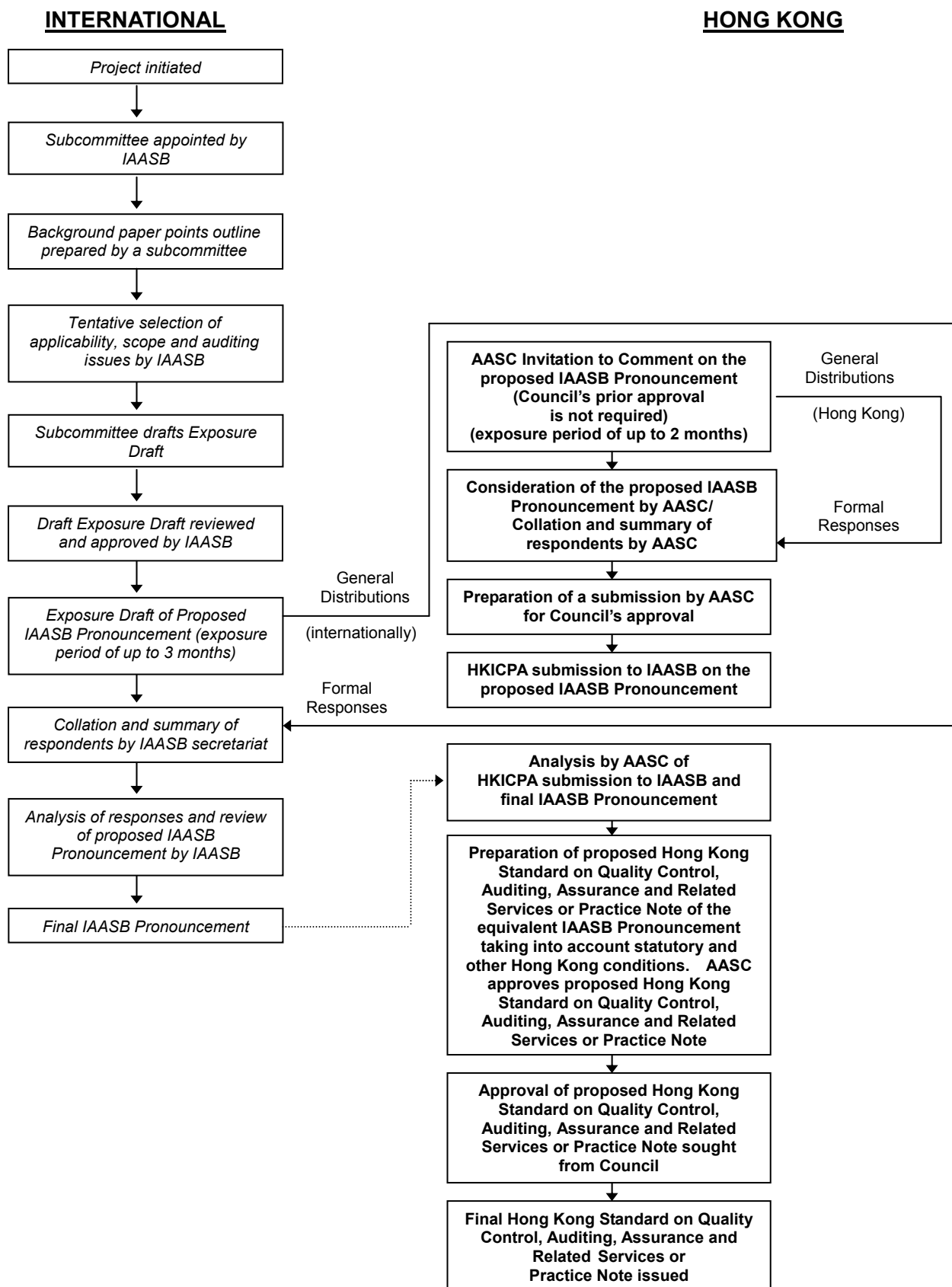
APPENDIX 1

Structure of Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services, Practice Notes and Auditing Guidelines



APPENDIX 2

**Auditing And Assurance Standards Committee
Due Process to Adopt IAASB Pronouncements**



APPENDIX 3

**Auditing And Assurance Standards Committee
Due Process for the Development of Local Practice Notes**

