



18 September 2014

Prof The Hon K C Chan GBS JP  
Secretary for Financial Services and the Treasury  
24/F, Central Government Offices  
2 Tim Mei Avenue  
Tamar, Hong Kong

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Dear Professor Chan

**Proposals to improve the regulatory regime for listed entity auditors  
(Consultation Paper)**

CPA Australia welcomes the opportunity to provide input to the Financial Services and Treasury Bureau (FSTB) in regard to the above Consultation Paper (CP). CPA Australia represents the diverse interests of more than 150,000 members in 121 countries, including over 15,000 members in the Greater China region. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia concurs with the CP that the audit profession plays a critical role in underpinning the integrity of financial reporting, which is of paramount importance to the effectiveness of capital markets. We support the overall aims of achieving a more internationally comparable regulatory regime for listed company auditors in Hong Kong in order to safeguard the interests of the investing public and underpin Hong Kong's development as an international financial centre.

In our response to the CP, we have referred extensively to the system of regulation applicable to auditors in Australia, which has undergone a similar change from being largely self-regulated to an independent regulatory infrastructure over the past ten years. Through extensive strategic review, including that carried out by the Australian Treasury in 2010, the Australian system has been found to reflect a robust regulatory regime that represents international best practice. We have also referred to other systems internationally including notably the United Kingdom, United States and New Zealand.

We note that to achieve an effective audit regulatory regime, it is critical to foster an environment that promotes and supports a sustainably strong and effective auditing profession. This objective demands a balance between independent regulation and programs facilitated by the profession, which are important for collaboration on continuous improvement and efficiency. The model proposed in the CP has appropriately addressed this balance in many ways.

It is also crucial to consider the overall impact of a regulatory system in the context of the auditing profession's ability to continue to attract a high caliber of talented individuals. Without in any way detracting from the imperative of prudent and internationally comparable regulatory measures, we submit that the culture of the auditing profession is as important as compliance or regulation and underpins audit effectiveness and its role in the capital markets.

We note our agreement with most of the measures proposed in the CP as reflected in Appendix 1, which contains our responses to the specific questions. There are also a number of key areas where we respectfully submit our recommendations for the FSTB's consideration. Along with detailed comments in regard to other specific areas contained in Appendix 1, our primary recommendations include:

1. **Independence of the disciplinary body:** Noting the significance of the proposed penalty regime, we strongly recommend that the imposition of penalties is through referral by the Financial Reporting Council (FRC) to an independent disciplinary panel comprised of both independent members and members with current knowledge of Hong Kong listed company auditing. An arbiter for the imposition of penalties independent from the investigating enforcement body brings an increased level of public confidence to the process and is generally recognized internationally as an important tenet of transparency and accountability. With reference to auditor disciplinary arrangements in other jurisdictions such as Australia, we recommend an independent disciplinary panel could be administered under the FSTB, providing a further level of independence and oversight.
2. **Consideration of auditor liability:** Consideration and appropriate calibration of auditor liability is a crucial part of effective audit regulatory systems found in other key jurisdictions internationally. For example, a critical aspect in achieving an effective professional environment for audit in Australia through recent reforms has been the introduction of a professional liability scheme for auditors. We understand the liability faced by auditors in Hong Kong is strict in comparison to other key jurisdictions and would strongly recommend consideration of measures that would contain auditor liability given the proposed introduction of significantly enhanced regulatory measures.

While these represent our primary recommendations, we have also commented on a number of detailed areas in the CP. Please refer to specific responses to the questions in the CP in Appendix 1.

If you require further information on any of our views expressed in this submission, please contact Amir Ghandar, CPA Australia by email at [amir.ghandar@cpaaustralia.com.au](mailto:amir.ghandar@cpaaustralia.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alex Malley', with a stylized flourish at the end.

