



29 May 2012

EXTRACT

Dear Member and Student,

Subject: CE Update May 2012 (Part 2) – Practice Concerns

1. **Criminal sanctions on auditors proposed - Companies Amendment Bill**

Clause 399 of the Companies Amendment Bill, currently going through final hearings at LegCo, makes it a criminal offence, punishable by a fine, for an auditor if the auditor knowingly or recklessly omitted a required statement in the audit report, where (i) the financial statements are not in agreement with the accounting records in any material respect; or (ii) all the necessary and material information and explanations for the audit have not been obtained.

This will be the first time the audit profession is put under a criminal penalty regime for an omission in its professional work without need to prove any dishonest intent.

We have written to the Bills Committee expressing grave concerns about the impact of the clause on the profession and were invited to attend a bills committee hearing on 16 May. I together with vice president Clement Chan represented the Institute, and made the following points: -

1. The test of recklessness does not include a test of dishonesty. Auditors could find themselves in a state of increased uncertainty, as they may face not just unlimited liability under a civil suit and potential bankruptcy but also, with the new provisions in place, the temptation may be to look for recklessness in their conduct and additional criminal charge.
2. Professional neglect, which is a target of clause 399, while serious and punishable, is already subject to unlimited civil liability. It is also a disciplinary offence that could result in a permanent removal of practice licence. The case for introducing additional criminal sanctions has not been made.
3. While the criminal offence is punishable by a fine and no imprisonment is imposed, a criminal record carries reputational damage for a professional and may mean the end of a career.

4. As regards persons liable to be prosecuted under clause 399, the bill currently covers, amongst others, employees and agents of the auditor who is eligible for appointment as auditor of the company. The concept of eligibility for appointment as auditor is ambiguous and adds another element of uncertainty. While the Government is likely to propose committee stage amendments to this, we are doubtful they will eliminate all uncertainty.
5. The Administration has argued that similar legislation exists in the U.K. Companies Act from which clause 399 drew reference. However, the UK provision was brought into the Companies Act 2006 by the U.K. government as an adjunct to other provisions which in principle allow auditors to limit their liability. The Institute considers that clause 399 should not be introduced on its own into the Companies Ordinance, when no similar liability relief or protection, is to be given to auditors in the Companies Bill or elsewhere.

A number of legislators also spoke against the imposition of criminal sanctions against professional negligence (albeit of a more serious kind) without dishonest intent. We have asked that the clause be removed from the bill, and we are actively seeking to ensure at least that the test of dishonest intent is clearly spelt out in the clause by requesting that the words "dishonestly or with intent to defraud" be added, in place of "knowingly or recklessly", as these words make the line for committing an offence too uncertain for comfort.

I [attach](#) a copy of my latest submission to the Bills Committee dated 24 May 2012, and [extract](#) of clause 399 for your reference. You may write to the Institute or the Bills Committee directly if you wish to express your comments on this clause.



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