

Effective as of 15 June 2005*

Hong Kong Standard on Quality Control 1

Quality Control for Firms That Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements

* HKSA 230, "Audit Documentation" gave rise to conforming amendments to HKSQC 1. Systems of quality control in compliance with the amended HKSQC 1 are required to be established by 15 June 2006. The conforming amendments previously set out in the Appendix to HKSQC 1 (revised February 2006 under Handbook Update 26) is now incorporated in the body of this HKSQC 1 (revised July 2006 under Handbook Update 31), marked-up for reference. They are paragraphs 6(a) and 73a – 73l.



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

HONG KONG STANDARD ON QUALITY CONTROL 1
QUALITY CONTROL FOR FIRMS THAT PERFORM
AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION,
AND OTHER ASSURANCE AND RELATED SERVICES ENGAGEMENTS

(Effective as of 15 June 2005^{*})

(Issued October 2004, revised February 2006 and revised July 2006)

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Hong Kong Standard on Quality Control (HKSQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSQCs.

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Introduction

1. The purpose of this Hong Kong Standard on Quality Control (HKSQC) is to establish basic principles and essential procedures and to provide guidance regarding a firm's responsibilities for its system of quality control for audits and reviews of historical financial information, and for other assurance and related services engagements. This HKSQC is to be read in conjunction with the Code of Ethics for Professional Accountants (the Code).
2. Additional standards and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements are set out in other pronouncements of the HKICPA. HKSA 220, "Quality Control for Audits of Historical Financial Information", for example, establishes standards and provides guidance on quality control procedures for audits of historical financial information.
3. **The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.**
4. A system of quality control consists of policies designed to achieve the objectives set out in paragraph 3 and the procedures necessary to implement and monitor compliance with those policies.
5. This HKSQC applies to all firms. The nature of the policies and procedures developed by individual firms to comply with this HKSQC will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.

Definitions

6. In this HKSQC, the following terms have the meanings attributed below:
 - (a) "Engagement documentation" – the record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers" are sometimes used). The documentation for a specific engagement is assembled in an engagement file;
 - (b) "Engagement partner" – the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body;
 - (c) "Engagement quality control review" – a process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report;
 - (d) "Engagement quality control reviewer" – a partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report;
 - (e) "Engagement team" – all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement;
 - (f) "Firm" – a sole practitioner, partnership, corporation or other entity of professional accountants;
 - (g) "Inspection" – in relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures;

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- (h) “Listed entity”^{*} – an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body;
- (i) “Monitoring” – a process comprising an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively;
- (j) “Network firm”^{*} – an entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally;
- (k) “Partner” – any individual with authority to bind the firm with respect to the performance of a professional services engagement;
- (l) “Personnel” – partners and staff;
- (m) “Professional standards” – Hong Kong Engagement Standards, as defined in the “Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services,” and relevant ethical requirements of the Code;
- (n) “Reasonable assurance” – in the context of this HKSQC, a high, but not absolute, level of assurance;
- (o) “Staff” – professionals, other than partners, including any experts the firm employs; and
- (p) “Suitably qualified external person” – an individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

Elements of a System of Quality Control

7. **The firm’s system of quality control should include policies and procedures addressing each of the following elements:**
 - (a) **Leadership responsibilities for quality within the firm.**
 - (b) **Ethical requirements.**
 - (c) **Acceptance and continuance of client relationships and specific engagements.**
 - (d) **Human resources.**
 - (e) **Engagement performance.**
 - (f) **Monitoring.**
8. **The quality control policies and procedures should be documented and communicated to the firm’s personnel.** Such communication describes the quality control policies and procedures and the objectives they are designed to achieve, and includes the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. In addition, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

^{*} As defined in the Code.

Leadership Responsibilities for Quality Within the Firm

9. **The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent), to assume ultimate responsibility for the firm's system of quality control.**
10. The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm's management emphasizing the firm's quality control policies and procedures, and the requirement to:
 - (a) Perform work that complies with professional standards and regulatory and legal requirements; and
 - (b) Issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards high quality work. They may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They are incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.
11. Of particular importance is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Accordingly:
 - (a) The firm assigns its management responsibilities so that commercial considerations do not override the quality of work performed;
 - (b) The firm's policies and procedures addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, are designed to demonstrate the firm's overriding commitment to quality; and
 - (c) The firm devotes sufficient resources for the development, documentation and support of its quality control policies and procedures.
12. **Any person or persons assigned operational responsibility for the firm's quality control system by the firm's chief executive officer or managing board of partners should have sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.**
13. Sufficient and appropriate experience and ability enables the responsible person or persons to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Ethical Requirements