Alex Malley FCPA  
Chief Executive

## Appendix 1: responses to specific CP questions

Question	Initial comments
Question 1 Do you agree with the proposed objective of the reform, i.e. to enhance the independence of the regulatory regime for auditors of listed entities from the profession itself with a view to ensuring that the regime is benchmarked against international standards and practices and continues to be appropriate in the local context?	Yes.
Question 2 Do you agree that the new regulatory regime should only cover auditors of public interest entities, which will be defined to cover listed entity auditors?	Yes.
Question 3 Do you agree that the definition of public interest entities should be set out in the main legislation such that any change in future could only be made by way of an amendment bill?	Yes.
Question 4 Do you agree that FRC should become the independent auditor oversight body with respect to listed entities in Hong Kong by enlarging its regulatory remit?	Yes.
Question 5 (a) Do you agree that a listed entity auditor must be a practice unit as defined under the existing PAO and a fit and proper person to be registered as a listed entity auditor?	Yes.
(b) If yes, do you agree that for the purpose of the reform, there should be no change to the existing qualification and experience requirements for considering whether a person is fit and proper to be registered as a listed entity auditor, i.e. by reference to the existing fit and proper test for becoming a CPA?	Yes.
Question 6 (a) Do you agree that in order for an application for registration as a listed entity auditor to be approved, the individuals who are authorised by the auditor to perform the roles of an audit engagement authorised person, an engagement quality control reviewer or a quality control system responsible person should be fit and proper persons to perform such roles?	Yes.
(b) If so, do you agree that for the purpose of the reform, there should be no change to the existing qualification and experience requirements for individuals taking up such roles with respect to a registered listed entity auditor when considering whether they are fit and proper to perform those roles?	Yes.
Question 7 Do you agree that an individual, partnership or body corporate who wishes to enter into an audit engagement with a listed entity in Hong Kong should be required to register as a listed entity auditor, and that it shall be a criminal offence if an unregistered person entered into an audit engagement with a listed entity?	We recommend that the breach outlined in this question and appropriate penalties are considered by an independent disciplinary panel as recommended in our covering letter, rather than as a criminal offence.

<p>Question 8 (a) Do you agree that HKICPA Registrar should be assigned the role of Registrar of Listed Entity Auditors and be vested with the registration functions and powers as outlined in paragraph 3.23, and FRC should exercise oversight through arrangements as proposed in paragraph 3.24?</p>	<p>Yes.</p>
<p>(b) Do you agree that FRC should publish the periodic reports received by the HKICPA Registrar as mentioned in paragraph 3.24(a) on its website, and provide information on the results of its quality review and the written directions given by it in its annual report?</p>	<p>Yes</p>
<p>Question 9 Do you agree that any person subject to a registration decision by the HKICPA Registrar may appeal against the decision, and any such appeal should be handled by an appeal mechanism which is independent of both the HKICPA Registrar and FRC?</p>	<p>Yes.</p>
<p>Question 10 Do you agree with the proposal that registration shall remain in force until 1 January in the year following the year in which the auditor was so registered, and each registration is subject to annual renewal?</p>	<p>Yes.</p>
<p>Question 11 Do you agree that the register of listed entity auditors should include the types of information on each registered listed entity auditor as proposed in paragraph 3.27?</p>	<p>Yes.</p>
<p>Question 12 Do you agree that FRC should be vested with statutory powers to take over SFC/HKEx's existing roles in receiving and making decisions on applications for recognising overseas auditors of specific overseas entities which have been approved for listing in Hong Kong on a case-by-case basis?</p>	<p>Yes. Additionally, we recommend that implementing a more defined process than currently exists on a case-by-case basis, could streamline this aspect of audit regulation. Globally, audit regulation is moving towards streamlining cross-border recognition in order to deal with and promote greater congruity with increasingly globalised markets and businesses. Most larger economies and capital markets have established criteria for the recognition of overseas auditors, which are not restricted to individual engagements or overseas entities on a case-by-case basis.</p>
<p>Question 13 Do you agree that an applicant must meet the criteria as proposed in paragraph 3.30 for being recognised as an overseas auditor of the overseas entity listed in Hong Kong as set out in its application?</p>	<p>Yes. Additionally, as outlined above, we recommend to clarify and elaborate further on the requirements denoted by point c – “he must demonstrate to the satisfaction of FRC that he has adequate resources and possesses the capability to perform the audit of the relevant overseas entity listed in Hong Kong”. We note the international standard on auditor competence IES 8 <i>Professional Competence for Engagement Partners Responsible for Audits of Financial Statements</i> details extensive pronouncement on relevant capabilities and may serve as a useful reference point.</p>

