



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

Consultation paper on

Proposed changes to auditing practices

(A revision to the consultation paper January 2009)

December 2009

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Background

1. In January 2009 a consultation paper was issued entitled "Proposed changes to the practising certificate regime." That paper drew a significant amount of responses and members were divided over some of the proposals, which they believed were controversial. The Institute has closely examined all responses received, including those received where the respondents could not be identified. Comments collected at forums were also included. We promised that no changes would be introduced without a full analysis of the comments and further consultation in respect of amended proposals. This consultation paper satisfies that promise.

The three most commented on proposals

2. There were three proposals which brought out the most comments and in some respects the three are linked and therefore it is proposed to deal with them together. The three proposals were to:
 - (i) extend the ordinarily resident requirement for practising certificate holders to include residence in mainland China and also to recognize auditing experience in mainland China;
 - (ii) require practising certificate holders to demonstrate recent audit experience for annual renewal of their practising certificate; and
 - (iii) require practising certificate holders to register a firm to provide audit services.
3. Auditing experience is the cornerstone for obtaining a practising certificate and in the past it has been assumed that this link between practising certificate and auditing is a continuing one. The consultation process has clarified that this is no longer a correct assumption. There is therefore a need to recognize that some practising certificate holders no longer carry out audits but practise in other areas of accounting, such as taxation, insolvency, forensic accounting, bookkeeping, secretarial and other advisory services. Insisting that these members demonstrate recent auditing experience to retain and renew their practising certificate is counter-intuitive to recognizing the significantly different role that our members in practice play today.
4. There is a need to assist our members who work in the mainland to retain their practising certificate, and to be able to apply for a practising certificate where they are working on Hong Kong related clients. We recognize that our previous proposal of recognizing all work in mainland China and recognizing ordinary residence in mainland China went beyond that principle.
5. As a result of the comments raised in the above proposals, the Institute has reconsidered its proposals and in so doing has re-established the principles behind the recommendations. Consequently, we have identified the following objectives:

Objectives

6. The objectives of any proposed changes should:
 - (a) improve the quality of auditors by ensuring that they possess relevant and up-to-date knowledge and experience for audits in Hong Kong.
 - (b) enhance the image of the audit profession by meeting the high quality work standards expected of us.
 - (c) enable Hong Kong practitioners who work in the mainland on Hong Kong-related engagements to retain their practising certificates, and qualified CPAs who work in the mainland on Hong Kong-related engagements either during or after their training, to obtain a practising certificate.

The revised proposals

Ordinary residence

7. The Institute is no longer proposing to extend the location of ordinary residence for practising certificate issuance to include mainland China.
8. Instead, it is proposed that Council shall deem people as ordinarily resident in Hong Kong for issuing a practising certificate if:
 - (a) they have been present in Hong Kong for not less than 180 days in the past 12 months prior to the date of their practising certificate application or renewal; or
 - (b) they have the right of abode in Hong Kong, i.e. they are permanent residents of Hong Kong.
9. This deeming provision would enable all practising certificate holders who are Hong Kong permanent residents to apply or renew their practising certificate wherever they reside, including the mainland. It would help Hong Kong practising certificate holders, professional staff and trainees of Hong Kong CPA firms who have relocated to the mainland or have spent more than 180 days in the mainland performing audit work on Hong Kong-related engagements to acquire or renew their practising certificates provided they are Hong Kong permanent residents.

10. The proposed deeming provision can be adopted by Council immediately without changing the law. However, it is also proposed that the Professional Accountants Ordinance be amended such that the residency requirement for practising certificate issuance shall be stipulated as defined by Council from time to time. It will give the Institute's Council the flexibility to redefine the residency requirement for practising certificate issuance as circumstances change.