14. **The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.**
15. The Code establishes the fundamental principles of professional ethics, which include:
 - (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality; and

- (e) Professional behaviour.
- 16. The Code includes a conceptual approach to independence for assurance engagements that takes into account threats to independence, accepted safeguards and the public interest.
- 17. The firm's policies and procedures emphasize the fundamental principles, which are reinforced in particular by (a) the leadership of the firm, (b) education and training, (c) monitoring and (d) a process for dealing with non-compliance. Independence for assurance engagements is so significant that it is addressed separately in paragraphs 18-27 below. These paragraphs need to be read in conjunction with the Code.

Independence

- 18. **The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code. Such policies and procedures should enable the firm to:**
 - (a) **Communicate its independence requirements to its personnel and, where applicable, others subject to them; and**
 - (b) **Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.**
- 19. **Such policies and procedures should require:**
 - (a) **Engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall impact, if any, on independence requirements;**
 - (b) **Personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and**
 - (c) **The accumulation and communication of relevant information to appropriate personnel so that:**
 - (i) **The firm and its personnel can readily determine whether they satisfy independence requirements;**
 - (ii) **The firm can maintain and update its records relating to independence; and**
 - (iii) **The firm can take appropriate action regarding identified threats to independence.**
- 20. **The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for:**
 - (a) **All who are subject to independence requirements to promptly notify the firm of independence breaches of which they become aware;**
 - (b) **The firm to promptly communicate identified breaches of these policies and procedures to:**
 - (i) **The engagement partner who, with the firm, needs to address the breach; and**
 - (ii) **Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action; and**

- (c) **Prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter, so that the firm can determine whether it should take further action.**
21. Comprehensive guidance on threats to independence and safeguards, including application to specific situations, is set out in the Code.
22. A firm receiving notice of a breach of independence policies and procedures promptly communicates relevant information to engagement partners, others in the firm as appropriate and, where applicable, experts contracted by the firm and network firm personnel, for appropriate action. Appropriate action by the firm and the relevant engagement partner includes applying appropriate safeguards to eliminate the threats to independence or to reduce them to an acceptable level, or withdrawing from the engagement. In addition, the firm provides independence education to personnel who are required to be independent.
23. **At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the Code.**
24. Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the firm demonstrates the importance that it attaches to independence and makes the issue current for, and visible to, its personnel.
25. The Code discusses the familiarity threat that may be created by using the same senior personnel on an assurance engagement over a long period of time and the safeguards that might be appropriate to address such a threat. **Accordingly, the firm should establish policies and procedures:**
- (a) **Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; and**
- (b) **For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code.**
26. Using the same senior personnel on assurance engagements over a prolonged period may create a familiarity threat or otherwise impair the quality of performance of the engagement. Therefore, the firm establishes criteria for determining the need for safeguards to address this threat. In determining appropriate criteria, the firm considers such matters as (a) the nature of the engagement, including the extent to which it involves a matter of public interest, and (b) the length of service of the senior personnel on the engagement. Examples of safeguards include rotating the senior personnel or requiring an engagement quality control review.
27. The Code recognizes that the familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the Code requires the rotation of the engagement partner after a pre-defined period, normally no more than seven years, and provides related standards and guidance.

Acceptance and Continuance of Client Relationships and Specific Engagements

28. **The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it will only undertake or continue relationships and engagements where it:**
- (a) **Has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity;**
- (b) **Is competent to perform the engagement and has the capabilities, time and**

resources to do so; and

(c) Can comply with ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

29. With regard to the integrity of a client, matters that the firm considers include, for example:
- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
 - The nature of the client's operations, including its business practices.
 - Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
 - Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
 - Indications of an inappropriate limitation in the scope of work.
 - Indications that the client might be involved in money laundering or other criminal activities.
 - The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

30. Information on such matters that the firm obtains may come from, for example:
- Communications with existing or previous providers of professional accountancy services to the client in accordance with the Code, and discussions with other third parties.
 - Inquiry of other firm personnel or third parties such as bankers, legal counsel and industry peers.
 - Background searches of relevant databases.
31. In considering whether the firm has the capabilities, competence, time and resources to undertake a new engagement from a new or an existing client, the firm reviews the specific requirements of the engagement and existing partner and staff profiles at all relevant levels. Matters the firm considers include whether:
- Firm personnel have knowledge of relevant industries or subject matters;
 - Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge effectively;
 - The firm has sufficient personnel with the necessary capabilities and competence;
 - Experts are available, if needed;
 - Individuals meeting the criteria and eligibility requirements to perform engagement quality control review are available, where applicable; and
 - The firm is able to complete the engagement within the reporting deadline.