Question 14 Do you agree that the recognition of an overseas auditor of an overseas entity listed in Hong Kong should remain in force until the following 1 January or the time when the overseas auditor ceases to be the auditor of the listed entity in question, whichever is earlier, subject to renewal of the recognition?	Yes.
Question 15 Do you agree that the HKICPA Registrar shall maintain and update a list of overseas auditors who were recognised by FRC for entering into audit engagements with specific overseas entities listed in Hong Kong, and make available for public inspection/publish on HKICPA's website the list?	Yes.
Question 16 (a) Do you agree that HKICPA should continue to perform its statutory functions and exercise its statutory powers with regard to setting CPD requirements for listed entity auditors, subject to independent oversight by FRC in accordance with paragraph 4.6?	Yes.
(b) Do you agree that FRC should publish the periodic reports received by it as mentioned in paragraph 4.6(a) on its website, and provide information on the results of its quality review and the written directions given by it in its annual report?	Yes.
Question 17 (a) Do you agree that HKICPA should continue to perform its statutory functions and exercise its statutory powers in specifying standards on professional ethics, auditing and assurance to be observed, maintained or otherwise applied by CPAs (practising), and FRC should exercise oversight of the performance of such functions and the exercise of such powers by HKICPA which are applicable to listed entity auditors as proposed in the arrangements set out in paragraph 5.8?	Yes.
(b) Do you agree that FRC should publish the periodic reports received by it as mentioned in paragraph 5.8(a) on its website, and provide information on the results of its quality review and the written instructions given by it in its annual report?	Yes.
Question 18 Do you agree that HKICPA and FRC should establish procedures to ensure that the HKICPA Council would duly take into account FRC's views before it makes any decision on the setting of standards on professional ethics, auditing and assurance in relation to listed entity auditors?	Yes.
Question 19 Do you agree with the proposal to transfer statutory functions for conducting recurring inspections of listed entity auditors in respect of their listed entity audit engagements from HKICPA to FRC, with FRC being given the necessary powers as set out in paragraph 6.13 (which are similar to the powers which HKICPA is equipped with under its practice review programme)?	Yes.
Question 20 Do you agree that FRC's inspection programme should adopt the statutory procedures as set out in paragraph 6.14 with reference to the existing arrangements for HKICPA's practice review programme?	Yes.

Question 21 Do you agree that FRC may delegate its inspection functions and relevant powers to committees formed under its auspices?	Yes.
Question 22 What are your views on whether FRC should be allowed to delegate to HKICPA its functions and powers to inspect listed entity auditors in respect of their listed entity audit engagements; and if so, what checks-and-balances measures should be introduced to ensure proper delegation and accountability for the quality of the work so delegated to HKICPA?	We support the ability of the FRC to delegate inspection powers provided adequate resources are maintained to oversee the inspection program and if required increase involvement on individual inspections or in particular areas.
Question 23 Do you agree that FRC reviewers should be given the proposed statutory powers as set out in paragraph 6.17 in relation to their inspections?	We recommend that reasonable prior notice should be provided for entry to listed company auditor business premises in all but exceptional circumstances where this would be expected to jeopardise the inspection.
Question 24 (a) Do you agree with the proposal to provide for criminal offences against a person who fails to comply with the requirements in relation to FRC's inspections?	We recommend that the breach outlined in this question and appropriate penalties are considered by an independent disciplinary panel as recommended in our covering letter, rather than as a criminal offence.
(b) If so, do you agree that the provisions on such criminal offences should be modelled on the existing provisions in the FRCO concerning failure to comply with requirements in relation to an investigation into relevant irregularities?	N/A
Question 25 Do you agree that the secrecy provisions in the PAO and the FRCO should be suitably amended to provide that both HKICPA and FRC could share their inspection results with each other to facilitate them to coordinate their inspection activities?	Yes.
Question 26 Do you agree that FRC should continue to be responsible for conducting independent investigations into relevant irregularities by listed entity auditors?	Yes.
Question 27 Do you agree that a disciplinary action may be imposed on a listed entity auditor, a person approved to be its audit engagement authorised person and/or a person approved to be its engagement quality control reviewer if the listed entity auditor and/or the person concerned (as the case maybe) is proved to have committed an irregularity in relation to an audit engagement?	Yes.
Question 28 Do you agree that the definition of "irregularity" under the new regulatory regime should be refined to cover irregularities in respect of all audit and assurance engagements undertaken by listed entity auditors with listed entities as required under the Listing Rules?	We recommend that in respect to auditing and assurance engagements, "irregularity" is defined in terms of a breach of applicable ethical, auditing and assurance standards.

