



# Report on independent audit oversight

# The global picture



## International Forum of Independent Audit Regulators (IFIAR) members:

- |                  |                  |
|------------------|------------------|
| Abu Dhabi        | Liechtenstein    |
| Albania          | Lithuania        |
| <b>Australia</b> | Luxembourg       |
| Austria          | Malaysia         |
| Belgium          | Malta            |
| Brazil           | Mauritius        |
| Bulgaria         | Netherlands      |
| <b>Canada</b>    | Norway           |
| Croatia          | Poland           |
| Denmark          | Portugal         |
| Dubai            | <b>Singapore</b> |
| Egypt            | Slovak Republic  |
| Finland          | Slovenia         |
| France           | South Africa     |
| Germany          | Spain            |
| Gibraltar        | Sri Lanka        |
| Greece           | Sweden           |
| Hungary          | Switzerland      |
| Indonesia        | Chinese Taipei   |
| Ireland          | Thailand         |
| Italy            | Turkey           |
| Japan            | <b>UK</b>        |
| Korea            | <b>USA</b>       |

## European Union (EU) member states:

- |                |         |             |           |
|----------------|---------|-------------|-----------|
| Austria        | Finland | Latvia      | Romania   |
| Belgium        | France  | Lithuania   | Slovakia  |
| Bulgaria       | Germany | Luxembourg  | Slovenia  |
| Cyprus         | Greece  | Malta       | Spain     |
| Czech Republic | Hungary | Netherlands | Sweden    |
| Denmark        | Ireland | Poland      | <b>UK</b> |
| Estonia        | Italy   | Portugal    |           |

## Third countries with European Commission (EC) equivalence\* status:

- |                                    |                  |
|------------------------------------|------------------|
| Abu Dhabi                          | Japan            |
| <b>Australia</b>                   | Jersey           |
| Brazil                             | Malaysia         |
| <b>Canada</b>                      | <b>Singapore</b> |
| China                              | South Africa     |
| Croatia                            | South Korea      |
| Dubai International Finance Centre | Switzerland      |
| Guernsey                           | Taiwan           |
| Indonesia                          | Thailand         |
| Isle of Man                        | <b>USA</b>       |

*\* Equivalence of third countries' regulatory systems is determined by the EC, the executive body of the EU. Auditors of an entity incorporated outside the EEA (the EU plus Norway, Liechtenstein and Iceland) but listed on an EEA regulated market must generally be registered as third country auditors. However, if the systems of public oversight, quality assurance, investigations and penalties are deemed to be equivalent by the EC, these requirements may be disapplied.*

*(**Bold font** denotes the jurisdictions covered in this study)*



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Dear Mr Poon,

**Independent consultancy services for the Financial Reporting Council: Independent audit oversight**

We are delighted to present our study of independent audit oversight, based on information available to June 2013.

This study was conducted to investigate how other jurisdictions meet the EC equivalence requirements and those required for IFLAR membership and the additional features of their systems, and to identify the gaps in Hong Kong's current system of auditor oversight, with a view to it achieving EC equivalence / IFLAR membership.

The data for the six jurisdictions covered by the study (EU, UK, US, Canada, Australia and Singapore) was gathered using a question set provided to Deloitte by the FRC. This comparative study includes gap analyses, firstly of Hong Kong against the IFLAR-EC requirements and secondly of Hong Kong against the jurisdictions listed above. It also considers both possible approaches to auditor oversight and thematic comparisons.

As set out in the study, in order to obtain EC equivalence and membership of IFLAR, independent audit regulators are required to have ultimate oversight responsibility for registration, inspection, investigation, enforcement, standard setting and continuing professional education. In each of the jurisdictions under review, these requirements were met. As permitted by both the EC equivalence requirements and IFLAR Principles, delegation to a relevant authority is adopted in some jurisdictions, provided that there is oversight by the independent regulator. It is clear from the study that the international standard practised by major jurisdictions is for regulatory oversight of at least registration, inspection, investigation, enforcement, standard setting and continuing professional education to be vested in an independent statutory regulator.

Yours sincerely,

**David Barnes**

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# 1. Executive Summary

# 1.1 Executive Summary: Hong Kong gap analyses

## Analysis of Hong Kong compared with IFIAR and EC requirements

- Hong Kong does not currently meet the requirements for membership of the International Forum of Independent Audit Regulators (IFIAR).
- In June 2013 we learnt that the European Commission had amended Decision 2011/30/EU. This granted a further 10 countries EC equivalence (adding to the existing 10 - see 'the global picture' at the front of this study for the full list); it extended the transitional status granted to seven countries (Bermuda, Cayman Islands, Egypt, Mauritius, New Zealand, Russia and Turkey); it did not extend the transitional period granted to Hong Kong, India and Israel. The equivalence (and adequacy) decisions for the United States were renewed. Hong Kong's transitional status therefore expired for audit reports on financial years beginning on or after 1 August 2012.
- Based on the detailed analysis set out in section 3, Deloitte considers that the main gaps are focused around:
  - **The governance structure of the HKICPA** (Hong Kong Institute of Certified Public Accountants) (items 3.4 and 3.9) - membership of the Council of the HKICPA currently consists of approximately one third (8 out of 22 total non-executives) practising Certified Public Accountants (CPA). The remaining members are not current practitioners but the constitution of the HKICPA Council does not require that the 'non-practising' Council members have not within the past three years, carried out statutory audits, held voting rights in an audit firm, been a member of the administrative or management body of an audit firm or been employed by, or otherwise associated with, an audit firm. This means that, whilst at any one time the HKICPA Council may in fact comprise a majority of 'non-practitioners', a change in the membership of the Council may result in it ceasing to meet this requirement (i.e. composition of a majority of non-practitioners) – for example, if a recently retired audit partner was appointed to the Council. This gap is particularly relevant given: (a) the EU requirement that the system of public oversight shall be mainly governed by non-practitioners; and (b) IFIAR's requirement that the audit regulator should be operationally independent from external political interference and from commercial or other sectoral interests in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. It should also be noted that if the EU reforms were to take place as proposed by the EC, no practitioners could be involved in the governance of the oversight system.
  - **Source of funding of the HKICPA** (items 1.2, 3.4 and 3.8) – there is a gap in relation to the funding of the HKICPA, which does not appear to meet the IFIAR and EC criteria of being completely free from any possible undue influence by auditors and audit firms as required.

# 1.1 Executive Summary: Hong Kong gap analyses (cont'd)

## Analysis of Hong Kong compared with IFIAR and EC requirements (cont'd)

- **The composition of the Practice Review Committee** (PRC) (items 3.4 and 3.9) - Committee membership mainly comprises practising members, drawn from the full spectrum of audit firms. The Quality Assurance Department (and its reviewers who are full-time employees of the HKICPA) carry out practice reviews following the Committee's instructions and in turn report to the Committee. This creates a gap (both EC and IFIAR) in relation to the (perceived) objectivity and independence of the quality assurance programme.
- **The frequency of reviews** (item 1.7) – auditors of listed entities (including those listed in the EEA) are reviewed every three years, meeting the EC equivalence criteria. However, the system does not ensure that all audit practices are reviewed on a regular basis or at least in a minimum cycle, which is required for IFIAR membership (Principle 8).
- **The disciplinary mechanism** (items 1.11 and 2.4) – other than complaints recommended by the PRC and Investigation Committee to the HKICPA Council for disciplinary action, all other complaints against HKICPA members and member practices are reviewed by the Professional Conduct Committee (PCC) which is composed of mainly practising CPAs. The PCC has the power to dismiss complaints considered not pursuable, adjudicate complaints and issue formal letters of disapproval, or recommend the HKICPA Council to refer more serious complaints to the Disciplinary Panels. This presents a gap (both EC and IFIAR) as currently there is no independent public oversight body which has specific oversight of the PCC and the ability to enforce disciplinary actions against the auditors as a result of its investigations.
- Disciplinary actions are determined by the Disciplinary Panel which is composed of three persons from Disciplinary Panel A (appointed by government) and two persons from Disciplinary Panel B (appointed by the HKICPA Council). This creates a gap in relation to the independent oversight of the disciplinary mechanism as members of Disciplinary Panel B (CPAs) are appointed by the HKICPA Council, and matters that can be referred to the Disciplinary Panels are raised by the HKICPA Council only. This gap is particularly relevant given the EC requirement that there should be an independent oversight body which has the right to conduct investigations and enforce penalties (in particular, the sanction of removal of registration has to be within the ultimate responsibility of the independent oversight body). IFIAR Principle 4 goes further; it requires that the audit regulator itself should have the right to investigate and impose sanctions.
- **The system of public oversight** (item 3.5) – EC equivalence requires that the system of public oversight shall have the ultimate responsibility for the oversight of statutory auditors or audit firms with regard to registration; standard setting; continuing education, quality assurance and investigative and disciplinary systems. A gap is identified (in relation to EC equivalence) as currently there is no independent public oversight body in Hong Kong which has the ultimate responsibility for oversight of the above. Note: EC requirements permit the delegation of certain activities (for example the registration of statutory auditors and audit firms; proposing professional standards; organisation of the continuing education programme) to a professional body, provided that this is subject to independent public oversight. In practice this means that the professional body can carry out these functions, with the oversight body receiving a report and/or doing a performance check on the discharge of these functions so that it can monitor how delegation is operating and retaining a reserve right to act itself (or compel the professional body to act in accordance with its directions) in the (rare) event that the public oversight body does not think that the professional body is acting appropriately.

# 1.1 Executive Summary: Hong Kong gap analyses (cont'd)

## Analysis of Hong Kong compared with the regimes in the UK, US, Canada, Australia and Singapore

We understand that the minimum requirements for any new system of regulation in Hong Kong are:

- IFIAR membership; and
- recognition as EC equivalent – i.e. the standard needed such that Hong Kong auditors will not necessarily need to be separately regulated by EEA audit regulators in order to audit companies incorporated outside the EEA (e.g. in Hong Kong) with securities admitted to trading on an EEA regulated market.

Implementing additional changes to align with European Union (EU) requirements, over and above those mandated for EC equivalence, may improve the standard of audit regulation in Hong Kong. It will not, however, lessen the burden on a Hong Kong auditor wishing to audit a company incorporated or listed in Europe. Equally, EEA regulators cannot insist on implementation of additional requirements over and above the minimum for EC Equivalence before accepting an overseas auditor's report on an overseas entity. Other jurisdictions are similar – for example, the PCAOB has no equivalence regime and registration with the PCAOB would always be required for a Hong Kong auditor of an SEC registrant.

The key additional gaps identified in the Hong Kong regime versus other jurisdictions are:

- Registration – the UK and US require registration of the auditors of a range of other types of entity, over and above 'statutory audits'.
- Inspection – many regimes impose shorter inspection cycles – typically 12-18 months for the largest firms, to three years for smaller firms.
- Enforcement – all regimes have more detailed sanction regimes. Most include fines, censure and removal or restriction of audit registration. The UK, Canada and Singapore also allow removal or restriction of the wider right to practice as an accountant. The UK, Australia and US make clear that the conditions on registration that might be imposed might include not serving certain types of client / additional internal or external quality control reviews.
- Standard-setting – The UK, Australia and Singapore all feature some form of joined-up standard-setting between accounting and auditing. The UK and US have joined-up auditing and ethical standard-setting. All of these regimes have more specific funding regimes designed to address the IFIAR principle that the funding shall be free of influence by the audit profession.



