Auditors' Duty of Care to Third Parties and the Audit Report

Wilson Lai [April 2004]

It is clear that auditors assume responsibility for the audit reports solely to the shareholders as a body. However, a recent court case in Scotland (*Royal Bank of Scotland v Bannerman Johnstone Maclay and Others [2003] PNLR 77*) highlighted the risk that a company's auditors could owe a duty of care to a lending bank if they knew or ought to have known that the bank would rely on their client's audited financial statements and they did not explicitly disclaim liability. While the judgment in this court decision might be overturned on appeal, the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales had issued guidance to assist auditors in managing the risk of advertently assuming a duty of care to third parties in relation to their audit reports.

Given that the establishment of liability under Hong Kong law has so far tended to follow the same route in law as the United Kingdom, the Hong Kong Society of Accountants ("HKSA") issued a technical bulletin in May 2003 for the same topic.

Having taken the advice from counsel, HKSA recommended in the Bulletin that auditors who seek to manage the risk of liability to third parties to adopt the following clarification wording in the statement of auditors' responsibility of the audit report:

"It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion solely to you, as a body, in accordance with section 141 of the Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report."

The above wording clarifies which the responsibilities of auditors under the Companies Ordinance will serve to disclaim liability to parties other than the shareholders as a body so as to attempt to reduce the scope of assumption of responsibilities to third parties.

The clarification wording does not mean that auditors will never agree to take on responsibilities to third parties. All it does is to make clear that auditors will only accept duties that are expressly agreed. If the third parties want to rely on their work, then they should approach auditors to agree expressly the scope and nature of work to meet their purposes.

In conclusion, it should be noted that the best risk management policy for auditors is to take up the necessary steps to carry out quality audits in accordance with the Statements of Auditing Standards issued by the HKSA with a view to produce audit reports that are independent, reliable and supported by adequate audit evidence.

Notes:

If the auditors wish to inform their clients of the clarification wording in the above way, they may include the following clarification language as paragraph 1.4 in the section "Responsibilities of directors and auditors" in the revised audit engagement letter:

> *" Our report will be made solely to your shareholders, as a body, in accordance with section 141 of the Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. "*