32. The firm also considers whether accepting an engagement from a new or an existing client may give rise to an actual or perceived conflict of interest. Where a potential conflict is identified, the firm considers whether it is appropriate to accept the engagement.
33. Deciding whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous engagements, and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary knowledge or expertise.
34. **Where the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:**
- (a) **The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and**
 - (b) **The possibility of withdrawing from the engagement or from both the engagement and the client relationship.**
35. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:
- Discussing with the appropriate level of the client's management and those charged with its governance regarding the appropriate action that the firm might take based on the relevant facts and circumstances.
 - If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the reasons for the withdrawal.
 - Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
 - Documenting significant issues, consultations, conclusions and the basis for the conclusions.

Human Resources

36. **The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.**
37. Such policies and procedures address the following personnel issues:
- Recruitment;
 - Performance evaluation;
 - Capabilities;
 - Competence;
 - Career development;

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- Promotion;
- Compensation; and
- The estimation of personnel needs.

Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes include procedures that help the firm select individuals of integrity with the capacity to develop the capabilities and competence necessary to perform the firm's work.

38. Capabilities and competence are developed through a variety of methods, including the following:
- Professional education.
 - Continuing professional development, including training.
 - Work experience.
 - Coaching by more experienced staff, for example, other members of the engagement team.
39. The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. The firm therefore emphasizes in its policies and procedures the need for continuing training for all levels of firm personnel, and provides the necessary training resources and assistance to enable personnel to develop and maintain the required capabilities and competence. Where internal technical and training resources are unavailable, or for any other reason, the firm may use a suitably qualified external person for that purpose.
40. The firm's performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. In particular, the firm:
- (a) Makes personnel aware of the firm's expectations regarding performance and ethical principles;
 - (b) Provides personnel with evaluation of, and counseling on, performance, progress and career development; and
 - (c) Helps personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.
41. The size and circumstances of the firm will influence the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

Assignment of Engagement Teams

42. **The firm should assign responsibility for each engagement to an engagement partner. The firm should establish policies and procedures requiring that:**
- (a) **The identity and role of the engagement partner are communicated to key members of client management and those charged with governance;**
 - (b) **The engagement partner has the appropriate capabilities, competence, authority and time to perform the role; and**
 - (c) **The responsibilities of the engagement partner are clearly defined and communicated to that partner.**

43. Policies and procedures include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.
44. **The firm should also assign appropriate staff with the necessary capabilities, competence and time to perform engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.**
45. The firm establishes procedures to assess its staff's capabilities and competence. The capabilities and competence considered when assigning engagement teams, and in determining the level of supervision required, include the following:
- An understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
 - An understanding of professional standards and regulatory and legal requirements.
 - Appropriate technical knowledge, including knowledge of relevant information technology.
 - Knowledge of relevant industries in which the clients operate.
 - Ability to apply professional judgment.
 - An understanding of the firm's quality control policies and procedures.

Engagement Performance

46. **The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issue reports that are appropriate in the circumstances.**
47. Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:
- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
 - Processes for complying with applicable engagement standards.
 - Processes of engagement supervision, staff training and coaching.
 - Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
 - Appropriate documentation of the work performed and of the timing and extent of the review.
 - Processes to keep all policies and procedures current.
48. It is important that all members of the engagement team understand the objectives of the work they are to perform. Appropriate team-working and training are necessary to assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.
49. Supervision includes the following:
- Tracking the progress of the engagement.
 - Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand

their instructions and whether the work is being carried out in accordance with the planned approach to the engagement.

- Addressing significant issues arising during the engagement, considering their significance and modifying the planned approach appropriately.
 - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
50. Review responsibilities are determined on the basis that more experienced engagement team members, including the engagement partner, review work performed by less experienced team members. Reviewers consider whether:
- (a) The work has been performed in accordance with professional standards and regulatory and legal requirements;
 - (b) Significant matters have been raised for further consideration;
 - (c) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
 - (d) There is a need to revise the nature, timing and extent of work performed;
 - (e) The work performed supports the conclusions reached and is appropriately documented;
 - (f) The evidence obtained is sufficient and appropriate to support the report; and
 - (g) The objectives of the engagement procedures have been achieved.