<p>Question 29 What is your view on whether the new regime should specifically provide that the individual/individuals who assume(s) ultimate responsibility for the system of quality control of a practice unit would be held accountable for the absence/systemic failure of such system, and whether it should stipulate expressly that such responsible person(s) shall be the practice unit's chief executive officer (or equivalent) or, if appropriate, members of the practice unit's managing board of partners (or equivalent)?</p>	<p>Although the proposed responsibilities are largely consistent with ISQC 1 <i>Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements</i>, providing an additional pronouncement on the responsibilities separate to those set out in ISQC 1 could lead to uncertainty as to their context and interpretation. We note that ISQC 1 has been adopted in Hong Kong and recommend that this standard is the most appropriate location for pronouncement on responsibilities related to quality control in audit firms and the full context of these responsibilities. We recommend that any additional reference to these responsibilities is framed by direct reference to ISQC 1 and avoids the introduction of any alternative concepts or terminology which may inadvertently lead to a lack of clarity around the responsibilities or inconsistency with ISQC 1.</p>
<p>Question 30 Do you agree that FRC, as the future independent auditor oversight body, should be vested with disciplinary powers, including powers to make decisions on disciplinary cases, concerning listed entity auditors, subject to the requirements for ensuring fairness and a due process as proposed in paragraphs 7.21 to 7.24?</p>	<p>As set out in our covering letter above, we strongly recommend that the disciplinary powers are vested in a body that is independent from the FRC.</p>
<p>Question 31 Do you agree that FRC should be empowered to exercise the range of disciplinary powers on a person subject to disciplinary action outlined in paragraph 7.27?</p>	<p>As set out in our covering letter above, we strongly recommend that the disciplinary powers are vested in a body that is independent from the FRC.</p> <p>With respect to the proposed penalties, we recommend that it is also important to consult on and establish a comprehensive, transparent set of guidelines on the application of penalties and how decisions regarding penalties should be approached – this is particularly the case with respect to monetary penalties that could conceivably involve a range of outcomes. We note the existence of appropriate points of reference internationally for such guidelines such as those established in the UK.</p>
<p>Question 32 Do you agree that FRC should be required by law to issue guidelines to indicate the manner in which it exercises its power to order a person subject to disciplinary action to pay a pecuniary penalty, and to have regard to the issued guidelines when exercising such power?</p>	<p>We concur that the FRC and an independent disciplinary body should issue guidelines indicating the manner in which both investigative and disciplinary powers will be exercised.</p>
<p>Question 33 Do you agree that any pecuniary penalty paid to or recovered by FRC would be paid by FRC into the Government general revenue?</p>	<p>Yes, subject to our strong recommendation for an independent disciplinary body as set out in the covering letter above.</p>

Question 34 Do you agree that FRC may enter into a resolution with the person subject to disciplinary action at any time it is contemplating exercising its disciplinary power, and in exercising such power, FRC must consider it appropriate to do so in the interest of the investing public or in the public interest?	Yes.
Question 35 Do you agree that any amount paid to or recovered by FRC arising from a resolution would be paid by FRC into the Government general revenue?	Yes.
Question 36 Do you agree that a new independent appeals tribunal should be set up for hearing appeals in respect of registration decisions made by the HKICPA Registrar and disciplinary decisions made by FRC?	Yes.
Question 37 (a) Do you agree that a person who disagrees with a registration decision made in respect of him or is aggrieved by a disciplinary decision made in respect of him may apply to the new independent appeals tribunal for a review of the decision within 21 days after a notice of the relevant decision has been served upon him?	Yes. We further recommend, particularly in respect of registration decisions and in the absence of an independent disciplinary panel, that such a disciplinary decision should remain confidential until the lapse of the 21-day review period or appeal process has been completed where applicable. We note that for an audit firm, loss of reputation as a result of disciplinary action can inflict a significant business penalty in itself and hence the confidentiality of disciplinary investigation and decisions until a full opportunity for appeal has been provided is of critical importance.
(b) If so, do you agree that the independent appeals tribunal may, upon application by the relevant person, grant an extension to application for review of a specified decision, and that such extension should only be granted after the applicant and FRC have been given a reasonable opportunity to be heard on the proposed extension and the independent appeals tribunal is satisfied that there is a good cause for granting the extension?	Yes.
Question 38 Do you agree with the composition of the independent appeals tribunal as proposed in paragraph 8.6, i.e. a chairman who is a person qualified for appointment as a judge of the High Court and two members who are not public officers, all to be appointed by the Chief Executive?	We recommend that specific, current listed company audit expertise would be required on the appeals tribunal in addition to the judicial expertise and power proposed. From our experience in other jurisdictions, the matters considered by the Appeals Tribunal are likely to involve practical and advanced auditing and assurance related matters and professional judgements.
Question 39 Do you agree that the independent appeals tribunal may exercise the proposed powers as outlined in paragraph 8.7 in the review proceedings?	Yes.
Question 40 Do you agree that sittings of the independent appeals tribunal should be held in public unless in the interests of justice it determines otherwise?	No. We note that for an audit firm, loss of reputation as a result of disciplinary action can inflict a significant business penalty in itself and hence the confidentiality of disciplinary investigation and decisions until a full opportunity for appeal has been provided is of critical importance.