Mainland auditing

11. The Institute is not proposing to grant general recognition to any audit experience gained in the mainland.

12. The Institute shall continue with the current practice of accepting auditing experience gained in the mainland for practising certificate issuance if, and only if, all the following conditions are met :

- (a) the mainland CPA practice is a branch or subsidiary of, or affiliated with, a CPA practice in Hong Kong;
- (b) the practising certificate applicant's work significantly relates to a Hong Kong engagement; and
- (c) the applicant is working under the direct supervision of a Hong Kong practising certificate holder.

13. These conditions are intended to ensure that, while addressing the need to recognize

experience gained by Hong Kong residents in the mainland, an equivalent standard to that acquired in Hong Kong is imposed so as to address a concern that non-relevant mainland auditing experience should not be recognized for practising certificate issuance.

14. The experience gained by employees of Hong Kong CPA firms who perform audit work in mainland China on Hong Kong engagements is already recognized as Hong Kong experience for practising certificate issuance under the current policy, and the policy will continue.

Recent auditing experience and registered firms

15. The two proposals requiring recent auditing experience for practising certificate renewal and registration of a firm or corporate practice to provide audit services are linked and therefore are reviewed together.

16. Currently, no recent experience requirement exists for applicants who wish to renew their practising certificates. During the consultation, it was noted that practising certificate holders providing professional service other than auditing would not be able to retain their certificates if audit experience was required as a condition of renewal.

17. On the other hand, to raise public trust in audit quality, it is necessary to introduce a stronger regime to ensure that those who are authorised to sign audit reports continue to possess relevant and up-to-date knowledge and experience for audits in Hong Kong.

18. The Institute is now proposing that:
- (i) practising certificate holders continue to be allowed to renew their practising certificate without meeting the recent auditing experience requirement; and
 - (ii) practising certificate holders may perform audits in their own name, a firm or corporate practice provided that such practice units are registered as a Registered Audit Practice.
19. It is proposed that a register of Registered Audit Practices be created with the following features:
- (a) A Registered Audit Practice may be an individual practising certificate holder, firm or corporate practice.
 - (b) Only those practice units on the register of Registered Audit Practices are eligible to perform audits and issue audit reports.
 - (c) The register will be available to the public and will identify the Registered Audit Practice name, and the names of all nominated Authorised Signatories.
20. To be eligible for registration as a Registered Audit Practice, a practice must meet the following requirements:
- (i) New “fit and proper” requirement for an audit practice (see para. 36 - 40);
 - (ii) Majority voting rights to be in the hands of practising certificate holders (see para. 61); and
 - (iii) Identify the individuals that the Registered Audit Practice has nominated as Authorised Signatories.
21. Authorised Signatories are individuals nominated by the Registered Audit Practice to sign audit reports on behalf of the Registered Audit Practice. All Authorised Signatories must be:
- (i) a practising certificate holder; and
 - (ii) competent to conduct audit work.
22. Assessment of competency will continue to be carried out as part of the Institute’s practice review programme. In addition to compliance with the Institute’s continuing professional development requirements, competency will be assessed by reference to recent experience in being responsible for significant judgments in an audit and the results of performance on audit engagements subject to review. The Institute intends to adopt the International Federation of Accountants International Education Standard 8, which sets out the competence requirements for audit professionals. The Institute will publish guidance on expected competency levels that will draw on International Education Standard 8 and other sources.
23. The revised proposal does not focus on firm or corporate registration for performing audits. As long as the registration requirements for Registered Audit Practices are met, a practising certificate holder practising in his own name can also become a Registered Audit Practice and provide auditing services.