# 1.2 Executive Summary: possible future changes

## Possible future change in IFIAR and EC requirements

- The auditing profession and its oversight arrangements are under close scrutiny at present. This is particularly the case in both the UK (Competition Commission) and at the level of the EU. In the EU discussions, the scrutiny has a political angle as well as drivers around market concentration, choice and quality. We are closely engaged in these various discussions, and have consistently emphasised our commitment to measures that preserve and enhance audit quality and, subject to that point, which increase competition and choice.
- In relation to our analysis of IFIAR-EC requirements (section 2) and our assessment of Hong Kong's current status against those requirements (section 3), we are conscious that there may be changes to those requirements, notably in light of the ongoing scrutiny of the audit profession and its regulation worldwide.
- We include detail on audit regulatory reform in the UK and at EU level in section 9 (which also features additional information on other jurisdictions, notably in relation to mandatory rotation/tendering), and with the following key points relevant:
  - Our assessment is that it is unrealistic to conclude definitively on what is 'likely', as there is a high degree of uncertainty around proposals, particularly in Europe. However, we are well placed to make an informed assessment as to the possible changes currently under discussion.
  - Accordingly, whilst we caveat our commentary with a clear message that there is limited visibility as to what is 'likely', we have given an analysis of what is currently under discussion – this is provided in section 9. The principal themes are threefold: (1) Quality, (2) Market churn and (3) Investor engagement.
  - The points set out in section 9 cover the potential for: increasingly transparent and robust auditor inspections; measures to prompt churn in the marketplace (such as mandatory tendering and rotation of audit firms, over and above rotation of audit partners); closer links between auditors and audit committees/shareholders (for example the Audit Committee (comprising independent non-executives) to appoint the auditor, rather than the Board); extended auditor reporting to shareholders (as proposed in the International Auditing and Assurance Standards Board (IAASB)'s June 2012 Invitation to Comment: Auditor Reporting); excluding the professional bodies and practitioners from the oversight system.
- Also, the European Securities and Markets Authority may take on the role of the European Group of Auditor Oversight Bodies (EGAOB), or the EGAOB may be adapted and strengthened, which would result in a more formalised way of co-ordinating the way in which transnational audit networks are regulated. These proposals will not directly affect EC Equivalence.

# 1.3 Executive Summary: consideration points

## Some points of detail to consider

- **Registration**
  - The consensus approach amongst the jurisdictions reviewed is to distinguish between public interest companies (entities) (PIEs) and private companies. The focus of the independent regulators is on the former, with most jurisdictions covering all listed companies (equity and debt issuers), significant financial institutions and in some cases, a wider class of PIEs, with the professional bodies focusing on the remaining population of statutory audits. This allows a balance of resource and focus, recognising the need to demonstrate benefits in support of the cost of independent regulation.
- **Inspection**
  - The importance of independent challenge to the audit firms is evident from each of the jurisdictions considered. Whilst the mechanics vary, there is a trend towards transparency as well as rigour and independence. The UK practice of publishing annual reports for the largest firms, and providing a copy of individual inspection reports to the entity audit committee, is of particular note. The US, in contrast, issues individual firm inspection reports as well as summarised reports (under PCAOB Rule 4010). These practices demonstrate different approaches to striking a balance between fostering improvement and transparency of findings.
- **Investigation and Enforcement**
  - The need for disciplinary process and potential sanctions is evident from each of the jurisdictions reviewed. Processes vary in their focus on and interpretation of 'public interest', but there is an operational consensus that high profile listed companies are of public interest, as is confidence in the largest audit firms. The jurisdictions under consideration generally adopt a quasi-legal approach to disciplinary processes, with a recognition of the right to a fair hearing and to appeal.
    - The range of sanctions is generally wide, ranging from reprimand, to fine, to some form of exclusion from practice. In certain circumstances, the fines can be unlimited and one jurisdiction allows for imprisonment as a sanction for non-compliance with a notice. Publicity is typically part of the sanction, and anonymity is granted only in exceptional cases.
- **Standard setting**
  - The regulatory bodies are typically responsible for implementing applicable auditing standards, and will normally conduct their deliberations in public. With an increasingly global regulatory agenda, in most cases the bodies are implementing international standards rather than drafting entirely new ones for local use only.
- **Funding**
  - In most cases, the regulator's funding is obtained from a combination of direct levies on companies, levies on the professional bodies of which the audit firms are members, and levies on the audit firms themselves. The level of funding from government is, with one exception, usually minimal; the regulator is intended to be independent and self-funding.

# 1.3 Executive Summary: consideration points (cont'd)

## Points of principle for reform of auditor oversight

- The journey to amend the audit oversight system in Hong Kong, and to move away from the previous system of self-regulation, has begun. We trust that this comparative study provides valuable information to guide and signpost that journey.
- Preserving an open and constructive relationship with the regulated market is an important consideration in developing an effective audit quality framework. However, it is essential that the regulator construct is seen as robust and independent, and balancing these two elements requires careful judgement.
- It is also critical that the regulator gives careful consideration to the nature of the relationship it ultimately wishes to have with the auditing profession. Those considerations can then inform the judgements and decisions taken around how best to implement its new role, drawing on the lessons from other regulatory systems.
- We understand that the level of administration is another consideration in terms of approach and roll-out; we therefore include information on funding models.
- The spectrum of possible regulatory approaches can be seen as extending from 'collegial' to 'legalistic', and a key consideration is ensuring that any structure is proportionate, and acts as a visible and transparent challenge without stifling competitiveness and innovation.
- Conceptual, cultural and other considerations are also important, and should be borne in mind along with the balance outlined in the second bullet point above.

## 2. IFIAR-EC mapping

# 2.1 Overview

## IFIAR Core Principles for Independent Audit Regulators<sup>1</sup>

IFIAR is the organisation for independent audit regulators. Membership of IFIAR requires subscription to the IFIAR Charter (revised in 2013), which requires that members must be independent of the profession and engage in audit regulatory functions in the public interest. Membership of IFIAR does not require implementation of all the IFIAR Core Principles, but members are encouraged to work towards their implementation and IFIAR considers that the Principles will also assist audit regulators who are not members of IFIAR to develop effective independent audit oversight arrangements.

## EC 'Equivalence' Requirements

The EU Statutory Audit Directive 2006/43/EC<sup>2</sup> ('SAD') applies throughout the European Economic Area (EEA – the European Union plus Norway, Liechtenstein and Iceland). Auditors of an entity incorporated in an EEA Member State must be registered with the relevant competent authority in that state. Auditors of an entity incorporated outside the EEA but listed on an EEA Regulated Market (as defined in the Markets in Financial Instruments Directive) must generally be registered as Third Country Auditors (Article 45 SAD). However, if the system of public oversight, quality assurance, investigations and penalties are deemed to be equivalent by the European Commission, these requirements may be disapplied. The table below sets out the provisions of the SAD against which the third country regime must be assessed in order to achieve equivalence under Article 46 SAD.

*There are currently no proposed or expected changes to the EC equivalence requirements themselves or IFIAR Core Principles; but refer to section 9 of this report for more detail on ongoing regulatory reform in the audit market.*

1. <http://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf>

2. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0043:20080321:EN:PDF>

## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence

Area	EC 'Equivalence' requirements	IFIAR
Quality assurance	Article 29 SAD	
	<p><i>Note that in addition to the SAD, the Commission has also published a Recommendation on external quality assurance for statutory auditors and audit firms auditing public interest entities.<sup>3</sup></i></p> <p><i>Whilst EU Directives must be enacted into national law by member states, recommendations need not be and implementation of the Recommendation is not required for equivalence.</i></p> <p><i>The Commission recognised that the SAD, which incorporated parts of a recommendation issued in 2000, had been overtaken by international developments and the increasing tendency for external quality assurance systems to be managed independently from the auditing profession and for quality assurance reviews to be performed by persons other than practising auditors. As such, the Recommendation should be seen as representing the Commission's updated 2008 views on quality assurance systems.</i></p>	
	1. Each Member State shall ensure that all statutory auditors and audit firms are subject to a system of quality assurance which meets at least the following criteria:	
	(a) the quality assurance system shall be organised in such a manner that it is independent of the reviewed statutory auditors and audit firms and subject to public oversight as provided for in Chapter VIII; Chapter VIII of the SAD includes Article 32: Principles of public oversight (see below) and Articles 33 to 36 which set out requirements for cooperation at community level, mutual recognition between member states, designation of competent authorities and professional secrecy and regulatory cooperation between member states.	<p>IFIAR Principle 4: Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p> <p>IFIAR Principle 4 explanatory material: Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities.</p>
	(b) the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms;	<p>IFIAR Charter: Funding should be free of undue influence by the profession.</p> <p>IFIAR Principle 2 explanatory material: The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p>
(c) the quality assurance system shall have adequate resources;	IFIAR Principle 5 explanatory material: In order for audit regulators to be effective, it is a prerequisite that there is sufficient staff of appropriate competence. This also means that adequate arrangements for consultation and discussion amongst inspectors are in place.	
(d) the persons who carry out quality assurance reviews shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;	<p>IFIAR Principle 5 explanatory material: The persons carrying out the reviews of quality assurance systems of audit firms should have appropriate professional training and relevant experience in auditing and financial reporting, and training in regulatory quality assurance reviews.</p> <p>This also means that adequate arrangements for consultation and discussion amongst inspectors are in place. New inspectors should be subject to proper supervision and appropriate training.</p>	

3. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:120:0020:0024:EN:PDF>

## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence (cont'd)

Area	EC 'Equivalence' requirements	IFIAR
Quality assurance (cont'd)	(e) the selection of reviewers for specific quality assurance review assignments shall be effected in accordance with an objective procedure designed to ensure that there are no conflicts of interest between the reviewers and the statutory auditor or audit firm under review;	IFIAR Principle 8: Audit regulators should as a minimum conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations. IFIAR Principle 8 explanatory material: The recurring inspections should be conducted pursuant to a process comprising the selection of the audit firms to inspect, appointment of an inspection team with appropriate expertise and competence, notification to the audit firm, advance documentation request, notification of selection of audit engagements for review, meetings with management, and on-site inspection arrangements. The inspection process should be subject to appropriate internal quality control within the audit regulator to ensure high quality and consistency.
	(f) the scope of the quality assurance review, supported by adequate testing of selected audit files, shall include an assessment of compliance with applicable auditing standards and independence requirements, of the quantity and quality of resources spent, of the audit fees charged and of the internal quality control system of the audit firm;	IFIAR Principle 10 explanatory material: The risk-based inspection approach should also be reflected in both firm-wide and audit file inspection procedures. The firm-wide procedures should address the audit firm's quality control system as reflected in the firm's organisation, policies and procedures. ISQC 1 or similar standards should be used as a benchmark in performing firm-wide procedures. The inspection process should also include adequate testing of selected audit files in order both to determine the effectiveness of the firm's quality control system and to assess compliance with applicable laws, rules and professional standards.
	<i>No direct equivalent in SAD</i>	IFIAR Principle 9: Audit regulators should ensure that a risk based inspections programme is in place. IFIAR Principle 9 explanatory material: Audit regulators should have a process for assessing risks in the audit environment and audit risks in individual regulated firms and their audit engagements. Audit regulators should have a process for taking into account their risk assessment in allocating their inspection resources and in the inspection approaches they adopt. These processes should be commensurate with the size and complexity of the audit firms and their clients. Audit regulators should have an established minimum cycle regarding the frequency of inspections.

## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence (cont'd)

Area	EC 'Equivalence' requirements	IFIAR
Quality assurance (cont'd)	(g) the quality assurance review shall be the subject of a report which shall contain the main conclusions of the quality assurance review;	<p>IFIAR Principle 11: Audit regulators should have a mechanism for reporting inspection findings to the audit firm and ensuring remediation of findings with the audit firm.</p> <p>IFIAR Principle 11 explanatory material: Audit regulators should have a process that ensures that criticisms or potential defects in an audit firm's quality control systems and issues related to an audit firm's performance of audits that are identified during an inspection are reported to the audit firm. Audit regulators' reporting processes should include the preparation and issuance of a draft inspection report, a process for the audit firm to respond, and the preparation and issuance of a final inspection report.</p>
	(h) quality assurance reviews shall take place at least every six years;	<i>No direct equivalent in IFIAR principles</i>
	(i) the overall results of the quality assurance system shall be published annually; and	IFIAR Principle 3 explanatory material: Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.
	(j) recommendations of quality reviews shall be followed up by the statutory auditor or audit firm within a reasonable period. If the recommendations referred to in point (j) are not followed up, the statutory auditor or audit firm shall, if applicable, be subject to the system of disciplinary actions or penalties referred to in Article 30.	<p>IFIAR Principle 4: Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p> <p>IFIAR Principle 4 explanatory material: Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities (as above).</p> <p>Audit regulators should have the authority and ability to enforce inspection findings and recommendations. The audit regulator should have comprehensive enforcement arrangements such as fines, suspensions and the removal of an auditor's or audit firm's licence or registration.</p> <p>IFIAR Principle 11 explanatory material: In addition, audit regulators should have a process for ensuring that audit firms satisfactorily address inspection findings that were reported to the audit firm by the audit regulator.</p>
	2. The Commission may adopt implementing measures in order to enhance public confidence in the audit function and to ensure uniform application of points (a), (b) and (e) to (j) of paragraph 1. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 48(2a). None have been adopted to date.	<i>No direct equivalent in IFIAR principles</i>



## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence (cont'd)

Area	EC 'Equivalence' requirements	IFIAR
Systems of investigations and penalties	Article 30 SAD	
	1. Member States shall ensure that there are effective systems of investigations and penalties to detect, correct and prevent inadequate execution of the statutory audit.	IFIAR Principle 4 explanatory material: The audit regulator should have comprehensive enforcement arrangements such as fines, suspensions and the removal of an auditor's or audit firm's licence or registration.
	2. Without prejudice to Member States' civil liability regimes, Member States shall provide for effective, proportionate and dissuasive penalties in respect of statutory auditors and audit firms, where statutory audits are not carried out in conformity with the provisions adopted in the implementation of this Directive.	<i>No direct equivalent in IFIAR principles</i>
	3. Member States shall provide that measures taken and penalties imposed on statutory auditors and audit firms are appropriately disclosed to the public. Penalties shall include the possibility of the withdrawal of approval.	<i>No direct equivalent in IFIAR principles</i>
	<i>No direct equivalent in SAD</i>	IFIAR Principle 4 explanatory material: Audit regulators should have adequate and appropriate mechanisms for enabling information to be brought to their attention by third parties and for then dealing with such information, such as through complaints procedures or through whistle blowing arrangements. These mechanisms should act in a timely and effective manner and their results followed up through an appropriate system of investigations and penalties in relation to cases of inadequate or noncompliant execution of an audit.

## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence (cont'd)

Area	EC 'Equivalence' requirements	IFIAR
Principles of public oversight	Article 32 SAD	IFIAR Principle 1 The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation.
	1. Member States shall organise an effective system of public oversight for statutory auditors and audit firms based on the principles set out in paragraphs 2 to 7 below.	IFIAR Principle 1 explanatory material: The legal framework for audit oversight should set forth the audit regulator's mandate and responsibilities, and provide the regulator with adequate powers and authority that enable the regulator to perform its audit oversight duties, including powers to address, through inspection and enforcement, compliance with the requirements for the authorisation/registration of auditors/audit firms and compliance with applicable auditing, professional and independence standards.
	2. All statutory auditors and audit firms shall be subject to public oversight.	IFIAR Principle 1 explanatory material: Audit regulators should have a mandate to work in the public interest and protect investors by seeking to improve audit quality. The responsibilities and powers of audit regulators should, at a minimum, require independent oversight of the audits of public interest entities.
	3. The system of public oversight shall be governed by non-practitioners who are knowledgeable in the areas relevant to statutory audit. Member States may, however, allow a minority of practitioners to be involved in the governance of the public oversight system. Persons involved in the governance of the public oversight system shall be selected in accordance with an independent and transparent nomination procedure.	IFIAR Charter: [Members] must be independent of the profession, and engaged in audit regulatory functions in the public interest. IFIAR Principle 2: Audit regulators should be operationally independent. IFIAR Principle 2 explanatory material: Independence means the ability to undertake regulatory activity and to take and enforce decisions without external interference by those regulated. The audit regulator should be operationally independent from external political interference and from commercial or other sectoral interests, in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities. IFIAR Principle 5: Audit regulators should ensure that their staff is independent from the profession and should have sufficient staff of appropriate competence. IFIAR Principle 5 explanatory material: Audit regulators should have arrangements in place to ensure that inspection staff members are independent of the profession. These arrangements will, as a minimum, include ensuring that staff members should not be practising auditors or employed by or affiliated with an audit firm, and that the arrangements are not controlled in any form by a professional body.

## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence (cont'd)

Area	EC 'Equivalence' requirements	IFIAR
Principles of public oversight (cont'd)	<p>4. The system of public oversight shall have the ultimate responsibility for the oversight of:</p> <ul style="list-style-type: none"> <li>a) the approval and registration of statutory auditors and audit firms;</li> <li>b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing; and</li> <li>c) continuing education, quality assurance and investigative and disciplinary systems.</li> </ul>	<i>No direct equivalent in IFIAR principles</i>
	<p>5. The system of public oversight shall have the right, where necessary, to conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action.</p>	<i>No direct equivalent in IFIAR principles</i>
	<p>6. The system of public oversight shall be transparent. This shall include the publication of annual work programmes and activity reports</p>	<p>IFIAR Principle 3: Audit regulators should be transparent and accountable.</p> <p>IFIAR Principle 3 explanatory material: The audit regulator should have public accountability in the use of its powers and resources to ensure that the audit regulator maintains its integrity and credibility. Further, the decisions and actions of the audit regulator should be subject to appropriate scrutiny and review, including appeal to a higher authority. Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.</p>
	<p>7. The system of public oversight shall be adequately funded. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms.</p>	<p>IFIAR Principle 2 explanatory material (as above): The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p>
	<p><i>No direct equivalent in SAD</i></p>	<p>IFIAR Principle 6: Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements.</p> <p>IFIAR Principle 6 explanatory material: Audit regulators should maintain the highest standards of ethical conduct to provide the public with confidence in the objectivity of their decisions. Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff and ensure that appropriate arrangements are in place to protect confidential information from public dissemination.</p>

## 2.2 Analysis of the requirements for IFIAR membership and EC equivalence (cont'd)

Area	EC 'Equivalence' requirements	IFIAR
Principles of public oversight (cont'd)	<p><i>No direct equivalent in SAD</i></p> <p><i>SAD itself requires EEA audit regulators to cooperate with other EEA audit regulators, subject to certain conditions, but does not impose these requirements on non EEA regulators or on third country auditors in order to be deemed 'equivalent'.</i></p> <p><i>A form of cooperation ('working arrangements on the basis of reciprocity') is one of the conditions to be met under Article 47 to allow EEA auditors' working papers to be transferred to a non EEA regulator (subject to a national security exemption) but this is not a pre-requisite for equivalence.</i></p>	<p>Principle 7: Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties.</p> <p>IFIAR Principle 7 explanatory material: Taking into account the global nature of the financial markets, where necessary and relevant, cooperation and information sharing with other audit regulators and other third parties, including financial market regulators, is helpful to improve audit quality.</p> <p>Audit regulators should provide timely assistance to each other within reasonable limits. Arrangements should be in place for sharing information between audit regulators and other regulators (or between parts of the audit oversight system if it involves more than one body), and for protecting the confidentiality of such information.</p>

### 3. Hong Kong - IFIAR-EC gap analyses

# 3. Hong Kong - IFIAR-EC gap analyses

## Analysis of Hong Kong audit oversight system versus the requirements for gaining regulatory equivalence of the EC / membership of IFIAR

This section sets out three gap analyses:

- 3.1 maps the existing system in Hong Kong against both a) the IFIAR charter and principles, and b) the EC Equivalence requirements, with reference to the EU Statutory Audit Directive (SAD).

As subsets of this:

- 3.2 maps the existing system in Hong Kong against the EC Equivalence requirements, with reference to the EU Statutory Audit Directive (SAD); and
- 3.3 maps the existing system in Hong Kong against the IFIAR charter and principles.



# 3.1 Hong Kong - IFIAR-EC gap analysis

## Analysis of Hong Kong audit oversight system versus the requirements for gaining both regulatory equivalence of the EC and membership of IFIAR

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems (Article 29 of SAD)			
	1. Each Member State shall ensure that all statutory auditors and audit firms are subject to a system of quality assurance which meets at least the following criteria:			
1.1	<p>(a) the quality assurance system shall be organised in such a manner that it is independent of the reviewed statutory auditors and audit firms and subject to public oversight as provided for in Chapter VIII; Chapter VIII of the SAD includes Article 32: Principles of public oversight (see below) and Articles 33 to 36 which set out requirements for cooperation at community level, mutual recognition between member states, designation of competent authorities and professional secrecy and regulatory cooperation between member states.</p>	<p><b>IFIAR Principle 4:</b> Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p> <p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities.</p>	<p>The Hong Kong Institute of Certified Public Accountants (HKICPA) is incorporated by the Professional Accountants Ordinance (PAO) which sets out its statutory obligations. It is the only statutory licensing body of accountants in Hong Kong responsible for professional training, development and regulation of the accountancy profession.</p> <p>In 1992, the HKICPA introduced a Practice Review programme under the authority and powers granted by the PAO with the objective of enhancing the quality of work of the HKICPA members engaged in audit and related assurance activities.</p> <p>The Practice Review programme forms an important element in the overall scheme of audit regulation in Hong Kong. The practice review covers the provision of audit and other related assurance services in Hong Kong by firms, corporate practices and individual practising certificate holders (i.e. practice units). The programme aims to assess whether a practice unit has an adequate system of quality control to ensure work quality is maintained in every assurance and related service engagement. The Practice Review programme was revised in 2006 in light of international developments and increasing expectations of regulation and monitoring of auditors. The revised programme places greater emphasis on addressing areas of significant public interest, such as audits of public listed companies and the review process has been revised to focus on risk – in the selection of practice units and specific audit engagements for review. The practice reviews focus on practice units that are engaged in auditing public interest entities of a higher profile, predominantly listed entities.</p>	<p><i>Neither EC nor IFIAR</i></p> <p><i>The practice reviews are conducted by the full-time employees of the Quality Assurance Department of the HKICPA following the instructions of the Practice Review Committee (PRC) and in turn report to the Committee. Also, the results of the practice reviews are reported to the PRC. The composition of the PRC which comprises mainly practising members presents a gap in relation to the (perceived) objectivity and independence of the quality assurance programme that are basic principles for an independent public oversight body, in terms of both EC and IFIAR requirements (see 3.4 and 3.9 for details).</i></p>



## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.1			<p>The practice reviews are conducted under the responsibility of the full-time employees of the Quality Assurance Department (QAD) of the HKICPA which report to the Practice Review Committee (PRC). The PRC is the committee responsible for exercising the powers and duties given to the HKICPA as the regulator of auditors in Hong Kong under Sections 32A to 32I of the PAO. The QAD is headed by a Director who is supported by professional and administrative review staff. Under Section 32D of PAO, the PRC may determine the practice and procedure to be observed in relation to practice reviews; issue instructions to any reviewer on any matter relating to practice reviews or a particular practice review, or perform any other thing as considered necessary. The PRC has also prepared for reviewers a reviewer's manual which determines the procedures reviewers should adopt with respect to practice reviews.</p> <p>The results of the practice reviews carried out on practice units by the QAD are reported to the PRC. The HKICPA's practice review programme identifies deficiencies in quality control and audit work of the practice subject to review. Where deficiencies are identified, the practice will be required to produce an action plan or specific remedial action to address the deficiencies. If a deficiency is sufficiently serious or remedial action is not taken or is not effective, disciplinary action may be taken against the practice. The power of exercising disciplinary actions by the HKICPA against members or member practices is set out in the PAO.</p> <p>For details of the practice review process, refer to 1.5 below.</p>	
1.2	(b) the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms;	<p><b>IFIAR Charter:</b> Funding should be free of undue influence by the profession.</p> <p><b>IFIAR Principle 2 explanatory material:</b> The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p>	The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and continuing professional development (CPD) fees.	<p><i>Neither EC nor IFIAR</i></p> <p><i>The funding of the operation of the HKICPA is mainly dependent on its members and students, and the amount of subscription fees is determined by the Council. The Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the IFIAR and EC equivalence criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.3	(c) the quality assurance system shall have adequate resources;	<b>IFIAR Principle 5 explanatory material:</b> In order for audit regulators to be effective, it is a prerequisite that there is sufficient staff of appropriate competence. This also means that adequate arrangements for consultation and discussion amongst inspectors are in place.	<p>There is a team of full-time reviewers reporting to the Director of QAD. The time allocated for reviews varies depending on the nature and size of the practice and its client base.</p> <p>Details of arrangements for on-site inspection, findings and recommendations coming out from the practice reviews are discussed amongst the team of reviewers and the Director of QAD.</p>	<p>Yes *</p> <p><i>The HKICPA has a full team of reviewers who conduct the practice reviews.</i></p>
1.4	(d) the persons who carry out quality assurance reviews shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;	<b>IFIAR Principle 5 explanatory material:</b> The persons carrying out the reviews of quality assurance systems of audit firms should have appropriate professional training and relevant experience in auditing and financial reporting, and training in regulatory quality assurance reviews. This also means that adequate arrangements for consultation and discussion amongst inspectors are in place. New inspectors should be subject to proper supervision and appropriate training.	All the reviewers of the QAD are qualified accountants with experience in auditing and are required to undergo regular technical training and updates. The reviewers have an audit background and have been engaged in learning and development activities to keep them up to date with professional standards and to enhance their skills in dealing with practices in a fair and sensitive manner.	<p>Yes *</p> <p><i>All reviewers are qualified CPAs with a background in auditing and regular professional training and updates are required.</i></p>

\* To note: if the HKICPA were independent, it would be compliant with the requirements.