<p>Question 41 (a) Do you agree that a party to the appeal who is dissatisfied with a determination of the independent appeals tribunal may further appeal to the Court of Appeal on a question of law, fact, or mixed law and fact?</p>	<p>Yes.</p>
<p>(b) If so, do you agree that no appeal to the Court of Appeal may be made unless leave to appeal has been granted by the same Court, and the leave may only be granted if the Court of Appeal is satisfied that the appeal has a reasonable prospect of success or there is some other reason in the interests of justice why the appeal should be heard?</p>	<p>Yes.</p>
<p>Question 42 Do you agree that under the new regulatory regime, FRC should be funded by way of introducing three new levies on (a) listed entities; (b) securities transactions; and (c) listed entity auditors such that they will each provide roughly equal contributions to FRC i.e. one third from listed entities, one third from securities investors and one third from listed entity auditors?</p>	<p>We note the practical context and a number of challenges that may arise in the proposed funding model. Primarily, the levy on audit firms would increase a cost burden which is already expected to rise as a result of the proposed regulatory regime. Achieving fairness in the construction of levies across the myriad of stakeholders that benefit from the integrity provided by the audit function, in addition to considering the audit profession itself, is a challenging and almost inevitably arbitrary exercise.</p> <p>As detailed in our covering letter, we are of the view that it is also critical to consider the sustainability of the Hong Kong auditing profession and its attractiveness in a global market for talent. The strength of the auditing profession is ultimately a key input to market integrity and hence the desired outcome of underpinning Hong Kong's development as an international financial centre.</p> <p>We note from relevant experience in other jurisdictions that it is critical to foster a genuine partnership between the profession and regulatory infrastructure, towards the shared objectives of integrity and effective markets, in order to realise the benefits of independent regulation.</p> <p>It is important to consider the calibration of the FRC's funding model in this context. A funding model that has been demonstrated to address these challenges in other jurisdictions is funding of the audit regulator from general government revenue, rather than special levies. We would recommend, particularly in initially implementing the revised regulatory regime, that this option is a preferable approach.</p> <p>We further recommend further consideration of auditor liability as detailed in the covering letter above and also emphasise the importance of monitoring the overall increase in costs for audit firms arising from the proposed regulatory regime and how</p>

	this may impact on decisions regarding the proposed levy.
Question 43 Do you agree that –	
(a) the levy on listed entities should be based on the prevailing formula under which listed entities pay their annual listing fees to HKEx, and that the levy should be collected by HKEx on behalf of FRC;	Refer response to question 42 above.
(b) the levy on securities transactions should be based on the modus operandi for the existing levy charged by SFC under the Securities and Futures Ordinance, and that the levy should be collected by SFC on behalf of FRC; and	Refer response to question 42 above.
(c) the levy on listed entity auditors should be directly proportional to the number of listed entity audit engagements entered into by the listed entity auditors, and that the levy should be collected by the HKICPA Registrar on behalf of FRC?	Refer response to question 42 above.
Question 44 Do you agree that the three levies should be stipulated in subsidiary legislation subject to negative vetting by the Legislative Council?	Refer response to question 42 above.
Question 45 Do you agree that FRC should be required to review the levels of the three levies once its reserve has reached a level equivalent to 24 months of its operating expense, after deducting depreciation and all provisions?	Refer response to question 42 above.
Question 46 (a) Do you agree with the proposed new composition of FRC membership, i.e. not fewer than seven members appointed by the Chief Executive, together with the FRC Chief Executive Officer as an ex-officio member, and abolishing the existing arrangements for the nomination of FRC members and for the Registrar of Companies to be an ex-officio member as set out in paragraph 10.6?	Yes.
(b) Do you agree that there should be at least two persons who possess knowledge of and experience in the auditing of Hong Kong listed entities out of the FRC members to be appointed by the Chief Executive?	Yes. We further recommend specifying that the knowledge of auditing of Hong Kong listed entities is “current knowledge” given the propensity of auditing practice, methodology and standards to change frequently and rapidly.
Question 47 Do you agree that FRC will be required to have a chairman and a majority of members who are non-practitioners, with a non-practitioner being defined as a person who (a) is not, or has not during the previous three years been, a CPA (practising); and (b) is not, or has not during the previous three years been, a partner, director, agent or employee of a practice unit?	We agree with the importance of having a combination of both non-practitioner FRC members and those with current knowledge in auditing. However, we note in our view that the proposed definition of “non-practitioner” may not aid in facilitating this objective. Independence and an alternative perspective – two of the key attributes a “non-practitioner” would bring to the FRC – cannot be demarcated in a simple, quantitative three-year cooling off period. Rather, we recommend that the consideration and decision of the Chief Executive as outlined in question 46(a), based on a full range of qualitative factors, is a more meaningful way of achieving and maintaining an appropriate FRC membership mix.