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# Outside audit ban seen as setback

***Ahead of Alibaba's huge US listing, Chinese regulator proposes a ban on international firms auditing the books of mainland IPO hopefuls***

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Beijing has imposed a surprise roadblock to financial reform by foreshadowing severe restrictions on international accountants, including those from Hong Kong, when auditing mainland companies listing overseas, increasing investor concern over whether their books are clean.

The proposals come at a time when the Alibaba Group is preparing to list in the United States, with investors keenly interested in the degree to which accounting firms have gone over the books of the mainland e-commerce giant.

Under the 10 new rules announced by the Ministry of Finance on its Chinese-language website last week, international accounting firms are barred from sending their staff to audit a mainland company. Instead, they are required to team up with local accounting firms so that the domestic partners' accountants will do the audit.

"This is moving the clock backwards. The proposals, if they are implemented, would cut down the transparency of the auditing process and erode the role of Hong Kong and other international accountants," Clement Chan, the president of the Hong Kong Institute of Certified Public Accountants, told the South China Morning Post.

"This would affect international investors' confidence because for the past 20 years Hong Kong and other international accountants have acted as a gatekeeper [for investors and the markets]."

In addition, the new rules reinforce the requirement that all accountants must strictly follow the country's secrecy laws and cannot pass on any information to overseas regulators or exchanges.

"The proposal(s) allow mainland companies listing overseas to be able to meet the listing rules of the markets they are going to list in while at the same time the international firms can work with the experienced domestic firms to do the audit. This would enhance the quality of the auditing standards of these mainland companies," the Ministry of Finance paper said.

In the US, mainland firms must hire auditing companies registered with the US Public Company Accounting Oversight Board and the Securities and Exchange Commission.

Mainland companies that plan to list in the US, such as Alibaba, would normally hire an international firm to audit their books. Under the new Ministry of Finance rules, however, the international accounting firm would need to team up with one of the 100 mainland accounting firms to conduct the audit.

Chan said the key issue was that the proposal did not let international firms decide if they could send staff to do the entire audit work themselves or verify that the job conducted by their mainland partner was done according to internationally accepted auditing standards.

Worse, international firms are required to sign off on the books so they are liable for any audit failures by the local auditing companies.

"This creates a big problem as the international firms would take the blame for any mistakes in the work of their mainland partners," Chan said.

He said the HKICPA would work with the Hong Kong government to raise these concerns with the Ministry of Finance, which is collecting views on the suggested rules until the end of this month. The ministry's published paper indicated the rules would be implemented this year.

The new rules would be a threat to the jobs of thousands of Hong Kong accountants as they may not be able to work on the mainland.

The rules would also ban the current practice where Hong Kong or international accounting firms could send their staff to do the audit under a temporary licence. The Ministry of Finance paper said these accountants should not be allowed to work on the mainland through temporary licences.

Hong Kong listing rules require all mainland-listed companies to hire Hong Kong-based accounting firms to do the audit for their initial public offerings as well as the annual audit. The exception would be H-share companies that can choose to prepare their financial statements under Chinese accounting standards and be audited by one of the firms nominated by the Ministry of Finance.

Stockbrokers said the rules came at a time when Beijing was worried that overseas regulators might force accountants or mainland firms to disclose government or company information in the name of checking their books. This is a concern as Alibaba and other mainland technology firms have compiled sensitive data on many companies and individuals in the country.

China's secrecy laws apply a wide definition on what is a considered a "state secret", and can range from accountants' working notes to student examination papers.

One example of such a conflict was when the Securities and Futures Commission started a legal battle with Ernst & Young in 2012 after the accounting firm said it had to follow mainland secrecy laws and refused to hand over working papers on water treatment firm Standard Water to help the SFC in an investigation. The Hong Kong court has not made a decision on the issue yet.

The proposals were aimed at clarifying the roles of mainland and international accounting firms, the Ministry of Finance said.

It added that in some cases investors blamed mainland accountants for mistakes which were instead made by the international firms.

Caption: Under new rules proposed, international firms would have to team up with a mainland partner to audit the books of Alibaba, which is seeking to list in the US. Photo: Reuters