



Our Ref.: C/CMP M83873

(By email and by hand to the Legislative Council)

(English version)

Dear

Representatives of the Hong Kong Institute of CPAs and the accounting profession met legislators from different parties over the past week, to explain the very serious concerns of the accounting profession in relation to clause 399 of the Companies Bill (Appendix 1) and the committee stage amendments ("CSA") to the clause proposed by the Administration (Appendix 2).

Many of the legislators that we met understood our position and recognised that the Institute has valid concerns that ought to be addressed by the Administration. We were advised to provide a letter to the Administration, which legislators who sympathise with our concerns can sign to support the call for appropriate changes to be made to clause 399.

### **Far-reaching problems with clause 399**

We believe that the implications of this clause, if passed, will be far reaching and extend beyond the accounting profession. It will set a very dangerous precedent for all professionals who need to exercise judgment in different circumstances and situations. We explained that the clause will potentially impose a criminal sanction in relation to the actions of an auditor in circumstances involving a high degree of professional judgment, where, with the benefit of hindsight, that judgment proves to be mistaken.

The CSA will further aggravate the harm by extending the scope of potential liability to include fairly junior managerial staff, in addition to partners of audit firms.

Our specific concerns and proposals are outlined below. A letter is attached herewith which asks the Administration to take certain actions to address the problems that will be created by clause 399.

We would respectfully urge you to sign the reply slip addressed to Prof KC Chan, secretary for financial services and the treasury (attached), which specifically asks the Administration to implement the changes we propose below. Please pass the signed reply slip to the Hon. Paul Chan or return it to Ms. Winnie Cheung, chief executive of the Hong Kong Institute of CPAs (by fax: 25300239 or email: [winnie@hkicpa.org.hk](mailto:winnie@hkicpa.org.hk)). If you have any questions please either speak to the Hon Paul Chan directly or contact Winnie Cheung at the Institute (on 22877032).

A) Clause 399(1)

**Proposal:**

Delete "or recklessly"

**Concerns:**

- Clause 399 will potentially criminalise conduct involving a high degree of professional judgment. Decisions on whether or not to include a qualification in an audit report can be close decisions. Clause 398(3), for example, requires an auditor to state the fact in the audit report if the auditor fails to obtain all the information or explanations that, to the best of his knowledge and belief, are necessary and material for the purpose of the audit. Auditors commonly do not receive all the information they request. Whether or not to qualify a report is a judgment call, which experience shows may well be challenged with the benefit of 20/20 hindsight, if things subsequently go wrong.
- Recklessness is a highly subjective test and, as the *Sin Kam Wah v HKSAR* [2005] HKEC 792 case shows, it is not necessarily a very high hurdle for prosecutors to prove. (See Appendix 3, which is an extract of paper on clause 399 from the Administration to the Bills Committee.)
- The threat of a criminal sanction will change the way in which audits of Hong Kong companies are conducted. It will lead to "defensive" auditing, which will increase costs, disadvantage Hong Kong audits and Hong Kong companies, and distinguish Hong Kong audits from audits conducted in nearly all other jurisdictions, in a way that is unhelpful to our market.
- As 75 percent (by value) of the listed company sector is non-Hong Kong companies, to which clause 399 will not be applicable, the effect of the clause will be to create an unlevel playing field and it also means that, in practice, much of the burden of this provision will fall on Hong Kong SMEs.
- For the above reasons, clause 399 will spread uncertainty in the Hong Kong's corporate sector and the audit profession, which will be made worse by the Administration's proposed CSA.
- No evidence has been offered of a problem that requires a criminal sanction as a remedy.
- It will add to the risk of huge civil claims under the current unlimited liability regime to which Hong Kong auditors are subject at present, and will make auditing less desirable as a career. Consequently, instead of having a positive effect on the quality of audits, in the long run, it will lower standards, because the best young people will choose other career options.