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.5	<p>(e) the selection of reviewers for specific quality assurance review assignments shall be effected in accordance with an objective procedure designed to ensure that there are no conflicts of interest between the reviewers and the statutory auditor or audit firm under review;</p>	<p><b>IFIAR Principle 8:</b> Audit regulators should, as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</p> <p><b>IFIAR Principle 8 explanatory material:</b> The recurring inspections should be conducted pursuant to a process comprising the selection of the audit firms to inspect, appointment of inspection teams with appropriate expertise and competence, notification to the audit firm, advance documentation request, notification of selection of audit engagements for review, meetings with management, and on-site inspection arrangements.</p> <p>The inspection process should be subject to appropriate internal quality control within the audit regulator to ensure high quality and consistency.</p>	<p>The reviewers of QAD have a cooling off period whereby they will not perform a review of the firm where they were employed by before joining the HKICPA. The practice reviews include the following major processes:</p> <p><u>(i) Selection of practice for practice review visit</u> All the practice units defined in the PAO below are subject to the Practice Review by the HKICPA unless they are not carrying out audit or assurance work:</p> <p>a) A firm of (practising) certified public accountants, practising accountancy pursuant to the PAO;</p> <p>b) A (practising) certified public accountant, practising accountancy on its own account pursuant to the PAO; or</p> <p>c) A corporate practice pursuant under the PAO.</p> <p>The QAD selects the practices for review primarily based on risk factors including the public interest profile of audit clients. The selection of practices is identified from a desktop review of practices' responses in the practice review self-assessment questionnaire<sup>(1)</sup> and other relevant information. Practices with regulated or significant public interest entity clients (but not listed entities) are given priority for site visit reviews. A number of practices are selected for site visit reviews on a random basis to ensure that all practices will have a reasonable chance of being selected. For details of frequency of review of different practices, please refer to 1.7 and 1.9 below.</p> <p><u>ii) Notification to audit firms</u> Practices selected for practice review visits are normally advised of the proposed visit date several weeks in advance. The QAD will agree the visit date with the practice before the issue of formal notification and request for key documents. The site visit will normally be scheduled for six weeks after the formal notification.</p> <p><u>iii) Preliminary assessment of submitted key documents</u> Practices will be requested to provide certain information and a client list for preliminary assessment by the reviewers. The reviewers will carry out preliminary assessment on the key documents and notify the audit firm of the list of audit engagements selected for the on-site review.</p>	<p>Yes * (see page 25)</p> <p><i>The reviewers should be independent of the audit practices and there is a cooling off period before a practitioner can act as an HKICPA reviewer for the firm he/she left.</i></p> <p><i>The HKICPA is authorised by the PAO to conduct practice reviews of the audit practices (including firms undertaking audits of listed entities) in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</i></p>

(1) As stipulated in paragraph 3 of the Appendix of Statement in 1.401 (March 2006) Practice Review – Review and Conduct of Members, all practice units are required to complete the practice review self-assessment questionnaire on an annual basis. The questionnaire will collect three main categories of information about a practice unit: i) organisation and management of the practice unit; ii) quality control policies and procedures established by the practice unit; and iii) client profile of the practice unit.

# 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.5			<p><u>(iv) Scope of review</u></p> <p>The scope of practice review includes: (a) obtaining an understanding of the practice's system of quality control; (b) assessing the effectiveness of the system of quality control in achieving compliance with Hong Kong Standard on Quality Control 1 (HKSQC 1); and (c) assessing compliance with professional standards in the operation of quality control procedures and the conduct of audit work.</p> <p>The detail and extent of review that the reviewers will need to carry out varies from practice to practice depending on a number of factors including the size of the practice and the nature of the client bases. However, the work typically carried out during the on-site visit includes:</p> <ul style="list-style-type: none"> <li>(a) interviewing different levels of personnel to assess the practice's culture and commitment to quality;</li> <li>(b) reviewing the documented quality control procedures and checking how they are applied in practice;</li> <li>(c) reviewing audit methodology and procedures to ensure they are up to date and include reference to current professional standards and relevant application guidance for staff;</li> <li>(d) reviewing selected engagement files to evaluate the application of audit procedures, the design and selection of audit working response to assessed risk; the basis for key audit judgements and conclusions, and the adequacy of audit evidence and documentation;</li> <li>(e) communication of findings from the practice review to the practice; and</li> <li>(f) providing practical advice to the practice on possible improvements in efficiency of the audit process and to address weaknesses that have been identified by the reviewers.</li> </ul> <p>Opening and exit meetings will be held among the practice review reviewers and the representatives of the practice.</p>	

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.6	<p>(f) the scope of the quality assurance review, supported by adequate testing of selected audit files, shall include an assessment of compliance with applicable auditing standards and independence requirements, of the quantity and quality of resources spent, of the audit fees charged and of the internal quality control system of the audit firm;</p>	<p><b>IFIAR Principle 8:</b> Audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</p> <p><b>IFIAR Principle 10:</b> Audit regulators should ensure that inspections include effective procedures for both firm-wide and file reviews.</p> <p><b>IFIAR Principle 10 explanatory material:</b> The risk-based inspection approach should also be reflected in both firm-wide and audit file inspection procedures. The firm-wide procedures should address the audit firm's quality control system as reflected in the firm's organisation, policies and procedures. ISQC 1 or similar standards should be used as a benchmark in performing firm-wide procedures. The inspection process should also include adequate testing of selected audit files in order both to determine the effectiveness of the firm's quality control system and to assess compliance with applicable laws, rules and professional standards.</p>	<p>The scope of practice review includes obtaining an understanding of the practice's system of quality control, assessing compliance of policies and procedures with HKSQC 1 and reviewing the conduct of audit work. See details in 1.5 above.</p> <p>HKSQC 1 requires the practice to establish a system of quality control designed to provide it with reasonable assurance that the practice and its personnel comply with professional standards, and regulatory and legal requirements (including ethical and independence requirements), and that reports issued by the practice or engagement partner are appropriate in the circumstances.</p> <p>HKSQC 1 also requires the practices to assess the integrity of a client during the process of acceptance and continuance of client relationships and specific engagements by considering whether the client is aggressively concerned with maintaining the firm's fees as low as possible. In addition, HKSQC 1 requires the practice to establish policies and procedures to monitor workload and availability of resources to enable the individuals to have sufficient time to adequately discharge their responsibilities.</p> <p>The current revamped practice review programme places greater emphasis on addressing areas of significant public interest, such as audits of public listed companies, and other public interest entities such as banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools. The review process has been revised to focus on risk – in the selection of practice units and specific audit engagements for review. The practice review focuses on inspecting practice units that are engaged in auditing higher profile, public interest, predominately listed entities and adopts risk-based inspection procedures.</p>	<p>Yes * (see page 25)</p> <p><i>The scope of HKICPA's practice reviews includes the review of firm's policies and procedures of internal quality controls according to HKSQC1 (which also covers the review of audit fees and time spent on the engagement) as well as the quality of audit engagements.</i></p> <p><i>The practice reviews are conducted on a risk-based approach.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.7	<b>No direct equivalent in SAD</b>	<p><b>IFIAR Principle 9:</b> Audit regulators should ensure that a risk-based inspections programme is in place.</p> <p><b>IFIAR Principle 9 explanatory material:</b> Audit regulators should have a process for assessing risks in the audit environment and audit risks in individual regulated firms and their audit engagements. Audit regulators should have a process for taking into account their risk assessment in allocating their inspection resources and in the inspection approaches they adopt. These processes should be commensurate with the size and complexity of the audit firms and their clients. Audit regulators should have an established minimum cycle regarding the frequency of inspections.</p>	<p>The selection of a practice for practice review is based on their risk profiles, primarily from information obtained from the electronic self-assessment questionnaire and other relevant sources. Apart from listed companies, practices with other public interest clients, for example, banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools, are given priority for reviews.</p> <p>The frequency of review varies from different practices:</p> <ul style="list-style-type: none"> <li>(i) Big Four firms – subject to practice review annually. It recognises the predominance of listed and other public interest entities in Big Four client portfolios.</li> <li>(ii) Practices with a significant number of listed clients – subject to a full review at least once every three years and an interim review during the three-year cycle. From 2011, practices with more than 20 listed clients will receive an additional interim review. The interim reviews focus on key changes in systems and procedures, action taken following the previous practice review, current auditing and accounting issues, and review of completed listed company audit engagements.</li> <li>(iii) Other practices with listed clients – subject to review at least once every three years.</li> <li>(iv) Other practices – the frequency of review is based on risk profiles and random selection.</li> </ul> <p>The reviews focus on the practice's own quality control procedures and how the practice ensures the quality of its own work. The reviews place emphasis on risk areas and key judgements in audit assignment reviews.</p> <p>The detail and extent of review work to be carried out varies from practice to practice depending on the size of the practice and the nature of the client base.</p>	<p>No – IFIAR</p> <p><i>In respect of the frequency of inspections, the HKICPA has established a minimum cycle regarding the frequency of inspections of CPA firms that audit listed entities (i.e. at least every three years; and annually for Big Four firms). This is considered compliant for EC equivalence, which only requires auditors that audit listed entities in EEA regulated markets to be reviewed at least every six years (please refer to 1.9 below).</i></p> <p><i>However according to the current HKICPA practice review system, there is no clear minimum cycle regarding the frequency of inspection of audit firms that do not audit listed entities – the frequency of review is based on risk profiles and random selection, therefore not all the audit practices are regularly inspected.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.8	<p>(g) the quality assurance review shall be the subject of a report which shall contain the main conclusions of the quality assurance review;</p>	<p><b>IFIAR Principle 11:</b> Audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm.</p> <p><b>IFIAR Principle 11 explanatory material:</b> Audit regulators should have a process that ensures that criticisms or potential defects in an audit firm's quality control systems and issues related to an audit firm's performance of audits that are identified during an inspection are reported to the audit firm.</p> <p>Audit regulators' reporting processes should include the preparation and issuance of a draft inspection report, a process for the audit firm to respond, and the preparation and issuance of a final inspection report.</p>	<p>Matters identified during the practice reviews are fully discussed with the practices. Subsequent to the on-site review, HKICPA will issue a draft report summarising findings and recommendations in relation to the review to the practice. The practice is asked to provide a formal written response to matters raised in the draft report. The response from the practice will be reviewed and submitted together with the reviewer's report to the PRC for consideration. The QAD is responsible for drawing conclusions on the review and making recommendations to the PRC for consideration. The PRC, having regard to the report and any response by the practice to the matters raised in the report, may act under the power given by the PAO to:</p> <p>(a) conclude a practice review with no follow-up action required;</p> <p>(b) make recommendations and specific requests to a practice (e.g. submission of a status report) to ensure appropriate follow-up action is taken to address weaknesses and shortcomings that have been identified by the review;</p> <p>(c) instruct that another visit is required; or</p> <p>(d) make a complaint to initiate a disciplinary action.</p> <p>The PRC sends each practice a formal notification of its decision. A final report will be issued to each audit firm upon completion of the review. The QAD monitors the progress of follow-up action undertaken by the practices at the direction of the PRC.</p>	<p>Yes * (see page 25)</p> <p><i>The HKICPA establishes a reporting mechanism to ensure matters identified from the practice reviews are communicated with the practices and appropriate steps have been taken in addressing the matters being raised.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.9	(h) quality assurance reviews shall take place at least every six years;	<b>No direct equivalent in IFIAR principles</b>	<p>As mentioned in 1.7 above, the frequency of review varies from different practices as follows:</p> <ul style="list-style-type: none"> <li>(i) Big Four firms – subject to practice review annually. It recognises the predominance of listed and other public interest entities in Big Four client portfolios.</li> <li>(ii) Practices with a significant number of listed clients – subject to a full review at least once every three years and an interim review during the three-year cycle. From 2011, practices with more than 20 listed clients will receive an additional interim review. The interim reviews focus on key changes in systems and procedures, action taken following the previous practice review, current auditing and accounting issues, and review of completed listed company audit engagements.</li> <li>(iii) Other practices with listed clients – subject to review at least once every three years.</li> <li>(iv) Other practices – the frequency of review is based on risk profiles and random selection.</li> </ul>	<p>Yes * (see page 25)</p> <p>See Note below</p> <p><i>In order to meet the EC equivalence requirement, the quality assurance review for CPA firms that audit entities listed on the EEA regulated markets shall take place at least every six years.</i></p> <p><i>The HKICPA carries out practice reviews of CPA firms with listed clients (including clients listed on EEA regulated markets) at least every three years (and annually for Big Four firms) – so in terms of the frequency of review of listed entities audits, the EC equivalence requirement should be met.</i></p> <p><u>Note:</u></p> <p><i>Whilst the current HKICPA frequency of review cycle meets the EC equivalence requirement, it does not appear to meet with the IFIAR requirement which requires that all audit firms (whether they audit listed or non-listed entities) shall be reviewed on a regular basis. Currently, the audit practices that do not audit listed entities are only reviewed on a risk and random selection basis. A gap is identified. Please refer to 1.7 for details.</i></p>



## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.10	<p>(i) the overall results of the quality assurance system shall be published annually;</p>	<p><b>IFIAR Principle 3 explanatory material:</b> Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.</p>	<p>The overall results of the practice review are provided to the individual practices which are generally not publicly disclosed. However, there is an annual report issued by the QAD of HKICPA which summarises the activities and findings of the practice review programme which is made public on the HKICPA website.</p> <p>The common issues found under the practice review programme are also communicated through the following channels:</p> <ul style="list-style-type: none"> <li>• Forums hosted by the QAD which go through the quality assurance annual report and discuss common issues identified from the practice review.</li> <li>• Key findings identified from reviews of practices with listed clients are reported in the HKICPA Financial and Auditing Alert.</li> <li>• Findings from the practice review had been used by HKICPA's technical team in providing relevant support for HKICPA's members through ongoing training sessions.</li> </ul> <p>In addition, the HKICPA's activities are made public in HKICPA's monthly newsletter, technical update, monthly magazine and annual report.</p>	<p>Yes * (see page 25)</p> <p><i>The activities and outcomes of the HKICPA practice reviews are published annually on its website and common issues are communicated via other public channels.</i></p>
1.11	<p>(j) recommendations of quality reviews shall be followed up by the statutory auditor or audit firm within a reasonable period. If the recommendations referred to in point (j) are not followed up, the statutory auditor or audit firm shall, if applicable, be subject to the system of disciplinary actions or penalties referred to in Article 30.</p>	<p><b>IFIAR Principle 4:</b> Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p>	<p>The results of practice reviews carried out on practice units by the QAD are reported to the PRC which is the committee responsible for exercising the powers given to the HKICPA by the PAO. Where deficiencies in quality control and audit work of practices are identified, the practice will be required to produce an action plan to address the deficiencies. In addition to proposed action plans, the practice may be required to take specific remedial action.</p> <p>The PRC, having regard to the report and any response by the practice to the matters raised in the report, may act under the power given by the PAO to:</p> <ol style="list-style-type: none"> <li>conclude a practice review with no follow-up action required;</li> <li>make recommendations and specific requests to a practice (e.g. submission of a status report) to ensure appropriate follow-up action is taken to address weaknesses and shortcomings that have been identified by the review;</li> <li>instruct that another visit is required; or</li> <li>make a complaint to initiate a disciplinary action.</li> </ol>	<p>Neither EC nor IFIAR</p> <p><i>A mechanism is established to ensure the practice review results and recommendations are communicated to the practices and appropriate steps are taken to address the matters raised.</i></p> <p><i>The enforcement powers as a result of the practice reviews are given to the PRC (which reports to the HKICPA Council) and the Disciplinary Committee of the HKICPA, subject to the fact that the composition of the PRC presents a gap to meet the EC/IFIAR criteria in relation to the (perceived) objectivity and independence of the quality assurance programme (see 3.4).</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.11		<p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities. Audit regulators should have the authority and ability to enforce inspection findings and recommendations. The audit regulator should have comprehensive enforcement arrangements such as fines, suspensions and the removal of an auditor's or audit firm's licence or registration.</p> <p><b>IFIAR Principle 11 explanatory material:</b> In addition, audit regulators should have a process for ensuring that audit firms satisfactorily address inspection findings that were reported to the audit firm by the audit regulator.</p>	<p>The effectiveness of remedial action will be assessed by the QAD of HKICPA, by review of submitted information or further site visit. If a deficiency is sufficiently serious or remedial action is not taken or is not effective, the PRC could raise a complaint to the HKICPA Council which shall determine whether to refer the complaint to the Disciplinary Panels to consider taking disciplinary actions against the practice.</p> <p>Section 33 of the PAO requires the set up of two Disciplinary Panels:</p> <ul style="list-style-type: none"> <li>• <b>Disciplinary Panel A</b> consists of not fewer than 18 lay persons appointed by the Chief Executive of the HKSAR government of whom one is appointed by the Chief Executive to be the Disciplinary Committee Convenor and another to his alternate.</li> <li>• <b>Disciplinary Panel B</b> consists of not fewer than 12 certified public accountants appointed by the HKICPA's Council of whom not fewer than six are holders of practising certificates.</li> </ul> <p>When a complaint is referred to the Disciplinary Panels, a Disciplinary Committee will be constituted to deal with the complaint by directing the Disciplinary Committee Convenor to appoint five independent persons selected from the two panels as follows:</p> <ul style="list-style-type: none"> <li>• one person appointed by the Disciplinary Committee Convenor from Disciplinary Panel A to be the chairman of the Disciplinary Committee;</li> <li>• two persons appointed by the Disciplinary Committee Convenor from Disciplinary Panel A; and</li> <li>• two persons from Disciplinary Panel B of whom one is the holder of a practising certificate.</li> </ul> <p>The Disciplinary Committee Convenor shall not be appointed as a member of a Disciplinary Committee.</p> <p>A Disciplinary Committee is set up to deal with formal complaints concerning allegations of misconduct by members, member practices or registered students pursuant to section 34 of the PAO and by-law 34 of the Professional Accountants By-laws. The proceedings of the Disciplinary Committee are governed by Part V of the PAO and the Disciplinary Committee Proceedings Rules.</p>	<p><i>The EC/IFIAR requirements state that the disciplinary mechanism must have independent oversight. Article 32(5) of EC Directive 2006/43/EC requires that the system of public oversight shall have the right, where necessary, to conduct investigations in relation to statutory auditors and audit firms, and the right to take appropriate action. IFIAR Principle 4 goes further, and requires that the audit regulator should have the right to investigate and impose sanctions.</i></p> <p><i>A gap is identified in the current disciplinary mechanism in relation to the independent oversight, since complaints against the HKICPA's members or member practices are made either by the PRC as a result of practice review findings or by the Professional Conduct Committee (PCC) which is mainly composed of practising CPAs and has the power to dismiss complaints it considers not pursuable, to adjudicate complaints and to issue formal letters of disapproval, or to recommend that the HKICPA Council refer more serious complaints to the Disciplinary Panels (see 2.4). There is currently no independent public oversight body which has specific oversight of the PCC and the ability to enforce disciplinary actions against the auditors. Also, the members of Disciplinary Panel B are selected by the HKICPA Council, and 2 out of 5 persons of each Disciplinary Panel to be constituted are from Disciplinary Panel B. In addition, matters can be referred to the Disciplinary Panel by the HKICPA Council only.</i></p> <p><i>In order to be EC/IFIAR compliant, whilst certain investigation and enforcement activities could be carried out by the professional body, an independent oversight body must have the ultimate right to investigate, and the right to enforce sanctions (in practice, this means that the sanction of removal of registration has to be within the ultimate responsibility of the independent oversight body).</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	Quality assurance systems			
1.11			<p>The Disciplinary Committee considers whether a prima facie case is established against the member, member practice or registered student, and, if so, whether a hearing of the complaint is necessary. A hearing may not be necessary if the complaints are admitted or the Disciplinary Committee considers the matter can be disposed of by consent order.</p> <p>Disciplinary hearings are normally conducted in public unless the Disciplinary Committee determines that, in the interests of justice, a hearing or any part of it shall be held in private.</p> <p>If the Disciplinary Committee is satisfied that a complaint referred to it under Section 34 of the PAO (including, without reasonable excuse, failure or neglect to comply with any direction with which the practice was required by the Practice Review Committee to comply) is proved, the Disciplinary Committee may in its discretion make the following orders according to the disciplinary powers of the Disciplinary Committee set out in Section 35 of the PAO:</p> <ul style="list-style-type: none"> <li>• an order that the name of the certified public accountant be removed from the register, either permanently or for such period as it may think fit;</li> <li>• an order that the certified public accountant be reprimanded;</li> <li>• an order that the certified public accountant pay a penalty not exceeding HK\$500,000 to the HKICPA;</li> <li>• an order that the certified public accountant pay the costs and expenses of proceedings;</li> <li>• an order that the practising certificate issued to the certified public accountant be cancelled; and</li> <li>• an order that a practising certificate shall not be issued to the certified public accountant either permanently or for such period as the Disciplinary Committee may think fit.</li> </ul> <p>The order of the Disciplinary Committee is published in (1) the HKICPA journal – "APLUS"; (2) a press release; (3) the HKSAR Gazette (removal orders only); and on (4) the HKICPA website.</p>	<p><i>It is a matter of judgement as to whether these penalties are effective, proportionate and dissuasive. The low number of enforcement actions (in relation to the number of registered auditors and audits) suggests that they are dissuasive, and the fact that an auditor can be removed from the register or have their ability to practice removed is effective at removing a threat to systemic audit quality.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
1	<b>Quality assurance systems</b>			
1.12	2. The Commission may, in accordance with the procedure referred to in Article 48(2), adopt implementing measures in order to enhance public confidence in the audit function and to ensure uniform application of points (a), (b) and (e) to (j) of paragraph 1. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 48(2a). None have been adopted to date.	<b>No direct equivalent in IFIAR principles</b>		
2	<b>Systems of investigations and penalties Article 30 of SAD</b>			
2.1	1. Member States shall ensure that there are effective systems of investigations and penalties to detect, correct and prevent inadequate execution of the statutory audit.	<b>IFIAR Principle 4 explanatory material:</b> Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.	<u>Investigations by the Financial Reporting Council (FRC)</u> In 2007, the HKSAR Government set up the FRC which is an independent statutory body established under the Financial Reporting Council Ordinance (FRCO). FRC is a body totally independent of the HKICPA that mainly conducts independent investigations into possible auditing and reporting irregularities in relation to listed entities in Hong Kong, and to enquire into possible non-compliances with accounting requirements on the part of listed entities. <sup>(2)</sup> Investigation and enquiry may be initiated by complaints from the public or referrals from other regulators such as the Securities and Futures Commission (SFC) or the Stock Exchange of Hong Kong (SEHK), or the FRC may initiate investigations or enquiries of complaints on its own initiative. Investigation of potential "relevant irregularities" may be initiated if the FRC believes that there are "circumstances suggesting" or "reasonable cause to believe" that there is or may be an irregularity committed by (i) an auditor in respect of an audit; or (ii) a reporting accountant in respect of the preparation of an accountant's report. The FRC has two operating arms, the Audit Investigation Board (AIB) and the Financial Reporting Review Committee (FRRC) to conduct investigations or enquiries.	Yes * (see page 25)  <i>The FRC and HKICPA have established effective systems of investigations of audit practices.</i>  <i>The HKICPA is authorised to enforce a range of disciplinary actions on the practices if a deficiency identified from the practice review is sufficiently serious, or remedial action is not satisfactorily taken or is not effective, or misconduct of the member or member practices is identified.</i>

