

17 January 2014

By email <[regulation@hki CPA.org.hk](mailto:regulation@hki CPA.org.hk)>

Mr. Raphael Ding  
Chief Executive and Registrar  
37/F. Wu Chung House  
213 Queen's Road East  
Wanchai  
Hong Kong

Dear Mr. Ding,

I am writing in response to your Institute's survey and information paper dated 8 October 2013 regarding the Regulatory Framework for Listed Company Audits proposed by the HKSAR government and the respective points raised by HKICPA on the preferred outcome.

I would like to share with you my thoughts and comments below:

- 1) I agree with the HKICPA's view that IFIAR membership is good to enhance Hong Kong auditing profession. Nevertheless, I see this may not be an efficient way to increase the quality of listed companies' audits and the advantages of EC equivalence may not be availed of in Hong Kong environment. The extent of regulatory reform in Hong Kong proposed by the government is considered far beyond the necessity as viewed by our profession.

At present, the function of HKICPA is effective and it is already carrying out its related disciplinary actions for any non-compliance or audit irregularities of CPA firms registered with HKICPA. I believe the proposed change is triggered by the worldwide noise of the audit failures in other established economic entities' listed companies such as USA, UK and Europe together with recent years' scandals of audit failures in Chinese based entities as well as the Fortune 500 companies which are either listed in USA, UK, Singapore and Hong Kong. However, the significance and occurrence rate of these audit failures in HK in terms of monetary and numbers are still low as compared with that in USA, UK, Europe and Singapore. I believe that the overall objective of the reform is limited to establish Independent Oversight Body (IOB) to carry out oversight power on the listed companies' audits as HK has increasing number of Chinese-based listed companies in order that Hong Kong can meet the IFIAR benchmarks for independent regulation of listed companies' auditors. Consequently, I agree that the new independent oversight body (IOB) should have an oversight role and work together with HKICPA to enhance our local listed companies' quality. However, the proposed regime of take over responsibilities from HKICPA is too much which will defeat this purpose while creating a confusion to public investors who is the actual authority governing the profession.

I believe the FRC current system remains effective though some suggestions can be made in selected areas of the current proposal. Because most of the audit failure cases in HK are due to failure of Corporate Governance and not auditors' negligence.

2) Since the current regulatory function of the listed companies' audits in H-Shares by those 12 licensed and authorized PRC audit firms in Mainland China is not fallen into the hands of HKICPA and the licensing regime of Hong Kong Stock Exchange (HKEX) is not subject to any review by HKICPA, my concern is whether the current system can provide adequate protection for investors in these cases if there are negligent, wrongdoing or found misstatements in these financial statements as audited by the 12 PRC audit firms. The investors are still not protected anyway.

3) General principles of reform and exercise of oversight

I agree with HKICPA's view no evidence to indicate HKICPA is not meeting public interest in its standard setting or public expectation. The removal of statutory responsibilities from HKICPA under PAO is not necessary. Nevertheless, we should propose an option of oversight by IOB of HKICPA responsibilities so as to secure Hong Kong's membership in IFIAR.

4) Registration

I agree with HKICPA shall remain responsible for registration of members and member firms. It is because the responsibilities should be derived from direct assignment in law and not delegated from the IOB.

The "fit and proper" test needs to be clearly defined. I agree that it should be the same as current practice as used by HKICPA for admission to membership and should not be used to introduce additional competency.

However, in respect of the register of "person who is in charge of the firm's quality control system", it is unfair to the relevant person by imposing him/her the liability as a result of non-compliance from a single audit engagement because different firms have different structure. Specific guidance on the scope of him/her responsibilities over the listed engagements and his/her consequences should be considered and provided before requiring to name such person in the register. In addition, the effectiveness of system of quality control of a CPA firm depends very much on the execution by each individual and their cooperation. Hence, the responsibility of this effectiveness should rest with the firm instead of any individual within a firm.