Consultation

51. **The firm should establish policies and procedures designed to provide it with reasonable assurance that:**
- (a) **Appropriate consultation takes place on difficult or contentious matters;**
 - (b) **Sufficient resources are available to enable appropriate consultation to take place;**
 - (c) **The nature and scope of such consultations are documented; and**
 - (d) **Conclusions resulting from consultations are documented and implemented.**
52. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter.
53. Consultation uses appropriate research resources as well as the collective experience and technical expertise of the firm. Consultation helps to promote quality and improves the application of professional judgment. The firm seeks to establish a culture in which consultation is recognized as a strength and encourages personnel to consult on difficult or contentious matters.
54. Effective consultation with other professionals requires that those consulted be given all the relevant facts that will enable them to provide informed advice on technical, ethical or other matters. Consultation procedures require consultation with those having appropriate knowledge, seniority and experience within the firm (or, where applicable, outside the firm) on significant technical, ethical and other matters, and appropriate documentation and implementation of conclusions resulting from consultations.
55. A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by (a) other firms, (b) professional and regulatory bodies, or (c) commercial organizations that provide relevant quality control services. Before contracting for such services, the firm considers whether the external provider is suitably qualified for that purpose.

56. The documentation of consultations with other professionals that involve difficult or contentious matters is agreed by both the individual seeking consultation and the individual consulted. The documentation is sufficiently complete and detailed to enable an understanding of:
- (a) The issue on which consultation was sought; and
 - (b) The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

Differences of Opinion

57. **The firm should establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted and, where applicable, between the engagement partner and the engagement quality control reviewer. Conclusions reached should be documented and implemented.**
58. Such procedures encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached. **The report should not be issued until the matter is resolved.**
59. A firm using a suitably qualified external person to conduct an engagement quality control review recognizes that differences of opinion can occur and establishes procedures to resolve such differences, for example, by consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Quality Control Review

60. **The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures should:**
- (a) **Require an engagement quality control review for all audits of financial statements of listed entities;**
 - (b) **Set out criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and**
 - (c) **Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b).**
61. **The firm's policies and procedures should require the completion of the engagement quality control review before the report is issued.**
62. Criteria that a firm considers when determining which engagements other than audits of financial statements of listed entities are to be subject to an engagement quality control review include the following:
- The nature of the engagement, including the extent to which it involves a matter of public interest.
 - The identification of unusual circumstances or risks in an engagement or class of engagements.
 - Whether laws or regulations require an engagement quality control review.
63. **The firm should establish policies and procedures setting out:**
- (a) **The nature, timing and extent of an engagement quality control review;**

- (b) **Criteria for the eligibility of engagement quality control reviewers; and**
- (c) **Documentation requirements for an engagement quality control review.**

Nature, Timing and Extent of the Engagement Quality Control Review

64. An engagement quality control review ordinarily involves discussion with the engagement partner, a review of the financial statements or other subject matter information and the report, and, in particular, consideration of whether the report is appropriate. It also involves a review of selected working papers relating to the significant judgments the engagement team made and the conclusions they reached. The extent of the review depends on the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The review does not reduce the responsibilities of the engagement partner.
65. An engagement quality control review for audits of financial statements of listed entities includes considering the following:
- The engagement team's evaluation of the firm's independence in relation to the specific engagement.
 - Significant risks identified during the engagement and the responses to those risks.
 - Judgments made, particularly with respect to materiality and significant risks.
 - Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
 - The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
 - The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
 - Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.
 - The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

66. The engagement quality control reviewer conducts the review in a timely manner at appropriate stages during the engagement so that significant matters may be promptly resolved to the reviewer's satisfaction before the report is issued.
67. Where the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the report is not issued until the matter is resolved by following the firm's procedures for dealing with differences of opinion.

Criteria for the Eligibility of Engagement Quality Control Reviewers

68. **The firm's policies and procedures should address the appointment of engagement quality control reviewers and establish their eligibility through:**
- (a) **The technical qualifications required to perform the role, including the necessary experience and authority; and**
 - (b) **The degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity.**
69. The firm's policies and procedures on the technical qualifications of engagement quality control reviewers address the technical expertise, experience and authority necessary to

perform the role. What constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement. In addition, the engagement quality control reviewer for an audit of the financial statements of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.

