Our ref.: H140 - 02

Date: 17 January 2014

Mr. Raphael Ding
Chief Executive and Registrar
Hong Kong Institute of Certified Public Accountants
37 Floor, Wu Chung House
213 Queen's Road East
Hong Kong

Dear Mr. Ding

Re: Regulatory Framework for Listed Company Audits

We thank you for your recent visit to our firm explaining in great depth about the draft proposed framework for independent regulation of listed company auditors, and the HKICPA's information paper and request for comment. We are pleased to provide our response and views as follows:

General Comments

We welcome the joint efforts of the HKICPA, the Financial Reporting Council and the Hong Kong SAR Government in driving the reform of the regulatory framework for listed company audits that will meet international standards benchmarks whilst being appropriate in the local context. We support the Institute's view that membership of IFIAR would provide benefits for Hong Kong to participate in and influence the international development of audit regulation. However, as the Hong Kong audit profession is serving Hong Kong being the world's third largest capital market powered by the world's largest and most rapidly growing China economy in the ensuring decades, we cast doubt whether attaining the benefits of EC equivalence would provide practical advantages to Hong Kong "in the local context" as stated under the Key Principles of the "Draft Proposed Framework for Independent Regulation of Listed Company Auditors".

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Specific Comments

Broad principles

We agree that in attaining the IFIAR membership requirements, the functions carried out by HKICPA will be subject to oversight by the independent oversight body (IOB). The designated authority for HKICPA should be assigned directly by law so that its performance is accountable to the public and stakeholders.

Registration

We support the HKICPA's position that it shall continue to be statutorily responsible for the registration of members and member firms subject to appropriate oversight by the IOB. We consider that under the current membership admission procedures, the "fit and proper" criteria stipulated by the HKICPA is well established and effective and we do not see the need for any form of proposed changes to pre-empt the mode of such exercise.

The reform framework should, however, look into the current arrangement allowing certain non-Hong Kong based audit firms to provide audit services to companies listed in the Hong Kong market. These firms are not subject to the Hong Kong regulation therefore leaving the Hong Kong home-grown firms operating in a non-level playing field.

Inspection

We agree that the IOB should have the direct authority to inspect Hong Kong auditors of Hong Kong listed companies. The non-Hong Kong based audit firms should be subject to the equal inspection obligation under the reform framework.

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Investigation

We have no comments to the investigation arrangement as there is no change to the current arrangement.

Enforcement/discipline

For any form of enforcement and disciplinary proceedings, the fundamental principle of natural justice and fairness must be upheld. While we agree to the framework proposal that the IOB will need to have the ability to take effective action to address misconduct, we are concerned with the proposed mechanism for the IOB to play the role as investigator, prosecutor and a judge under one roof for swift justice at the expense of proper check and balance.

We would support the HKICPA's view that option (b) can provide the necessary check and balance by separating the functions of disciplinary from inspection and investigation. We also support the HKICPA's proposal for the fourth option allowing a matter to be resolved swiftly for sanctioning with mutual consent of both parties without proceeding to a formal disciplinary hearing.

We object to the proposed monetary sanction of three times profit or loss up to a cap of HK$10 million. We consider that the rest of the provisions under clause 18 of the draft proposed framework have adequately served the public interest in dealing with disciplinary cases. If this monetary sanction is intended to be a punitive measure to top up the reputation damage and potential civil action, it should be proportionate to the degree of audit failing and determined by a range of factors including the firm's financial resources. We agree that an absolute monetary cap should be imposed and this sanction should be reasonable not to wipe out the financial resources of the firm in question.

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Continuing Professional Development (CPD)

We agree to the proposal for HKICPA to continue with the design and structuring of CPD programmes catering members' professional needs and oversight by the IOB. Such function should be assigned directly by law.

Standard Setting

We agree to the proposal for HKICPA to continue its role as standard setter in Hong Kong subject to oversight by the IOB. HKICPA has a long history in contributing to the international standard setting networks and Hong Kong has already converged with international standards promulgated by the IASB, IAASB and IESBA since 2005. These standard setters are already subject to oversight at the international level.

Funding

We concur with the HKICPA's position that the IOB's objective is to regulate the audits and financial statements of listed companies. It would be reasonable that the future operations of the IOB be funded primarily by listed companies. This also echo the proposed funding arrangements described under paragraphs 27 to 29 of the draft proposed framework.

Other comments

As the proposed changes refresh the intention of imposing heftier penalty on audit failings, coupled with the constant threat of litigation against auditors and the criminal sanction under Section 408 of the new Companies Ordinance, this has casted a giant shadow on the sustainability of the audit profession. Furthermore, it is disappointed that the Professional Liability Reform which would at least aim at providing a minimum protection package for the audit profession is not progressing by the government. It would be unfair for the existing practitioners to accept such a reform framework on a piecemeal basis.

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Concluding remarks

It is disappointed that the draft proposed framework is presented focused only on reconstituting the statutory duties of the regulating bodies of the Hong Kong audit profession without a global consideration of mapping such a change towards the future development of the Hong Kong capital market, which is now primarily dominated by PRC major issuers. The draft proposal had also failed to provide due consideration of maintaining a level playing field for the Hong Kong audit firms in the event that the IFIAR membership is being obtained despite its key principles are set out for such a change "being appropriate in the local context".

Yours faithfully
For and on behalf of
Pan-China (H.K.) CPA Limited

Patrick Ng
Managing Director

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