I also need to point out that the issues about the registration or regulation of Mainland and non-HK auditors of listed companies in HK should be properly and carefully considered, especially in terms of ethical standards. As most troubles came from PRC based Auditors (as indicated by the weakness, no ethics and audit failures of most A Shares), safeguarding the interests of Hong Kong auditors and promoting healthy development of the profession in the long term should be prioritized.

5) Inspection and investigation

I agree with HKICPA's position on inspection. For investigation aspect, there is no change from current position and I have no further comments.

## 6) Discipline and sanctions

I am very concerned with the proposed disciplinary mechanism. Upon due care consideration, I support option B of HKICPA's view. It is because it provides the necessary balance between discipline, inspection and investigation.

I agree that the disciplinary committee should be completely independent of the inspection and investigation body. However, we need to carefully determine the mechanism of its composition mix and member election. Hence, I also agree with HKICPA's view of giving a clear guidance on sanctioning procedures and application. That is, all sanctions should be proportionate and reasonable, being taken as a punitive action instead of a destructive purpose. I do not supportive to the proposed monetary sanctions of 3 times profit or loss, or HK\$10 million, whichever is the higher. Why it is not the "lower" instead of "higher"? Moreover, how to determine the so-called "profit" or "loss" concerned and which party should have the burden of proof at the end of the day?

My view is that a proposed cap of liability should be in place (similar to CPA in Australia regime), say HK\$5 million or below (versus currently HK\$500,000 under HKICPA rules, representing 10 times current amount) as most firms will be affordable on this level. As auditors will also face civil claims under civil laws with no stipulated cap under common laws for his/her wrongdoing under current HK laws, a cap as mentioned above is preferable and more reasonable. Alternatively, a proportionate liability cap is also acceptable with a more reasonable calculation mechanism.

It is because this will pose a threat to the continued survival and existence of many mid-tier and smaller CPA firms in HK as they are not decent enough to pay the heavy penalties versus the International Big Fours which has a greater support from international fund pooling and greater insurance indemnity. Based on my assessment, Mid-tiers and moderate smaller firms surely cannot afford this HK\$10 million price and these risks are not insurable in HK. This will surely reduce or slow down the number of enthusiastic practicing new junior partners/directors and new blood from the industry for a worth-of-doing professional career. The effect will be resulted in an environment of against the present rules of increasing "competition to avoid monopoly" slogan of the respective governments concerned.

As an auditor, our role is to express audit opinion based on our findings and perhaps act as a watchdog. We do not commit wrongdoing. For instance, if a postman delivers an ordinary mail into the mail box of the addressee but somehow the letter posted was lost and cannot be received by the right person, should he/she be punished on not finding the thief or reason behind? In all, auditors should not bear unreasonable and unacceptable high penalty as proposed by this excessive amount.

7) Limited insurance indemnity service providers in HK

As you may know, only one insurance company will be willing to undertake our professional indemnity insurance in HK, I need to suggest that government should make efforts to encourage more insurance companies eligible to provide us the necessary professional indemnity insurance in HK so as to allow our audit practices having a number of choices of insurance providers for protection.

8) Standard Setting

I agree with HKICPA's position that it should continue in its role as the standard setter in Hong Kong because the new IOB will not be able to recruit those with capable talent professions to handle and with proper industry experience to deal with the numerous member and public cases as well as the fast changes in accounting standards regime which may affect the whole business environment and practicability used in the SME and listed companies in HK.

9) Continuing professional development

I support the HKICPA's role of setting and monitoring with requisite CPD standards and requirements for its members.

10) Funding

I support the HKICPA's suggestion on the future operations of the independent body should be funded mainly by listed companies and investors. It is because they are the biggest and potential extra-profit and money chasers from the capital market.

Should you require any clarification, I am pleased to discuss any of the above points with you in detail. Wish you every success in the rest of the consultation process and fight for the best interests of our members in the professional body.

Yours sincerely,

(Anonymous)