

# Audit quality



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



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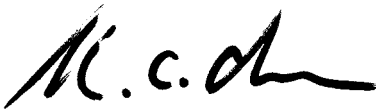
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## Foreword

I welcome the initiative by the Hong Kong Institute of CPAs to focus discussion on the importance of maintaining confidence in audit quality.

High quality auditing is a key component in ensuring that investors and other stakeholders, here and across the international community, can have confidence in the integrity of our capital markets. Quality independent audit gives investors trust and confidence in financial reporting of companies of all shapes and sizes.

The place audit fits in the financial capital market is at times undervalued. I am pleased to note that the Hong Kong Institute of CPAs has embarked on a programme to address this, which will benefit auditors and other stakeholders including shareholders, directors, audit committees and regulators and ultimately contribute to keeping Hong Kong at the forefront of international professional and business activities, a bedrock to maintain Hong Kong's status as an international financial centre.

A handwritten signature in black ink, appearing to read 'K.C. Chan', with a stylized flourish at the end.

Professor K.C. Chan  
Secretary for Financial Services and the Treasury  
The Government of the Hong Kong SAR

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## **The Hong Kong Institute of CPAs' commitment to audit quality**

The Institute is the only statutory licensing body of accountants in Hong Kong, responsible for professional training and development of students and members, setting audit and assurance, ethical and financial reporting standards and regulation of the profession.

With strong internationally converged professional standards and an effective practice review programme, Hong Kong has a highly regarded audit profession. In a dynamic professional world, we understand we need to pay constant attention to ensure that new challenges are met. The Institute takes audit quality seriously and recognizes that we have responsibility to auditors, businesses and other stakeholders to ensure that audit quality in Hong Kong is explained, promoted and maintained at the highest level.

To fulfill this public interest responsibility, the Institute is starting a programme of publications and events aimed at deepening understanding of what we mean when we talk about audit quality and the value of audit among auditors and other stakeholders including companies, audit committees, investors, government and regulators. The Institute will draw on its close connections through the Global Accounting Alliance with other leading professional bodies and its other international initiatives for source material and to make sure this subject is informed by leading thinking from around the world.

The Institute is committed to lead in this area and ensure that audit is valued by all stakeholders and the public at large. We are also charged with making sure that audit quality in Hong Kong is maintained at a high level to support our status as an internationally renowned capital market.



Winnie Cheung  
Chief Executive  
Hong Kong Institute of CPAs

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## **Why audit quality is important**

Statutory audit of companies has been established in many parts of the world for more than one hundred years and in Hong Kong is enshrined in the Companies Ordinance. There have been many misconceived expectations of what an audit is and does but it is essentially a process leading to the expression of a professional opinion on the truth and fairness of a company's statutory financial statements prepared in accordance with a recognized and accepted financial reporting framework.

The audit provides assurance to the owners and management of companies and to investors and stakeholders. Audit, along with financial reporting, corporate governance and regulation, supports confidence in capital markets.

Following the collapse of Enron and other high profile corporate scandals, the responsibility and quality of audit came under intense scrutiny on an international scale. Government, regulators and other stakeholders asked many hard questions about audit and the auditing profession. The very public debate that ensued on the role and quality of audit brought the auditing profession centre stage and resulted in significant changes in how auditors are regulated and the way in which auditors communicate and interact with regulators and other stakeholders.

As commerce and financing have developed into truly international operations, so too, has the auditing profession become international. No single market can operate successfully in isolation from the global economy. Audit is a cornerstone of confidence in capital markets and making audit services of the highest quality is of crucial importance for all participants in the capital markets and especially important to the auditing profession.

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## **What is audit quality**

Auditors, shareholders, directors and regulators may be in agreement on the desirability of audit quality but each may have a different meaning of the term. The definition or measurement of audit quality has been the subject of much research, consultation and debate on an international scale. Audit is not a commodity and each audit will to some degree be tailored to address the circumstances of individual clients. Audit is not an exact science and relies on professional judgment in reaching conclusions and making decisions before expressing an opinion.

Audit quality is not defined in auditing standards. Standards guide auditors on what to do in an audit and compliance with standards will indicate that an audit has been carried out to acceptable levels of quality. In the standards in use now, two specifically address quality – HKSQC 1, which addresses quality control procedures across the whole audit firm and HKSA 220, which focuses on quality control in the context of individual audit engagements.

Many factors contribute to or influence the quality of audit, and chief among them are the skills and experience of the people doing the audit. Another is the rigour of the audit methodology. The balance may vary from audit to audit.

In February 2008 the United Kingdom Financial Reporting Council (UKFRC), following extensive international consultation and drawing on earlier work by the auditing profession, published “The Audit Quality Framework” to help communication between auditors, audit committees, preparers, investors and other stakeholders on audit quality. This publication identified five elements of audit quality, which have generally been accepted internationally as the key influences on audit quality and have been used in further consultation and discussion by bodies such as IOSCO.



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## **Elements of audit quality**

Listed below are the five elements of audit quality identified in the UKFRC publication and some brief examples of specific issues that come within the general context of each.

### ***Culture within an audit firm***

Culture includes leadership and an environment that promotes and recognizes quality.

### ***Skills and personal qualities of audit partners and staff***

This goes beyond technical skills to include adherence to ethical principles, application of professional skepticism and appropriate supervision and support for audit staff.

### ***Effectiveness of the audit process***

Application of a well structured and thorough audit methodology supported by effective and relevant teamwork and not constrained by financial pressures.

### ***Reliability and usefulness of audit reporting***

Reporting that clearly conveys the auditor's opinion and effective communication with audit committees.

### ***Factors outside the control of auditors***

These include client approach to corporate governance and financial reporting and the audit regulatory environment.

The Institute will host events and issue publications to further consider these elements and other matters relating to audit quality. This will help us bring together all parties with an interest in audit quality.

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## **In conclusion**

The Institute is taking this initiative to facilitate the involvement of all stakeholders in Hong Kong in a debate that is international in scale and of relevance to all participants in global capital markets. We recognize that this is a live topic and that the concepts and descriptions used in debate and publications may change over time.

The Institute believes that financial reporting and audit in Hong Kong are fundamentally sound. We are not promoting this initiative to address fundamental flaws or to introduce additional regulation but to encourage dialogue and promote understanding on the value of audit and the meaning of audit quality.



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