24. In order to accommodate these changes, the Institute will restructure fees and levy a single Registered Audit Practice fee and adjust practising certificate fees.
25. During the transition until the register is established, all existing practice units performing audit services will be allowed to enter the register without first undergoing an assessment. From the date the register is published, Registered Audit Practices will be subject to ongoing eligibility assessments. New applicants after that date will be required to demonstrate that they satisfy the eligibility requirements for first registration as a Registered Audit Practice.
26. If an Authorised Signatory fails to meet the competency requirements, his name will be removed from the list of Authorised Signatories in the register of Registered Audit Practices. The order for removal of Authorised Signatory may come from the Practice Review Committee. In the event that all Authorised Signatories of a Registered Audit Practice are removed, this will mean automatic removal of the Registered Audit Practice from the register of Registered Audit Practices. There will be an appeal mechanism to Council and further appeal process to the Court similar to existing provisions for removal from the register.
27. If a Registered Audit Practice is found not to meet the fit and proper requirement, it will be referred to the Disciplinary Committee for potential removal from the register.
28. With this proposal to create a new Registered Audit Practice mechanism and move away from the requirement for firm or corporate practice registration, the Institute has decided to drop the original proposal of requiring practising certificate holders to file annual declarations to satisfy recent audit experience for practising certificate renewal. Practising certificate holders can continue to keep their practising certificates to provide non-audit related accountancy services without being a Registered Audit Practice.

Other proposals

Recent auditing experience for first issuance

29. The first consultation paper proposed to revise the recency of the one-year local auditing experience for first-time practising certificate applicants from within the previous three years to within the previous two years immediately before the date of application.
30. This proposal has received majority support. There are some opposing views from certain members who find the revised period too harsh and are concerned that practising certificate holders who have left a CPA practice two years ago to join the commercial field will not be able to immediately form a registered audit practice if they wish to return to the auditing field. These members argued that they should be able to continue to maintain their auditing competency by taking continuing professional development courses and other self study activities.
31. In this revised consultation paper we suggest retaining the original proposal to revise the period to one year out of the previous two years. Practising certificate holders with a lapse in their audit experience will be able to retain their practising certificate under these proposals to provide non-audit professional services. They can obtain their one-year audit experience before returning to become an Authorised Signatory for a Registered Audit Practice. In assessing the competency

of an Authorised Signatory for a Registered Audit Practice, regard will be had to technical skills, experience and responsibility and the support and control mechanisms of the Registered Audit Practice. Competence will be demonstrated by performance of an assigned role in accordance with professional standards.

Confirmation of experience in testimonial for first issuance

32. In the consultation paper, it was proposed that the testimonial submitted by the employer audit practice in support of a first-time practising certificate application must also confirm that the experience gained by the applicants demonstrates that they have had responsibility or have been delegated responsibility for making significant judgements in an audit.
33. As this proposal has received majority support, it is proposed that it be adopted.

Four-year auditing experience for first issuance

34. The Institute proposed not to change the current requirement of four years auditing experience (including one-year post-qualifying experience) or two and a half-year post-qualified audit experience for first practising certificate issuance.
35. As the current requirement has received majority support, no change is proposed.

“Fit and proper” requirement for first issuance

36. The original proposal was that a requirement should be added to the Professional Accountants Ordinance to require applicants for first practising certificate issuance to be fit and proper to act as an auditor.
37. This proposal has received majority support. However, some respondents have pointed out that if the fit and proper requirement for practising certificate issuance is the same as that for membership, a further declaration for a practising certificate should not be necessary.
38. The Institute is of the view that auditors have a public interest role to play, and Registered Audit Practices should be subject to a set of fit and proper criteria to meet public expectation.
39. As the Institute is proposing to create a Registered Audit Practice mechanism for performing statutory audits, it will issue a set of fit and proper criteria for these practices. The criteria will be based on those used in the United Kingdom for audit firms eligible for registration as Registered Audit Practices.
40. We have therefore dropped the original proposal to require a new fit and proper declaration from practising certificate holders for first registration. A questionnaire listing out the fit and proper criteria will be included in the application form for registration of a Registered Audit Practice.

Annual practising certificate renewal

41. The Institute should move away from the current process of requiring an annual re-application for a practising certificate to a simpler annual renewal process.
42. As this proposal has received majority support, it is proposed that it be adopted.

