

# Audit committees and audit quality



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

Hong Kong Institute of Certified Public Accountants  
37th Floor, Wu Chung House  
213 Queen's Road East, Wanchai, Hong Kong  
Tel: (852) 2287 7228  
Fax: (852) 2865 6603  
Email: [hkicpa@hkicpa.org.hk](mailto:hkicpa@hkicpa.org.hk)  
Website: [www.hkicpa.org.hk](http://www.hkicpa.org.hk)

## Contents

Introduction

Purpose of this guide ..... 1

Role of the audit committee ..... 2

Communication on audit quality ..... 3



## Introduction

To date, there has been little guidance available to help businesses understand the quality of the audit service being provided to them. This lack of information has compounded the concept of the “audit expectation gap,” which we have seen emerge in the business and investor communities.

The Hong Kong Institute of Certified Public Accountants and the Institute of Chartered Accountants in Australia are committed to addressing this expectation gap by raising awareness of the benefits of audit and by educating the marketplace on a more commonly agreed basis for understanding audit quality.

A key component of good corporate governance in Hong Kong and internationally is the role and responsibilities of the audit committee.

We hope this guide will foster better communication, interaction, and understanding between audit committees, board members and their external auditor.

The Hong Kong Institute of CPAs is very pleased to make use of its international partnerships and to be able to draw on work done by the Institute of Chartered Accountants in Australia in bringing this guide to the Hong Kong market.



Wilson Fung  
President  
Hong Kong Institute of  
Certified Public Accountants



Michael Spinks  
President  
The Institute of  
Chartered Accountants in Australia



## **Purpose of this guide**

The purpose of this guide is to enhance communication between the audit committee and the external auditor. The guide provides assistance to audit committees and other relevant stakeholders to:

- Better understand the role and scope of an external audit
- Engage more effectively with the external auditor
- Consider the drivers of audit quality

This guide does not set out compliance requirements or override any existing requirements to which boards and committees may be subject, and it is not intended to deal with better practice of audit committees.

Audit committees using this guide will need to determine when to communicate with the external auditor on audit quality. For example, some discussion might occur at the initial planning phases of the external audit, while other communication will relate to the audit findings and conclusions. Audit committees could also consider using this guide during the proposal process to assist with auditor selection.

## **Role of the audit committee**

An independent audit committee is a fundamental component of a sound corporate governance structure.

Audit committee charters will typically focus on engagement with the external auditor and the quality of the external audit service. Examples of focus areas in audit committee charters include:

- Review the performance of the external auditor
- Consider the overall effectiveness and independence of the external auditor
- Review, at least annually, the scope, results and performance of the external auditor
- Assess and monitor the performance and effectiveness of the external auditor
- The committee will progressively evaluate the performance of the external auditor during its term of appointment and the progress of the audit. The committee will ensure that the criteria for evaluation of performance extend to cover the value delivered to shareholders and the audit.

This guide is designed to help audit committees meet their responsibilities.

## **Communication on audit quality**

This guide includes a practical range of questions to facilitate communication between audit committees and auditors on matters of audit quality. These questions are not designed to be comprehensive; rather they are intended to provide a foundation and will need to be tailored to the specific circumstances of each organization and its auditing requirements.

In line with the principles set out in the introduction to the audit quality initiative being undertaken by the Institute, the questions are structured around the five key elements of audit quality identified in “An Audit Quality Framework” published by the Financial Reporting Council of the United Kingdom in February 2008.

To recap, these five elements of audit quality are:

- Culture within an audit firm
- Skills and personal qualities of audit partners and staff
- Effectiveness of the audit process
- Reliability and usefulness of audit reporting
- Factors outside the control of auditors

## **Points for consideration and discussion with your external auditor**

### **1. Culture within an audit firm**

- What are the core values of your auditor?
- Does your auditor have a code of conduct that includes commitment to:
  - honesty and integrity
  - professional competence
  - independence
- Does your auditor regularly communicate the core values and principles of the code of conduct to staff?
- How does your auditor assess compliance with independence requirements?
- Does your auditor create an environment where achieving high quality is valued, invested in and rewarded?
- Does your auditor have appraisal systems for partners and staff that promote audit quality?
- Does your auditor have robust systems for client acceptance and continuation?
- Does your auditor promote and support consultations for exercising professional judgment in challenging circumstances?
- Does your auditor monitor audit quality across its firm and network?
- What actions would they take for shortcomings in these activities?
- Has any partner in the audit firm been the subject of regulatory action on the public record during the past year?

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

- Do the partners and staff of the audit firm demonstrate a thorough understanding of your business and the legal framework in which you operate?
- Do the partners and staff show technical competence and a thorough understanding of auditing and accounting standards, and professional and ethical standards? Does your auditor provide you with details of your engagement team, including the role and experience of the team, and the way in which the team is managed and supervised?
- Are the partners or staff involved in relevant industry based groups?
- Do audit staff receive mentoring and on the job training?
- Do the partners and staff show appropriate professional scepticism and address issues identified during the audit?

### **3. Effectiveness of the audit process**

- Are the audit partner(s) and manager(s) closely involved in the planning of your audit?
- Is the external audit plan discussed at audit committee meetings well before year end?
- Are your reporting deadlines realistic and achievable for the delivery of reliable and relevant information to your auditor to allow a quality audit?
- How does your audit firm use technology to support its audit approach?
- Is sufficient technical support available to the audit team when required?
- How does your auditor review the work of experts, including assessing their terms of reference, competence, capabilities and objectivity?
- How does your external auditor engage with, and use, the work of your internal auditor?
- Does your auditor have appropriate access to the audit committee?

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

- Does your auditor communicate with sufficient detail on the scope of the audit and the accompanying report, including the way in which the risk of material misstatement in the financial statements has been addressed?
- Does your auditor report on the key judgments made by management in assessing the application of accounting standards and the auditor's assessment of these judgments?
- Are your auditor's reports written in a clear manner? How could they be improved?
- Does your auditor suggest potential ways of improving financial reporting and internal controls?
- Does your auditor provide the audit committee with a list of unadjusted differences identified during the course of the audit?
- Does your auditor seek feedback from you on a formal basis?

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

- Does your organization attach appropriate importance to financial reporting and the audit process?
- What qualifications and level of experience do the preparers of financial statements have in your organization?
- Is the composition of your audit committee sufficiently balanced in skills, experience and industry knowledge to ensure audit quality?
- Does your audit committee engage in a robust and professional manner with issues identified during the audit?
- Is there sufficient capacity (nature, mix and size) in your organization's financial reporting capability to meet your expectations?
- Are your organization's financial reporting deadlines realistically focused to ensure quality financial reporting and auditing?
- Who in your organization is responsible for communicating with investors?
- Does the audit committee approve releases to the market?
- What remuneration systems does your organization have and how do they relate to key accounting judgments? Is there potential for bias and how is that monitored?





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



**Chartered  
Accountants  
Australia**