- Professionals rely on their reputations. Without this, they have nothing. In the case of the audit profession, this consideration, in addition, to extensive external regulatory oversight and a strong professional disciplinary framework, is what primarily drives audit quality. The audit profession cannot accept the argument that if an auditor makes an honest mistake, which a prosecutor subsequently alleges another auditor in the same circumstances would not have made, he deserves to be prosecuted as a criminal. If this is accepted, then, in future, other professionals will also be at risk of having their honest exercise of professional judgment called in question and they may find themselves accused of acting with a criminal mind whenever an error has been made with adverse consequences.
- In sum, whilst not materially benefiting companies or investors, clause 399 carries grave downside risks.

#### B) Administration's CSA

##### **Proposal:**

Withdraw the CSA which extends the scope of persons who may be held liable to prosecution to include relatively junior managerial staff, in addition to partners of audit firms.

##### **Concerns:**

- All the above under (A).
- The Administration's CSA will expose relatively junior, even not-fully-qualified, accountants, to the threat of a career-ending criminal sanction, which may be due to an error arising from nothing more than inexperience.

You may wish to note that it is not only accountants who have serious misgivings about the impact of clause 399. Concerns have also been expressed in the media. You may wish to see the attached article from the South China Morning Post of 26 June 2012 (Appendix 4).

We hope that you will recognise the seriousness of this issue and we thank you for your understanding and support.

Yours sincerely,

Keith Pogson  
President  
Hong Kong Institute of CPAs

Winnie Cheung  
Chief Executive  
Hong Kong Institute of CPAs

(English version)

Dear Prof. Chan,

I have seen the representations of the Hong Kong Institute of CPAs on clause 399 of the Companies Bill and I consider that the Institute has valid concerns which need to be addressed.

As a result, I, the undersigned member of the Legislative Council, propose that the Administration adopt the following course of action:

- (1) Withdraw the committee stage amendment to clause 399 put forward by the Administration; and
- (2) Support the committee stage amendment proposed by the Hon. Paul Chan to delete "or recklessly" in clause 399(1)

---

**Name (in BLOCK LETTERS)**

---

**Signature**



**Original version of Clause 399**  
**(proposed by HKICPA to be retained, but with the words  
"or recklessly" removed)**

**399. Offences relating to contents of auditor's report**

- (1) Every person specified in subsection (2) commits an offence if the person knowingly or recklessly causes a statement required to be contained in an auditor's report under section 398(2)(b) or (3) to be omitted from the report.
- (2) The persons are—
  - (a) if the auditor who prepares the auditor's report is a natural person—
    - (i) the auditor; and
    - (ii) every employee and agent of the auditor who is eligible for appointment as auditor of the
  - (b) if the auditor who prepares the auditor's report is a firm, every partner, employee and agent of the auditor who is eligible for appointment as auditor of the company; or
  - (c) if the auditor who prepares the auditor's report is a body corporate, every officer, member, employee and agent of the auditor who is eligible for appointment as auditor of the company.
- (3) A person who commits an offence under subsection (1) is liable to a fine of \$150,000.



**Administration's proposed Committee Stage Amendment**  
**(proposed by HKICPA to be withdrawn)**

**Revised Clause 399 / 經修訂的第 399 條**

**399. Offences relating to contents of auditor's report**

- (1) If a statement required to be contained in an auditor's report under section 398(2)(b) or (3) is omitted from the report, an offence is committed by each individual who—
  - (a) either—
    - (i) signs the auditor's report in accordance with section 400; or
    - (ii) performs managerial functions in relation to the auditing work in respect of the auditor's report under the immediate authority of the person mentioned in subparagraph (i); and
  - (b) knowingly or recklessly causes the statement to be omitted.
- (2) A person who commits an offence under subsection (1) is liable to a fine of \$150,000.