70. The firm's policies and procedures are designed to maintain the objectivity of the engagement quality control reviewer. For example, the engagement quality control reviewer:
- (a) Is not selected by the engagement partner;
 - (b) Does not otherwise participate in the engagement during the period of review;
 - (c) Does not make decisions for the engagement team; and
 - (d) Is not subject to other considerations that would threaten the reviewer's objectivity.
71. The engagement partner may consult the engagement quality control reviewer during the engagement. Such consultation need not compromise the engagement quality control reviewer's eligibility to perform the role. Where the nature and extent of the consultations become significant, however, care is taken by both the engagement team and the reviewer to maintain the reviewer's objectivity. Where this is not possible, another individual within the firm or a suitably qualified external person is appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement. The firm's policies provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired.
72. Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Where the firm contracts suitably qualified external persons, the firm follows the requirements and guidance in paragraphs 68-71.

Documentation of the Engagement Quality Control Review

73. **Policies and procedures on documentation of the engagement quality control review should require documentation that:**
- (a) **The procedures required by the firm's policies on engagement quality control review have been performed;**
 - (b) **The engagement quality control review has been completed before the report is issued; and**
 - (c) **The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.**

Engagement Documentation

Completion of the Assembly of Final Engagement Files

- 73a. **The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been finalized.**
- 73b. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement should be completed. Where no such time limits are prescribed in law or regulation, the firm establishes time limits appropriate to the nature of the engagements that reflect the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit is ordinarily not more than 60 days after the date of the auditor's report.

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73c. Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation

73d. **The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation.**

73e. Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

73f. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, the firm designs and implements appropriate controls for engagement documentation to:

- (a) Enable the determination of when and by whom engagement documentation was created, changed or reviewed;
- (b) Protect the integrity of the information at all stages of the engagement especially when the information is shared within the engagement team or transmitted to other parties via the Internet;
- (c) Prevent unauthorized changes to the engagement documentation; and
- (d) Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

73g. Controls that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation include, for example:

- The use of a password among engagement team members to restrict access to electronic engagement documentation to authorized users.
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement.
- Procedures for properly distributing engagement documentation to the team members at the start of engagement, processing it during engagement, and collating it at the end of engagement.
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation.

73h. For practical reasons, original paper documentation may be electronically scanned for inclusion in engagement files. In that case, the firm implements appropriate procedures requiring engagement teams to:

- (a) Generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;
- (b) Integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary; and
- (c) Enable the scanned copies to be retrieved and printed as necessary.

The firm considers whether to retain original paper documentation that has been scanned for legal, regulatory or other reasons.

Retention of Engagement Documentation

- 73i. **The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.**
- 73j. The needs of the firm for retention of engagement documentation and the period of such retention, will vary with the nature of the engagement and the firm's circumstances, for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether local law or regulation prescribes specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements. In the specific case of audit engagements, the retention period ordinarily is no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report.
- 73k. Procedures that the firm adopts for retention of engagement documentation include those that:
- Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation since the underlying technology may be upgraded or changed over time.
 - Provide, where necessary, a record of changes made to engagement documentation after the engagement files have been completed.
 - Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Ownership of Engagement Documentation

- 73l. Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the firm or its personnel.

Monitoring

74. **The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.**
75. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:
- (a) Adherence to professional standards and regulatory and legal requirements;

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- (b) Whether the quality control system has been appropriately designed and effectively implemented; and
 - (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
76. The firm entrusts responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility. Monitoring of the firm's system of quality control is performed by competent individuals and covers both the appropriateness of the design and the effectiveness of the operation of the system of quality control.
77. Ongoing consideration and evaluation of the system of quality control includes matters such as the following:
- Analysis of:
 - New developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm's policies and procedures where appropriate;
 - Written confirmation of compliance with policies and procedures on independence;
 - Continuing professional development, including training; and
 - Decisions related to acceptance and continuance of client relationships and specific engagements.
 - Determination of corrective actions to be taken and improvements to be made in the system, including the provision of feedback into the firm's policies and procedures relating to education and training.
 - Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with it.
 - Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.
78. The inspection of a selection of completed engagements is ordinarily performed on a cyclical basis. Engagements selected for inspection include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, including the following:
- The size of the firm.
 - The number and geographical location of offices.
 - The results of previous monitoring procedures.
 - The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
 - The nature and complexity of the firm's practice and organization.
 - The risks associated with the firm's clients and specific engagements.
79. The inspection process includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team. Those inspecting the engagements are not involved in performing the engagement or the engagement quality control review. In determining the scope of the inspections, the firm may take into account the scope or conclusions of an independent external inspection program. However, an

independent external inspection program does not act as a substitute for the firm's own internal monitoring program.