Fit and proper requirement for practising certificate renewal

43. It was suggested that the Professional Accountants Ordinance should be amended to make fit and proper a requirement for practising certificate renewal and in addition, ask practising certificate holders to declare that they have not been convicted in Hong Kong or overseas of a criminal offence or found guilty of professional misconduct by a professional or regulatory body in the previous year.
44. This proposal has received majority support. However, as the Institute is now proposing to introduce an appropriate set of fit and proper criteria for first registration as Registered Audit Practice (see para. 39 - 40), the original proposal to require practising certificate holders to meet the fit and proper requirement for practising certificate renewal is no longer required. The Institute would bring in a requirement in the annual practice review questionnaire for Registered Audit Practices to declare that there was no change in circumstances that would affect their compliance with the fit and proper criteria.

Declaration of commencement of practice for practising certificate renewal

45. The Institute proposed to remove the current requirement for practising certificate holders to declare their commencement of practice for annual renewal purpose.
46. As this has received majority support, it is proposed that it be adopted. With the introduction of the Registered Audit Practice mechanism for performing audits, the requirement for annual declaration for commencement of practice by individual practising certificate holders is no longer needed.

Former practising certificate holders obtaining a practising certificate

47. The original proposal was to maintain the current practice that any former practising certificate holder who has ceased practice, or whose practising certificate has not been renewed or has been cancelled, or whose membership has been removed, will need to re-apply for a practising certificate, in the same manner as a first time applicant.
48. The proposal has received majority support. However, there are some dissenting views which opine that only former practising certificate holders who have been disqualified by a disciplinary order should be required to re-apply as first-time applicants; others (for example, those whose practising certificates have lapsed) should not be required to meet the one-year recent local

auditing experience requirement on re-application for a practising certificate.

49. Given that under the revised proposals, a practising certificate holder can perform audits only by registering as a Registered Audit Practice, the original proposal should be revised. The Institute now proposes that any former practising certificate holder who has ceased practice, or whose practising certificate has not been renewed or has been cancelled, or whose membership has been removed, will need to re-apply for a practising certificate. For those who did not carry out audit and do not intend to perform audit work, they will not be required to meet the one-year recent local auditing experience requirement on re-application for a practising certificate. For those who will be Authorised Signatories in a Registered Audit Practice, re-application with the one-year recent local auditing experience requirement is still required unless there are extenuating circumstances in which case the Institute's Registration and Practising Committee will have the discretion to waive or modify the re-application requirement.

Re-application for practising certificate cancelled by disciplinary order

50. Individuals whose practising certificate was cancelled pursuant to a disciplinary order should be eligible to re-apply only after the expiry of the membership removal or practising certificate cancellation period stated in the disciplinary order.

51. As this has received majority support, it is proposed that it be adopted.

Attaching conditions to a practising certificate

52. For members whose practising certificate has been cancelled due to a disciplinary order, it was proposed that the Council should be empowered to attach conditions to their practising certificate restricting their practice as appropriate when the members re-apply.
53. This proposal has not received majority support. Those who oppose the proposal are mainly concerned about the nature of conditions imposed by the Council. Some respondents suggested that any conditions should already be specified in the disciplinary order.
54. The original proposal was intended to help those former practising certificate holders reintegrate into the practice of auditing. They may have been disciplined for a certain audit irregularity, and should be subject to a practice review or practise under supervision for a period of time before they are allowed to fully resume practise. In the light of the commentaries, the Institute is now proposing to revise the proposal to empower the Disciplinary Committee to include the conditions in the disciplinary order and Council to attach conditions where they are related directly to the disciplinary offence.
55. For example, if one of the member practice partners has been disciplined for his or her conduct in the audit of a company in

a regulated industry such as insurance or securities brokerage, the disciplinary order may specify that upon re-issuance of a practising certificate, the partner may not perform audits in the regulated industry until he or she has completed certain continuing professional development hours in related areas.

