

January 3, 2014

Mr. Raphael Ding  
Chief Executive & Registrar  
Hong Kong Institute of Certified Public Accountants  
37<sup>th</sup> Floor  
Wu Chung House  
213 Queen's Road East  
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Hong Kong

Dear Mr. Ding

**RE: Regulatory Framework for Listed Company Audits**

We refer to your letter of October 8, 2013 and are pleased to set out below our comments on the Information Paper and Request for Comment ("Information Paper") relating to the regulatory framework for listed company audits in Hong Kong ("the Reform").

A. Introduction

We take note that the overall aim of the Reform is to establish an independent body to exercise oversight over or assume direct responsibility for certain auditor regulation functions so that the Hong Kong system meets international benchmarks.

Whilst regulation of listed company auditors is important, it, nevertheless, is only a part of an overall system of regulation of the Hong Kong capital market. In so doing, the Reform must be relevant and appropriate in the Hong Kong context.

It is also important that the existing standing and reputation of Hong Kong audit profession shall be maintained following the Reform.

B. Specific Comments

We set out below our specific comments on the Information Paper and the Draft Proposed Framework.

1. IFIAR versus EC

We agree that in order for Hong Kong to maintain its status as an important and trusted international capital market, appropriate reform on its audit regulation is inevitable. The Reform, however, needs to be relevant and appropriate in the Hong Kong context.

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Given that the number of EU listed clients audited by Hong Kong audit firms is relatively few and the fact that audit firms can still provide such services to those clients, subject to registration requirements and potentially direct inspection, we see no compelling reasons for Hong Kong to opt for EC equivalence.

We believe that membership of IFIAR will provide real opportunities for Hong Kong to participate in and influence the international development of auditor regulation as well as enhancing the reputation and standing of Hong Kong as an international capital market.

## 2. Registration

We agree that the HKICPA should continue to be responsible for Registration of members and member firms, while subject to appropriate oversight by an independent body.

We also agree that since the “fit and proper” criteria has to be met for admission to membership for the HKICPA, there is no need to introduce additional registration criteria.

We are concerned that certain non-Hong Kong audit firms are allowed to provide audit services for listed companies in Hong Kong without having to be registered with the HKICPA, which are also not subject to the same regulatory system as Hong Kong audit firms. Such non-level playing field arrangement should be reviewed and addressed to during the Reform.

## 3. Inspection

We agree with the framework proposal in this regard.

Nonetheless, the inspection of non-Hong Kong audit firms should be reviewed and addressed to during the Reform.

## 4. Investigation

We have no specific comments in this regard as there is no change from the current arrangement.

## 5. Enforcement/Discipline

We agree in principle with the framework proposal whereby the independent body shall have the ability to take effective action to address misconduct.

However, we are concerned if the independent body is to act as investigator, prosecutor as well as the judge. There needs to be proper checks and balances amongst these functions. The fundamental principle of natural justice and fairness must be upheld.

In this regard, we support the HKICPA's view under Option B, whereby those responsible for investigation and inspection should not be responsible for sanctioning.

We are also concerned with the proposed monetary sanction of three times profit or loss, or HK\$10 million, whichever is greater. The level of the monetary fine is disproportionately heavy and would have detrimental impact for all Hong Kong audit firms, save, perhaps, for the Big 4.

Whilst we take note that in determining this monetary fine reference has been made to other Hong Kong regulators such as SFC and HKMA, one needs to bear in mind that these monetary penalties are imposed on regulatees who are directly involved in or committed the culpable acts, whereas the auditor's role is primarily to express an opinion on the financial statements prepared by the management of the company. As such, this heavy monetary penalty is definitely not a fair reflection of the culpability of the role of the auditor.

Further, such heavy punitive penalty would surely drive away capable smaller audit firms away from the market for listed company audits which thus affect the healthy development of the audit profession in Hong Kong as a whole.

We support the HKICPA's view that where a fine is to be imposed, it should be proportionate and reasonable in relation to the audit failing and should take into account relevant factors and there should be a reasonable absolute monetary cap.

We also support that an independent tribunal or disciplinary committee should be set up to consider the sanctions. The said tribunal or disciplinary committee should comprise at least five (5) members including the Chairman and of which two (2) must be experienced auditors or accountants.

Whilst we appreciate the need to maintain independence and to avoid conflict of interests, it is also essential that the independent tribunal or disciplinary committee members have appropriate level of knowledge of professional standards and practice of the auditing industry. Regulation of auditors, including the enforcement regime, should take note that auditing standards are principles and not rules based and that the audit process requires significant exercise of judgement by the auditor.

#### 6. Continuing Professional Development

We agree that the HKICPA should continue to exercise this function, while subject to appropriate oversight of an independent body.

#### 7. Standard Setting

We agree that the HKICPA should continue its role as standard setter in Hong Kong, while subject to appropriate oversight by an independent body.

One also needs to note that apart from listed company audits there are statutory audit requirements for private limited companies incorporated under the Hong Kong Companies Ordinance. Hence, it is more appropriate for the HKICPA, which has the experience and capability, to take full responsibility for setting standards for auditing.

Further, as Hong Kong has fully converged with International Standards since 2005, and as such, these international standard setters are already subject to oversight at the international level.

8. Funding

We agree that the funding of the independent body should be borne by the listed companies and investors as the independent body will be concerned solely with audits and financial statements of listed companies.

C. Other Comments

One should take the opportunity of the Reform to revisit the Professional Liability Reform. The constant threat of litigations and the recent catastrophic claims made against auditors as well as the criminal sanction under Section 408 of the new Companies Ordinance have no doubt had detrimental impact on the sustainability of the audit profession. Young and capable auditors are now becoming more reluctant to join and/or stay with the audit profession. This would in the long term affect the healthy development of the audit profession in Hong Kong.

D. Conclusion

All in all, we are in supportive of the views of the Council of the HKICPA on the proposed framework of key reform proposals as set out in the Information Paper issued on October 8, 2013.

Should you require any further information or clarification, please let us know.

Yours faithfully



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Managing Partner