**Interpretation of "recklessly" provided in the Administration's paper to the Bills Committee on the Companies Bill, dated 15 June 2012**

16. There is established legal authority on this test. The test for "recklessness" according to the principle set out in the case of *Sin Kam Wah v HKSAR* [2005] HKEC 792, is as follows, "*it has to be shown that the defendant's state of mind was culpable in that he acted recklessly in respect of the circumstances if he was aware of a risk which did or would exist, or in respect of a result if he was aware of a risk that it would occur, and it was, in circumstances known to him, unreasonable to take the risk. Conversely a defendant could not be regarded as culpable so as to be convicted of the offence if, due to his age or personal characteristics he genuinely did not appreciate or foresee the risks involved in his actions.*"





**JAKE'S VIEW**  
**JAKE VAN DER KAMP**

# Threat of jail will get in way of professional audit judgment

**Changes to accounting laws should not be left to the whims of lawmakers who don't know the work**

*Every person specified in subsection (2) commits an offence if the person knowingly or recklessly causes a statement required to be contained in an auditor's report under section 398 (2)(b) or (3) to be omitted from the report.*

**Companies Amendment Bill, clause 399**

When legislators turn righteous they turn to jail sentences. They now want to impose criminal penalties on auditors who have an understanding of "knowingly or recklessly" different from their own amateur grasp of these words.

Let's get a minor stupidity out of the way first. If you think this bill will

protect you from rapacious corporate sharks in the stock market, here is some news. It won't.

Clause 399 does not apply (cannot apply) to non-Hong-Kong companies incorporated in mainland China or such localities as the British Virgin Islands and the Cayman Islands. These represent 75 per cent of the market capitalisation on our exchange and the figure is rising. We have a teeny-tiny loophole, you see. Apart from this, our government now also welcomes non-Hong-Kong auditors for such firms on the grounds that it will encourage further listings from the mainland. It will also serve to make that oh-so-little loophole big enough to allow a planetary system through.

Who the bill will actually target are the youngsters. The Institute of Certified Public Accountants reckons that nearly one million companies in Hong Kong now require audits and the bulk of this work unavoidably falls to audit staff members who have only a few years' experience and may not yet have full professional qualifications.

They cannot check every transaction a company makes. They must spot-check and otherwise rely heavily on management representations. How are they to be sure that a civil servant following the letter of the law upon receiving a complaint will not take the view that they have "knowingly or recklessly" omitted something important?

But how would the civil servant know it was reckless? How would he react if he could be thrown in jail for doing something that a non-

bureaucrat deems reckless? What would the lawyers who proposed this legislation say if they were made subject to the same threat?

There is one good way for the young accountant to avoid this danger and that is to take up a job in finance, instead of auditing, on attaining professional qualifications. There are signs that rising numbers of them are doing just that. What a fine way to improve audit standards.

The institute takes the view that "knowingly and recklessly" is not succinct enough to provide clear guidance to the profession and want it changed to the more rigorous "dishonestly or with intent to defraud".

As chief executive Winnie Cheung put it in a letter to legislators earlier this month: "It is almost a cliché to say that an auditor is a 'watchdog and not a bloodhound'.

He cannot investigate everything and should display a reasonable degree of professional scepticism. This calls for judgment. Inevitably mistakes will sometimes be made and sometimes the auditor will be the victim of deliberate deception."

Exactly. It is simply unfair to make auditing, which relies significantly on matters of professional judgment, subject in hindsight to outsiders' whims of what auditing should be and, even more so, to make contravening these whims a criminal offence. The prison mania that afflicts our legislators has gone much too far.

But they show little sign of returning to common sense in the matter and the bill is likely to go through as it stands, in which case I am pretty sure of the result.

Auditing will be mechanised entirely. It will consist purely of a

checklist of the sort that pilots make before a flight – flaps on, lights off, doors closed – all devised by lawyers from case law and all done with the cameras and voice recorders rolling, black box-style.

Ask your auditor then whether you can carry your office premises at cost and he will consult his enormous case rule book and give you the one and only prescribed answer. It will be the only way he can be sure of escaping jail. Professional judgment, the whole idea of accounts giving you a "fair view" of a company's financial position, will go out the window.

It won't make those accounts any more shark-proof. The sharks will read the rule book, too, and will take advantage of its many inevitable loopholes. Clause 399 will weaken, not strengthen, public accounting. [jake.vanderkamp@scmp.com](mailto:jake.vanderkamp@scmp.com)