Identifying engagement partner in the audit report

56. A question was put in the original consultation to gauge the views of members and stakeholders about whether the requirement for a corporate practice to identify the director responsible for an audit engagement in the engagement letter and the audit report should be extended to firms, i.e. whether a firm should be required to identify the engagement partner in the engagement letter and the audit report.
57. The majority of the respondents have replied in the affirmative. Those who disagree are of the view that since all partners in a firm are jointly and severally liable for the acts of the firm, identification of the engagement partner may cause confusion to the readers and users of the audit report.
58. The Joint Government and Hong Kong Institute of CPAs Working Group to Review the Accounting and Auditing Provisions of the Companies Ordinance has discussed the proposal to require a firm to identify the engagement partner in the audit report and decided not to make

any change in the Companies Ordinance. Accordingly, the Institute does not propose to adopt the change.

Ratio of practising certificate holders as partners or directors

59. It was proposed in the consultation paper that consideration should be given to relax the current ratio of practising certificate-holder partner / director and non-practising certificate holder partner / director of a CPA firm or corporate practice from 2 : 1 to 51% : 49%.
60. This proposal has received majority support. However, some respondents pointed out that the key issue is to ascertain which individuals or groups of individuals control and determine the direction, culture and ethical standards of the CPA practice. The assessment based on the number of partners alone may not be indicative of control.
61. In the light of the commentaries, the Institute has looked at the requirements in Australia, the UK and the United States. These jurisdictions all require a majority of the voting rights in a firm to be held by individuals who have an audit licence or qualification. To bring the requirement in Hong Kong in line with these overseas jurisdictions, the Institute proposes that a majority of the voting rights in a registered audit practice be held by practising certificate holders. The firm or corporate practice will no longer be required to meet the proposed 51/49 percent ratio in number

of practising certificate-holder partner or director and non-practising certificate holder partner or director.

62. Currently, it is a statutory requirement that all partners or directors of a firm or corporate practice must be CPAs, of whom a proportion prescribed by Council must be practising certificate holders. There will be no change to this principle and in the future, all partners or directors of a Registered Audit Practice must be CPAs.

Appointment of authorised signatories by practices

63. The Institute proposed that firms and corporate practices should be allowed to appoint authorised signatories who are full-time practising certificate holder employees of the practice to sign audit reports on behalf of the practice. It was also proposed that sole proprietorship firms and sole-practising member corporate practices should be allowed to appoint no more than one non-employee practising certificate holder as its authorised signatory.
64. The proposal has received majority support. However, some respondents have expressed concerns that this might enable some partners to escape their professional liability, and make it more difficult to maintain ethical standards.
65. To clarify, the appointment of authorised signatories who are not necessarily employees is already allowed among CPA

firms and sole practising member corporate practices. The proposal will tighten up the policy by restricting the appointment of any number of authorised signatories to practising certificate-holder employees of the firm only. Practice reviews would ensure that the audit signed by an authorised signatory is conducted properly as the employees are under a system of quality control and procedures of the firm, which is subject to practice review.

66. The proposal extends the appointment of authorised signatories to multi-practising corporate practices and aligns the policy for firms and corporate practices. As in the case of a firm, by requiring authorised signatories to be employees, quality is enhanced as signatories will be subject to the corporate practice's quality control system and external monitoring under the Institute's practice review.
67. Under the proposal, sole proprietorship firms and sole proprietorship corporate practices may appoint any number of practising certificate holder employees of the practice and no more than one non-employee practising certificate holder as its authorised signatory. This would address the occasionally difficult circumstances when the sole proprietor is away from Hong Kong but needs to issue an audit report.
68. Accordingly, it is proposed that the original proposal be adopted.

Consultation process

69. Council is keen to hear the views of the Institute's stakeholders on the revised proposals outlined in this consultation paper. While the revised proposals represent the considered view of the Registration and Practising Committee, endorsed by Council, they are presented to elicit comments from practising certificate holders, CPA firms and corporate practices as well as other stakeholders and interested parties. Some proposals will require amendments to the Professional Accountants Ordinance.
70. Comments on the proposals should be made in writing on or before 1 March 2010 by email to admission@hkcipa.org.hk or by post addressed to:

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