



Grant Thornton

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Our ref: DL/CS/Office

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Dear Mr. Ding

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Regulatory Framework for Listed Company Audits

Grant Thornton Hong Kong Limited welcomes the opportunity to respond on the above named Information Paper and Request for Comment issued by the Institute. We support the efforts of the Institute, the Government and the Financial Reporting Council to improve the regulatory framework and to have an independent oversight body ("IOB") to exercise oversight over or assume direct responsibility for certain auditor regulation functions on public interest entities ("PIEs") so that the regulatory system in Hong Kong meets international benchmarks for regulation of listed company auditors.

We agree that the eligibility in membership of International Forum of Independent Audit Regulators ("IFIAR") is an appropriate international benchmark.

Overall, we also believe there is no need to remove the statutory powers of the Institute under the existing Professional Accountants Ordinance ("PAO") if not strictly necessary. The proposed IOB should directly assign those responsibilities that are currently managed by the Institute whenever appropriate back to the Institute. The Institute has been performing extremely well and professionally in executing its statutory powers under the PAO. Therefore we consider rather than having a separate IOB to take over the current responsibilities of the Institute, it is more desirable to have the IOB to simply monitor the performance and execution of the regulatory functions by the Institute.

We also consider that to have a successful regulatory reform with support from all our members, liability reform should be developed at the same time. The industry has long demanded for certain liability reform such as limited liability partnership and proportionate liability. While we agree regulatory reform is necessary, there is no justification for the practitioners to bear more regulatory risks such as the excessive pecuniary penalty mentioned below without corresponding liability reforms which most of our counterparts in the world have already enjoying.

In addition to our comments on the broad principles of the reform as set out above, the following are our comments on the six key regulatory functions under the proposed framework.



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Registration

We agree with the Institute's view that it should continue to be responsible for the registration matters with appropriate oversight by the IOB.

However,

- 1) it is not clear how the proposed framework would deal with the situations where *the individual who take responsibility for engagement quality control reviews* and *the individual who is ultimately responsible for the firm's system of audit quality control* are not members of the Institute (eg applying "fit and proper" test upon renewal) or even not a member of any professional accountancy bodies;
- 2) we suggest that *the individual who is ultimately responsible for the firm's system of audit quality control* should be nominated by the firm rather than as simply naming the managing partner (or equivalent) as such individual, given the structure of quality control of each firm is different;
- 3) it is not clear the reasons behind the requirements of registering "relevant individuals" in addition to the firm itself if there would not be any material change to the existing registration/renewal criteria. It is also not clear why the non-Hong Kong firm is not required to register such individuals;
- 4) it is not clear about the approval process and criteria of the IOB to recognise any non-Hong Kong firm currently not yet recognised by the Hong Kong Stock Exchange ("HKEx"). The proposed framework only mentions the basic qualifying requirements as set out in paragraph 9(b). We are extremely concerned as this will affect the interests of all local Hong Kong firms who are engaged in auditing companies listed on the HKEx;
- 5) in addition to 4) above, the arrangement of any changes on the *Convergence Scheme with Mainland on recognition of Mainland audit firms as auditor of H-share companies* is unclear such as where there is any new addition of Mainland audit firms to the Convergence Scheme – what would be the criteria? Also, application for registration from any Mainland audit firms not currently on the Convergence Scheme will be considered under the criteria and terms of the Convergence Scheme or under the criteria of other non-Hong Kong firm? Again, this will have significant impacts on all local Hong Kong firms who are engaged in auditing companies listed on the HKEx; and
- 6) we have concern over the paragraph 8(c) and its related note on the so-called "better position" and "additional information about the applicant". We believe these factors are unfair to the Hong Kong PIE audit firms. As long as the Hong Kong PIE audit firms satisfy the registration/renewal criteria, the IOB should allow the registration/renewal unless it has imposed any sanctions regarding registration/renewal on the Hong Kong PIE firms previously. Any investigation, whether private or have been known to public, do not prove any wrong doings until it is concluded. It is not justifiable for the IOB to simply disallow the registration/renewal without any valid reasons other than the so-called "better position" and "additional information about the applicant" and leave the burden to the applicant to appeal against the decision.

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Inspection

We agree that the IOB can delegate the functions of PIE inspection to the Institute under the directions of the IOB. However we also believe the framework should also set out a mechanism of inspecting non-Hong Kong firms.

Investigation

We agree that the IOB should be responsible for the investigation in respect of potential irregularities in respect of PIE auditors with respect to their PIE assurance engagements. We also emphasise that any investigation should involve practitioners with up to date audit experience and knowledge.

Enforcement / discipline and appeal mechanism

We believe there should be clear separation of responsibility between the inspection and investigation and subsequent disciplinary action. Clear guidance should be developed on the sanctioning procedures. We are also of the opinion that the firms should have unrestricted right to appeal to the Court of Appeal instead of those suggested by paragraph 17(f) of the proposed framework.

We agree with the Institute's view that the Option B is the preferred option and also the fourth option proposed by the Institute of which a disciplinary action may be resolved by the IOB offering with the auditor accepting a sanction. Despite the Option B is a preferred option, we believe the disciplinary committee should comprise practitioners with up to date audit experience and knowledge. "Non-practitioner with knowledge of the auditing profession" may not have direct or updated practising experience and it is doubtful if they truly understand complicated situations or where significant audit judgements are involved.

We are not supportive of the proposed pecuniary penalty which is the greater of HK\$10,000,000 or three times of the profit gained or loss avoided. The pecuniary penalty of HK\$10,000,000 is excessive when compared to the audit fees, in particular for mid-tier and smaller firms. This clearly creates a favour to the big firms and has a negative impact on market competition. Also, the pecuniary penalty is not insurable.

Standard setting

We agree with the Institute's view that this function should be carried out by the Institute under direct assignment by law.

Continuing education

We agree with the Institute's view that this function should be carried out by the Institute under direct assignment by law.

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Finally, we emphasise our above comments are on the proposed framework only. Once the details of reforms such as rules and procedures are released, we believe these should be subject to further comments by the professions and the industry and are subject to changes.

If you have any questions on our response, or wish us to amplify our comments, please do not hesitate to contact us.

Yours sincerely

Daniel Lin
Managing Partner

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