80. Small firms and sole practitioners may wish to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, they may wish to establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.
81. **The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and should determine whether they are either:**
- (a) **Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or**
 - (b) **Systemic, repetitive or other significant deficiencies that require prompt corrective action.**
82. **The firm should communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.**
83. **The firm's evaluation of each type of deficiency should result in recommendations for one or more of the following:**
- (a) **Taking appropriate remedial action in relation to an individual engagement or member of personnel;**
 - (b) **The communication of the findings to those responsible for training and professional development;**
 - (c) **Changes to the quality control policies and procedures; and**
 - (d) **Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.**
84. **Where the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm should determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. It should also consider obtaining legal advice.**
85. **At least annually, the firm should communicate the results of the monitoring of its quality control system to engagement partners and other appropriate individuals within the firm, including the firm's chief executive officer or, if appropriate, its managing board of partners. Such communication should enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities. Information communicated should include the following:**
- (a) **A description of the monitoring procedures performed.**
 - (b) **The conclusions drawn from the monitoring procedures.**
 - (c) **Where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.**
86. The reporting of identified deficiencies to individuals other than the relevant engagement partners ordinarily does not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

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87. Some firms operate as part of a network and, for consistency, may implement some or all of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies and procedures designed to comply with this HKSQC, and these firms place reliance on such a monitoring system:
- (a) At least annually, the network communicates the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms;
 - (b) The network communicates promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken; and
 - (c) Engagement partners in the network firms are entitled to rely on the results of the monitoring process implemented within the network, unless the firms or the network advises otherwise.
88. Appropriate documentation relating to monitoring:
- (a) Sets out monitoring procedures, including the procedure for selecting completed engagements to be inspected;
 - (b) Records the evaluation of:
 - (i) Adherence to professional standards and regulatory and legal requirements;
 - (ii) Whether the quality control system has been appropriately designed and effectively implemented; and
 - (iii) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
 - (c) Identifies the deficiencies noted, evaluates their effect, and sets out the basis for determining whether and what further action is necessary.

Complaints and Allegations

89. **The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:**
- (a) **Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and**
 - (b) **Allegations of non-compliance with the firm's system of quality control.**
90. Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.
91. As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.
92. The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.
93. Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action as discussed in paragraph 83.

Documentation

94. **The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.**
95. How such matters are documented is the firm's decision. For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections. Smaller firms may use more informal methods such as manual notes, checklists and forms.
96. Factors to consider when determining the form and content of documentation evidencing the operation of each of the elements of the system of quality control include the following:
- The size of the firm and the number of offices.
 - The degree of authority both personnel and offices have.
 - The nature and complexity of the firm's practice and organization.
97. The firm retains this documentation for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

Effective Date

98. Systems of quality control in compliance with this HKSQC are required to be established by 15 June 2005 (15 June 2006 for paragraphs 6(a) and 73a – 73l). Firms consider the appropriate transitional arrangements for engagements in process at these dates.

Conformity and Compliance with International Standards on Quality Control

99. As of July 2006 (*date of revision*), this HKSQC conforms with International Standard on Quality Control (ISQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements".

Public Sector Perspective

1. *Some of the terms in HKSQC 1, such as "engagement partner" and "firm", should be read as referring to their public sector equivalents. However, with limited exceptions, there is no public sector equivalent of "listed entities", although there may be audits of particularly significant public sector entities which should be subject to the listed entity requirements of mandatory rotation of the engagement partner (or equivalent) and engagement quality control review. There are no fixed objective criteria on which this determination of significance should be based. However, such an assessment should encompass an evaluation of all factors relevant to the audited entity. Such factors include size, complexity, commercial risk, parliamentary or media interest and the number and range of stakeholders affected.*
2. *HKSQC 1, paragraph 70, states that "The firm's policies and procedures are designed to maintain the objectivity of the engagement quality control reviewer". Subparagraph (a) notes as an example that the engagement quality control reviewer is not selected by the engagement partner. However, in many jurisdictions, there is a single statutorily appointed auditor-general who acts in a role equivalent to that of "engagement partner" and who has overall responsibility for public sector audits. In such circumstances, where applicable, the engagement reviewer should be selected having regard to the need for independence and objectivity.*
3. *In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, considerations regarding the acceptance and continuance of client relationships and specific engagements, as set out in paragraphs 28-35 of HKSQC 1, may not apply.*

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4. *Similarly, the independence of public sector auditors may be protected by statutory measures, with the consequence that certain of the threats to independence of the nature envisaged by paragraphs 18-27 of HKSQC 1 are unlikely to occur.*