<sup>(2)</sup>Prior to establishing the FRC, powers of investigation vested with a number of different parties who were often hampered by their inability to require assistance from all necessary sources. The HKICPA could only exercise its investigatory powers over its own members - its membership does not include listed entities or the majority of individuals (non-accountants) serving on their boards of directors. The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) could only deal with listed entities and directors, but not their auditors. Establishing the FRC with statutory powers of investigation over all relevant parties was seen as an important step in addressing the problem.

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	<i>Is the existing HK system compliant with the EC/IFIAR requirements?</i>
2	Systems of investigations and penalties			
2.1			<p>According to Sections 25 to 28 of the FRCO, the AIB may compel any party it considers it has relevant information to cooperate with its investigations by issuing a "requirement". Typically, auditors are required to produce the audit working papers in relation to a listed entity if that audit is being investigated.</p> <p>Upon completion of an enquiry or an investigation, a report is prepared and adopted by the Council of the FRC. The Council of FRC may decide to publish the entire report or a part of it. A report will not be published if the case is referred to other regulators for disciplinary actions (e.g. HKICPA). However, upon the completion of disciplinary proceedings by other regulators, the FRC may still decide to publish an enquiry or investigation report if it considers that the publication is in the interests of the investing public or in the public interest.</p> <p>Any auditing or reporting irregularities identified by the FRC will be referred to the HKICPA for follow-up action under HKICPA's disciplinary process. Any non-compliance relevant to the Listing Rules will be referred to the SFC or the SEHK for follow-up action. The FRC may require listed entities to remove any non-compliance identified or revise its financial statements to correct such compliance, however, is not empowered to discipline or prosecute.</p> <p>The FRC's investigatory and enquiry power is confined to the listed sector because of the broader public interest associated with such cases. The investigation of possible irregularities of auditors and accountants outside this scope continues to be undertaken by the HKICPA under the PAO.</p> <p>The FRC is not empowered to discipline or prosecute. Such power remains with the appropriate relevant regulatory body, for example, the HKICPA for professional accountants, and the SEHK/SFC for listed entities and their directors.</p> <p><u>Investigations into misconduct of members or member practices by the HKICPA</u></p> <p>The investigation proceedings of HKICPA are governed by Part VA of the PAO. Section 42B of the PAO requires to set up two Investigation Panels:</p> <ul style="list-style-type: none"> <li>• <u>Investigation Panel A</u> shall consist of not fewer than 18 lay persons appointed by the Chief Executive of HKSAR Government of whom one shall be appointed by the Chief Executive to be the Investigation Committee Convenor and another to be his alternate;</li> </ul>	

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
2	Systems of investigations and penalties			
2.1		<ul style="list-style-type: none"> <li>• <u>Investigation Panel B</u> shall consist of not fewer than 12 certified public accountants appointed by the Council of whom not fewer than six shall be holders of practising certificates.</li> </ul> <p>The Council of HKICPA will consider constituting an Investigation Committee when it becomes aware of a matter which gives the Council a reasonable suspicion or belief that a member or member practice has not followed professional standards issued by the HKICPA or has committed other improper acts and the powers of an Investigation Committee are required to facilitate the consideration by the Council of whether to make a referral to the Disciplinary Panels.</p> <p>An Investigation Committee investigates the conduct of a member or member practice of the HKICPA and reports to the Council whether, in its opinion, were a complaint that the member or practice has not followed professional standards issued by the Institute or has committed other improper acts made under section 34(1) of the PAO, the member or member practice would have a case to answer. <sup>(3)</sup></p> <p>The investigation process is as follows:</p> <ol style="list-style-type: none"> <li>1. An Investigation Committee comprises five independent persons: three members including the chairman from Investigation Panel A, which comprises no fewer than 18 lay persons appointed by Government; and two members (at least one of whom must hold a practising certificate) from Investigation Panel B, which comprises no fewer than 12 members of the Institute appointed by the Council.</li> <li>2. The Investigation Committee conducts its investigation and reports to the Council.</li> <li>3. The Council considers the report of the Investigation Committee and decides whether to refer the matter to the Disciplinary Panels or take other appropriate actions.</li> </ol> <p>For the power and types of disciplinary actions on members or member practices of the HKICPA, please refer to 1.11 above.</p>		

<sup>(3)</sup> Following the commencement of operations by the FRC in July 2007, the responsibility for investigation of matters involving listed entities has been assumed by the FRC. Accordingly, the HKICPA is only responsible for investigations of non-listed entities and those involving listed entities which commenced before July 2007.

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
2	<b>Systems of investigations and penalties</b>			
2.2	<p>2. Without prejudice to Member States' civil liability regimes, Member States shall provide for effective, proportionate and dissuasive penalties in respect of statutory auditors and audit firms, where statutory audits are not carried out in conformity with the provisions adopted in the implementation of this Directive.</p>	<p><b>No direct equivalent in IFIAR principles</b></p>	<p>Based on the practice reviews, where corrective action is required to be taken, the PRC has a range of options available that will ensure the follow-up action requested is relevant, appropriate and proportionate to the issues involved and the size and nature of the practice unit.</p> <p>The order of penalties is at the discretion of the Disciplinary Committee in accordance with Section 35 of the PAO. For details, please refer to 1.11 above.</p>	<p>Yes * (see page 25)</p> <p><i>Any disciplinary action or penalties imposed on the practices (and the practising CPAs) have undergone a process of fact finding, evaluation and hearing (if necessary), subject to the fact that the current disciplinary mechanism in Hong Kong is not EC compliant. See 1.11 for details.</i></p> <p><i>The form of penalties taken will be assessed dependent on the gravity of violations or deficiencies.</i></p>
2.3	<p>3. Member States shall provide that measures taken and penalties imposed on statutory auditors and audit firms are appropriately disclosed to the public. Penalties shall include the possibility of the withdrawal of approval.</p>	<p><b>No direct equivalent in IFIAR principles</b></p>	<p>Disciplinary actions against the audit firms and individual practising CPAs are publicised in HKICPA magazine and on the HKICPA website. Disciplinary hearings are also open to the public.</p> <p>The range of disciplinary actions is set out in Section 35 of the PAO. Please refer to 1.11 above for details.</p>	<p>Yes * (see page 25)</p> <p><i>Disciplinary actions imposed on the practices and the practising CPAs are disclosed to the public.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
2	Systems of investigations and penalties			
2.4	<b>No direct equivalent in SAD</b>	<p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should have adequate and appropriate mechanisms for enabling information to be brought to their attention by third parties and for then dealing with such information, such as through complaints procedures or through whistle blowing arrangements. These mechanisms should act in a timely and effective manner and their results followed up through an appropriate system of investigations and penalties in relation to cases of inadequate or noncompliant execution of an audit.</p>	<p>The HKICPA is responsible for regulating the conduct of its members. Accordingly, it deals with complaints concerning the ethical and professional conduct of members, member practices and registered students. Such complaints may arise from matters brought to the attention of the HKICPA by external parties, such as the FRC, Market Misconduct Tribunal, Office of the Commissioner of Insurance, Official Receiver and the SFC. They may also come from members, clients of members, the public or be matters which originate within the HKICPA itself.</p> <p>The HKICPA has no authority to deal with complaints against a person, firm, or body corporate which is not a HKICPA member or a HKICPA registered student. Complaints must be in writing and be adequately supported by adequate evidence indicating that a member, member practice, or registered student of HKICPA has not followed professional standards issued by the HKICPA or has committed other improper acts.</p> <p>The complaints against HKICPA members, member practices and registered students are dealt with by the Professional Conduct Committee of the HKICPA (PCC) supported by the HKICPA's compliance department. The PCC comprises both certified public accountants and lay members.</p> <p>Investigation of complaints concerning possible auditing and reporting irregularities or non-compliances with financial reporting requirements relating to listed entities is outside the jurisdiction of the HKICPA as all such investigations are handled by the FRC. For details of FRC's investigation power, please refer to 2.1 above.</p> <p>The HKICPA's investigation process of complaints is as follows:</p> <ol style="list-style-type: none"> <li>1. The HKICPA carries out an initial assessment of the adequacy of the supporting evidence to determine whether its member, member practice or registered student has failed to follow professional standards issued by the HKICPA or has committed other improper acts.</li> <li>2. On the conclusion of HKICPA enquiries, the compliance department will submit a report on its findings and conclusions to the PCC for its consideration of whether to: <ol style="list-style-type: none"> <li>a. dismiss complaints where the matter is outside the HKICPA's jurisdiction or where there is inadequate evidence to show a prima facie case of an alleged offence;</li> <li>b. issue formal letters of disapproval (Disapproval Letters) to adjudicate minor complaints; or</li> <li>c. Refer more serious complaints to the HKICPA Council for its consideration of whether to refer the matter to the Disciplinary Panels.</li> </ol> </li> </ol>	<p><i>Neither EC nor IFIAR</i></p> <p><i>The mechanism of complaints and system of investigations and penalties are established.</i></p> <p><i>However the PCC's role represents a gap as there is no independent public oversight body which has specific oversight of the PCC and the ability to enforce disciplinary actions against the auditors (see 1.11).</i></p>



## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
2	Systems of investigations and penalties			
2.4			<p>3. The PCC may request information and explanations relating to any complaint from any party, where necessary and may direct any other course of action in relation to dismissed or minor complaints as it may think fit.</p> <p>4. The HKICPA will inform all parties to a complaint as to the dismissal or adjudication of the complaint by the PCC and as to the procedure for lodging an appeal against the decision of the PCC.</p> <p>5. The time required for completing a complaint varies among cases and is affected by factors such as the complexity of the issues involved and the extent of correspondence with the relevant parties in the enquiry process.</p> <p>Where the Council of HKICPA concludes that a complaint is sufficiently serious to warrant the referral of the matter to the Disciplinary Panels, a Disciplinary Committee will be constituted to deal with the complaints. For details, please refer to 1.11 above.</p>	
3	Principles of public oversight (Article 32 of SAD)			
3.1	Article 32 SAD	<p><b>IFIAR Principle 1:</b> The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation.</p>	<p>The HKICPA is incorporated by the Professional Accountants Ordinance. It is the only statutory licensing body of accountants in Hong Kong responsible for professional training, development and regulation of the accountancy profession.</p> <p>The HKICPA's duties on public oversight of auditors are as follows:</p> <ol style="list-style-type: none"> <li>i. registering accountants and issuing practising certificates to professional accountants who have satisfied the professional qualification requirements under the PAO;</li> <li>ii. setting codes of ethics and standards of accounting and auditing;</li> <li>iii. regulating the quality of entry to the profession through its qualification programme and related courses;</li> <li>iv. providing continuing education and other services to members;</li> <li>v. conducting audit quality reviews (or practice reviews);</li> <li>vi. oversight of remedial action taken by audit firms for deficiencies identified during audit quality reviews;</li> <li>vii. conducting investigation and remedial/ disciplinary actions for complaints against or misconduct of its members; and</li> <li>viii. promoting the accountancy profession both in Hong Kong and overseas.</li> </ol> <p>Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.</p>	<p>Yes * ( see page 25)</p> <p><i>The responsibilities and powers of the HKICPA are clearly set out in the PAO.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	Principles of public oversight			
3.2	<p>1. Member States shall organise an effective system of public oversight for statutory auditors and audit firms based on the principles set out in paragraphs 2 to 7.</p>	<p><b>IFIAR Principle 1 explanatory material:</b> The legal framework for audit oversight should set forth the audit regulator's mandate and responsibilities, and provide the regulator with adequate powers and authority that enable the regulator to perform its audit oversight duties, including powers to address, through inspection and enforcement, compliance with the requirements for the authorisation/registration of auditors/audit firms and compliance with applicable auditing, professional and independence standards.</p>	<p>The PAO provides the statutory power to the HKICPA to exercise its authorities and duties for audit oversight. Specifically,</p> <ul style="list-style-type: none"> <li>• Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.</li> <li>• Sections 22 to 28F of the PAO set out the authority of the HKICPA for registration of auditor/audit firms and Sections 29 to 30 set out the requirements for issuing a practising certificate to professional accountants who have satisfied the professional qualification requirements under the PAO.</li> <li>• Sections 32A to 32I of the PAO set out the statutory powers and duties given to the HKICPA as the regulator of auditors in Hong Kong to implement the practice review programme of the practice units and to ensure the auditors/audit practices are in compliance with applicable auditing, professional and independence standards.</li> <li>• Sections 33 to 38 of the PAO and By-law 34 and 35 of the Professional Accountants By-laws set out the powers of the HKICPA to deal with complaints concerning allegations of misconduct of members, member practices or registered students and enforce disciplinary sanctions that the Disciplinary Committee considers appropriate to the circumstances. Disciplinary proceedings are governed by Part V of the PAO and the Disciplinary Committee Proceedings Rules.</li> </ul>	<p><i>Neither EC nor IFIAR, in terms of the funding model and the governance structure of the HKICPA.</i></p> <p>See 3.4 and 3.8 below.</p>
3.3	<p>2. All statutory auditors and audit firms shall be subject to public oversight.</p>	<p><b>IFIAR Principle 1 explanatory material:</b> Audit regulators should have a mandate to work in the public interest and protect investors by seeking to improve audit quality. The responsibilities and powers of audit regulators should, at a minimum, require independent oversight of the audits of public interest entities.</p>	<p>The HKICPA is incorporated by the PAO and works in public interest. Sections 7 and 8 of the PAO set out the objects and the powers of HKICPA. All the practice units defined in the PAO below are subject to practice review by the HKICPA unless they are not carrying out audit or assurance work:</p> <ol style="list-style-type: none"> <li>A firm of certified public accountants (practising) practising accountancy pursuant to the PAO;</li> <li>A certified public accountant (practising) practising accountancy on its own account pursuant to the PAO; or</li> <li>A corporate practice pursuant under the PAO.</li> </ol> <p>The Big Four firms are reviewed annually due to the degree of public interest that there is a predominance of listed and other public interest entities in their client portfolios. Apart from listed companies, practices with other public interest entities, such as banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools, are given priority for review. Please refer to 1.7 for details.</p>	<p><i>Neither EC nor IFIAR</i></p> <p><i>All the practice units defined in the PAO are subject to practice review by the HKICPA. However, on the basis that the current governance structure and funding model of the HKICPA do not appear to satisfy the EC/IFIAR requirements (see 3.4, 3.8, 3.9), the statutory auditors and audit firms are not subject to independent public oversight as required by EC and IFIAR.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	<i>Is the existing HK system compliant with the EC/IFIAR requirements?</i>
3	Principles of public oversight			
3.3				<p><i>In the EU, all statutory auditors must be subject to public oversight regardless of whether or not they are performing listed entity audits. The SAD does not mandate that the actual inspectors cannot be from a professional body or indeed seconded from audit firms, provided that they are under the oversight of the independent oversight body.</i></p> <p><i>Of the 28 EEA states who have notified their inspection systems to the EC:</i></p> <p><i>Nine - inspection by independent oversight body</i></p> <p><i>Eleven - some inspection by independent oversight body, some by professional bodies under independent oversight body supervision</i></p> <p><i>Eight – all inspection by professional bodies under independent oversight body supervision.</i></p>

# 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	Principles of public oversight			
3.4	<p>3. The system of public oversight shall be governed by nonpractitioners who are knowledgeable in the areas relevant to statutory audit. Member States may, however, allow a minority of practitioners to be involved in the governance of the public oversight system. Persons involved in the governance of the public oversight system shall be selected in accordance with an independent and transparent nomination procedure.</p>	<p><b>IFIAR Charter:</b> Member must be independent of the profession, and engaged in audit regulatory functions in the public interest.</p> <p><b>IFIAR Principle 2:</b> Audit regulators should be operationally independent.</p> <p><b>IFIAR Principle 2 explanatory material:</b> Independence means the ability to undertake regulatory activity and to take and enforce decisions without external interference by those regulated. The audit regulator should be operationally independent from external political interference and from commercial, or other sectoral interests, in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p> <p><b>IFIAR Principle 5:</b> Audit regulators should ensure that their staff is independent from the profession and should have sufficient staff of appropriate competence.</p>	<p><u>Governing structure of the HKICPA</u></p> <p>The governing body is the Council of the HKICPA which is responsible for making decisions on overall strategy, policy and direction and oversight of the HKICPA's operation and governance. It is also the decision-making body on matters stipulated in the PAO. Sections 17 to 18B of the PAO set out the powers of the Council.</p> <p>The Council currently consists of 22 non-executives who are volunteers and not compensated. The combination of these members are from within and outside the accounting profession as follows:</p> <ul style="list-style-type: none"> <li>• 14 certified public accountants directly elected by the HKICPA's membership including the immediate past president who sits on the Council to allow for continuity.</li> <li>• Two certified public accountants co-opted by the Council to round out skills.</li> <li>• Two ex-officio member from HKSAR Government.</li> <li>• Four lay members who are prominent business leaders appointed by the HKSAR Government to provide independent views and advice.</li> </ul> <p>The Council applies strict rules to prohibit a Council or committee member from taking part in any discussion or decisions on matters in which he or she has a real or apparent conflict of interest.</p> <p><u>Funding source</u></p> <p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees and income from examination and continuing professional development (CPD) fees.</p> <p>Regarding the funding source of the FRC, please refer to 3.8 below.</p> <p><u>Inspection staff member</u></p> <p>The practice reviews are conducted under the responsibility of the QAD headed by a Director who is supported by professional and administrative review staff. All reviewers of the QAD are employed by the HKICPA working solely in QAD. They are all qualified accountants and are required to undergo regular technical training and updates. To ensure independence, the reviewers have a cooling off period whereby they will not perform a review of the firm where they were employed before joining the HKICPA.</p>	<p>Neither EC nor IFIAR</p> <p><b>Governing structure of the HKICPA:</b> EC Directive 2006/43/EC defines 'non-practitioner' as follows: "any natural person who, for at least three years before his or her involvement in the governance of the public oversight system, has not carried out statutory audits, has not held voting rights in an audit firm, has not been a member of the administrative or management body of an audit firm and has not been employed by, or otherwise associated with, an audit firm."</p> <p><i>This creates a gap in relation to the governance of the audit oversight system, given that the membership of the Council of the HKICPA currently consists of approximately one third practising CPAs (8 out of 22 total members are practising CPAs in audit firms). Whilst enough other Council members may from time to time be 'non-practitioners' such that they form a majority, the current constitution of the Council does not guarantee that this will be the case. Any change (for example, replacement of a current 'non-practitioner' member with a recently retired audit partner) could upset this balance.</i></p> <p><i>The IFIAR charter requires that membership shall be confined to regulatory agencies that are independent of the profession (including audit firms, professional bodies and bodies or entities associated with the profession), which means, a majority of the relevant governing body should be non-practitioners (with an appropriate cooling off period for former auditors); and the funding should be free of undue influence by the profession. The funding model of the HKICPA does not appear to be free of undue influence by the profession, also the HKICPA, being a professional body, does not satisfy the IFIAR charter which requires that member must be independent of the profession.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	Principles of public oversight			
3.4		<p><b>IFIAR Principle 5 explanatory material:</b> Audit regulators should have arrangements in place to ensure that inspection staff members are independent of the profession. These arrangements will, as a minimum, include ensuring that staff members should not be practising auditors or employed by or affiliated with an audit firm, and that the arrangements are not controlled in any form by a professional body.</p>	<p><u>Practice Review Committee (PRC)</u></p> <p>Regarding the quality assurance programme of the HKICPA, the results of the practice reviews carried out on the practice units by the QAD are reported to the PRC which is the committee responsible for exercising the powers and duties given to the HKICPA as the regulator of auditors in Hong Kong under Sections 32A to 32I of the PAO. By law, at least two thirds of the Committee must hold practising certificates. The practising members of the Committee are drawn from the full spectrum of audit firms, representing small practices through Big Four firms. Non-practising members are also included in the Committee to bring an additional perspective to Committee decisions on the quality of work carried out by the practices subject to review. The composition of the Committee is reviewed by the Nomination Committee of the HKICPA every year to ensure a balanced composition.</p>	<p><i>This gap is particularly relevant given: (a) the EC requirement that the system of public oversight <u>shall be mainly governed by non-practitioners</u>; and (b) IFIAR's requirement that the audit regulator should be operationally independent from external political interference and from commercial or other sectoral interests in exercise of its functions and powers, including <u>not being controlled in its governance by audit practitioners</u>.</i></p> <p><b>Composition of the Practice Review Committee:</b> the Committee membership mainly comprises practising members, drawn from the full spectrum of audit firms. This creates a gap in relation to the (perceived) objectivity and independence of the quality assurance programme, which is operated by the HKICPA's own Quality Assurance Department, which in turn reports to the Committee.</p> <p><b>Source of funding of HKICPA:</b> the funding of HKICPA is dependent on its members and students, and the amount of subscription fees is determined by the Council of which the Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the IFIAR and EC criteria of being completely free from any possible undue influence by auditors and audit firms as required.</p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	<b>Principles of public oversight</b>			
3.5	<p>4. The system of public oversight shall have the ultimate responsibility for the oversight of:</p> <p>(a) the approval and registration of statutory auditors and audit firms;</p> <p>(b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing; and</p> <p>(c) continuing education, quality assurance and investigative and disciplinary systems.</p>	<b>No direct equivalent in IFIAR principles</b>	<p>See 3.1 above for duties of the HKICPA.</p> <p>See 2.1 above for FRC's investigation responsibilities.</p>	<p>No - EC</p> <p><i>The relevant responsibilities of the HKICPA are set out in the PAO and the the FRC's investigation power is set out in the FRC Ordinance. However, given that the HKICPA is not independent under EC/IFIAR , there is currently no independent oversight body in Hong Kong which has the ultimate responsibility for the oversight of these activities.</i></p> <p><i>The EC requirements state that certain activities including the administrative maintenance of registration of statutory auditors and audit firms, proposing new - or changes to - professional standards, and organising continuing education can be delegated and taken up by a professional body. This is provided that there is an independent oversight body which has the ultimate right to: enforce the decision of the professional body to withdraw an individual and/or firm's registration as a result of sanctions; approve any professional standards proposed by the professional body; enforce the professional body to report on their exercises; direct the professional body, if it does not think that the professional body is acting appropriately.</i></p>
3.6	<p>5. The system of public oversight shall have the right, where necessary, to conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action.</p>	<b>No direct equivalent in IFIAR principles</b>	<p>The HKICPA is empowered under the PAO to conduct investigations when the Council becomes aware of a matter which gives the Council a reasonable suspicion or belief that a member or a member practice has not followed professional standards issued by the HKICPA or has committed other improper acts. Sections 42B to 42E of PAO set out the appointment and powers of the Investigation Committee.</p> <p>In addition, in 2007, the FRC was established by the HKSAR Government which is charged with investigating possible non-compliances with financial reporting standards and audit deficiencies in relation to listed entities in Hong Kong. The investigation and enquiries power of the FRC are set out in the Financial Reporting Council Ordinance.</p> <p>For details, refer to 2.1 above.</p>	<p>Yes * (see page 25)</p> <p><i>The investigation responsibilities are taken up by both the HKICPA and the FRC.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	Principles of public oversight			
3.7	<p>6. The system of public oversight shall be transparent. This shall include the publication of annual work programmes and activity reports.</p>	<p><b>IFIAR Principle 3:</b> Audit regulators should be transparent and accountable.</p> <p><b>IFIAR Principle 3 explanatory material:</b> The audit regulator should have public accountability in the use of its powers and resources to ensure that the audit regulator maintains its integrity and credibility. Further, the decisions and actions of the audit regulator should be subject to appropriate scrutiny and review, including appeal to a higher authority. Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.</p>	<p>The overall results of practice review are provided to the individual practices which are generally not publicly disclosed. However, there is an annual report issued by the QAD which summarises the activities and findings of the practice review programme which is made public on the HKICPA website.</p> <p>The common issues found under the practice review programme were also communicated through various channels. For details, please refer to 1.10 above.</p> <p>The final results of practice review are reported to the PRC which reaches its own decisions on practices' compliance with professional standards and the appropriate follow-up action. The activities and operations of the PRC are subject to scrutiny by the Council of HKICPA and the Standards and Quality Accountability Board (SQAB). The SQAB oversees the performance of the HKICPA's practice review programme and ensures that the QAD activities are carried out in accordance with the strategies and policies determined by the Council and in the public interest.</p>	<p>Yes * (see page 25)</p> <p><i>The activities and outcome of the HKICPA practice reviews are annually published on its website and common issues are communicated via other public channels.</i></p>
3.8	<p>7. The system of public oversight shall be adequately funded. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms.</p>	<p><b>IFIAR Charter:</b> Funding should be free of undue influence by the profession.</p> <p><b>IFIAR Principle 2 explanatory material:</b> The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p>	<p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and continuing professional development ("CPD") fees.</p> <p><u>Funding of the FRC</u></p> <p>The operation of the FRC is currently funded jointly and equally by four parties, namely, the Hong Kong Government's Companies Registry Trading Fund, the Securities and Futures Commission (SFC), the Hong Kong Exchanges and Clearing Limited (HKEx) and the HKICPA. The four parties have signed a Memorandum of Understanding under which they have agreed to contribute as follows:</p> <ul style="list-style-type: none"> <li>- HK\$5 million each (a one-off total of HK\$20 million) to establish a Reserve Fund;</li> <li>- HK\$4 million each (a total of HK\$16 million) for recurring expenses of the FRC in 2010;</li> <li>- Contributions for the recurring expenses will be adjusted for inflation from 2011 to 2014.</li> </ul>	<p>Neither EC nor IFIAR</p> <p><i>The funding of HKICPA is mainly dependent on its members and students, and the amount of subscription fees is determined by the Council of which the Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the IFIAR and EC criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	Principles of public oversight			
3.9	<b>[No direct equivalent in SAD]</b>	<p><b>IFIAR Principle 6:</b> Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements. Audit regulators should maintain the highest standards of ethical conduct to provide the public with confidence in the objectivity of their decisions. Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff and ensure that appropriate arrangements are in place to protect confidential information from public dissemination.</p>	<p>The Council is the governing body of the HKICPA and consists wholly of volunteers – non-executive members who are not compensated. The Council is responsible for making decisions on overall strategy, policy and direction and oversight of the HKICPA's operation and governance. It is also the decision-making body on matters stipulated in the PAO. Members of the Council include CPAs elected by the members of HKICPA, ex-officio members from the HKSAR Government and lay members who are prominent business leaders appointed by the government. The combination of these members from within and outside the accounting profession gives the Council a balanced perspective from which to debate the issues it faces. The Council applies strict rules to prohibit a Council or committee member from taking part in any discussions or decision on matters in which he or she has a real or apparent conflict of interest.</p> <p>Regarding the practice review programme led by the QAD, the results of the practice review are required to be reported to the PRC, a committee of the HKICPA with responsibility to the Council for exercising the statutory powers and duties given to the HKICPA as the regulator of auditors in Hong Kong. The PRC is a crucial element in enabling the HKICPA to operate a robust but fair system of audit regulation that meets the expectation of local and international stakeholders. The membership of PRC is made up primarily of practising members. The inclusion of non-practising members could ensure the impartiality of PRC decisions on the quality of work carried out by the practices subject to practice review. The practising members of the PRC are drawn from the full spectrum of audit firms, representing small practices through to the Big Four, ensuring that there is sufficient and relevant knowledge of the audit profession to be drawn on.</p> <p>All PRC members are required to give undertakings regarding confidentiality of information that they have access to during the course of Committee work and there is careful monitoring to ensure any potential conflicts of interest are identified and effectively managed.</p>	<p>No - IFIAR</p> <p><i>Gaps identified in respect of the governance structure of the Council of the HKICPA and also the composition of the Practice Review Committee. See 3.4 above.</i></p>



## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC/IFIAR requirements?
3	Principles of public oversight			
3.10	<b>[No direct equivalent in SAD]</b>	<p><b>IFIAR Principle 7:</b> Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties. Taking into account the global nature of the financial markets, where necessary and relevant, cooperation and information sharing with other audit regulators and other third parties, including financial market regulators, is helpful to improve audit quality. Audit regulators should provide timely assistance to each other within reasonable limits. Arrangements should be in place for sharing information between audit regulators and other regulators (or between parts of the audit oversight system if it involves more than one body), and for protecting the confidentiality of such information.</p>	<p><u>Cooperation with domestic regulatory authorities</u></p> <p>There is a Memorandum of Understanding (MOU) in place between the FRC and the HKICPA dealing with referrals of matters from the HKICPA to FRC when the HKICPA becomes aware of issues that fall within the remit of the FRC; and the referral of cases from the FRC to HKICPA when an investigation results in a recommendation of disciplinary action.</p> <p>In addition, the FRC has signed a number of MOUs with other regulatory bodies including the HKEx, the SFC, the Hong Kong Monetary Authority and the Insurance Authority. The MOUs establish working arrangements and protocols between the signing parties.</p> <p>In Hong Kong, the HKICPA, the FRC and the HKEx carry out similar programmes of reviews of listed companies financial statements. The regulatory bodies regularly communicate with each other to share observations noted from reviews of listed company financial statements.</p> <p>In addition, Section 12 of the FRCO authorises the FRC to provide assistance and cooperation with the specified authorities under certain circumstances. If the FRC is of the opinion that certain conditions are satisfied, it may refer to or provide assistance to a specified authority on the authority's investigation or enquiry into, or dealing with, any case or complaint concerning a relevant irregularity or non-compliance in relation to a listed entity.</p> <p><u>Cross-border cooperation with overseas regulatory authorities</u></p> <p>We understand that the HKICPA is willing to engage and cooperate with other countries' audit regulators, including exchange of information with other audit regulators to the extent not prohibited the relevant laws and regulations.</p> <p>There are confidentiality and secrecy provisions in the PAO regarding information relating to audit inspections and disciplinary cases. Personal information is protected by Personal Data Privacy Ordinance in Hong Kong, and consent needs to be obtained before release of information. Certain audit entities might be subject to the State Secrets Law or relevant laws and regulations in Mainland China.</p> <p>In 2009, the HKICPA signed a MOU with the Ministry of Finance in the People's Republic of China (China MOF) to facilitate cooperation between both parties in fulfilling their respective regulatory responsibilities.</p>	<p>Yes * (see page 25)</p> <p><i>There are a number of cooperative MOUs in place with domestic and overseas regulatory authorities.</i></p> <p><i>However the FRC cannot enter into MOUs with IFIAR members because it does not have inspection and follow-up powers and HKICPA cannot sign MOUs with IFIAR members because it is not independent of the profession.</i></p>

## 3.1 Hong Kong - IFIAR-EC gap analysis (cont'd)

	EC Equivalence requirements	IFIAR	Features of current Hong Kong audit oversight system	<i>Is the existing HK system compliant with the EC/IFIAR requirements?</i>
3	Principles of public oversight			
3.10			<p>In 2007 and 2011, the HKICPA signed joint declarations with the China Auditing Standards Board and the Chinese Institute of CPAs (CICPA) on the ongoing convergence of Mainland and Hong Kong auditing standards and on the convergence of respective Code of Ethics for Professional Accountants.</p> <p>The HKICPA has also initiated various discussions with the Mainland regulatory authorities and overseas regulatory bodies to discuss standard setting, regulatory reform or cross-border oversight related matters.</p> <p>In 2009, the FRC signed a MOU with China MOF which established a framework for investigative cooperation. The FRC could investigate, through the China MOF, potential auditing irregularities in relation to Mainland auditors of Hong Kong listed companies. Increased interaction with the Mainland authorities with regard to the exchange of views and knowledge is anticipated. Specifically, the FRC has established a system designed to foster cross-border cooperation on cases with the China MOF. The FRC and China MOF have been developing detailed work processes and guidelines to implement that scheme.</p>	



## 3.2 Hong Kong - EC gap analysis

### Analysis of Hong Kong audit oversight system versus the requirements for gaining regulatory equivalence of the EC.

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems (Article 29 of SAD)		
	1. Each Member State shall ensure that all statutory auditors and audit firms are subject to a system of quality assurance which meets at least the following criteria:		
1.1	(a) the quality assurance system shall be organised in such a manner that it is independent of the reviewed statutory auditors and audit firms and subject to public oversight as provided for in Chapter VIII; Chapter VIII of the SAD includes Article 32: Principles of public oversight (see below) and Articles 33 to 36 which set out requirements for cooperation at community level, mutual recognition between member states, designation of competent authorities and professional secrecy and regulatory cooperation between member states.	<p>The Hong Kong Institute of Certified Public Accountants (HKICPA) is incorporated by the Professional Accountants Ordinance (PAO) which sets out its statutory obligations. It is the only statutory licensing body of accountants in Hong Kong responsible for professional training, development and regulation of the accountancy profession.</p> <p>In 1992, the HKICPA introduced a Practice Review programme under the authority and powers granted by the PAO with the objective of enhancing the quality of work of the HKICPA members engaged in audit and related assurance activities.</p> <p>The Practice Review programme forms an important element in the overall scheme of audit regulation in Hong Kong. The practice review covers the provision of audit and other related assurance services in Hong Kong by firms, corporate practices and individual practising certificate holders (i.e. practice units). The programme aims to assess whether a practice unit has an adequate system of quality control to ensure work quality is maintained in every assurance and related service engagement. The Practice Review programme was revised in 2006 in light of international developments and increasing expectations of regulation and monitoring of auditors. The revised programme places greater emphasis on addressing areas of significant public interest, such as audits of public listed companies and the review process has been revised to focus on risk – in the selection of practice units and specific audit engagements for review. The practice reviews focus on practice units that are engaged in auditing higher profile of public interest, predominantly listed entities.</p>	<p>No.</p> <p><i>The practice reviews are conducted by the full-time employees of the Quality Assurance Department of the HKICPA following the instructions of the Practice Review Committee (PRC) and in turn report to the Committee. Also, the results of the practice reviews are reported to the PRC. The composition of the PRC which comprises mainly practising members presents a gap in relation to the (perceived) objectivity and independence of the quality assurance programme that are basic principles for an independent public oversight body, in terms of the EC requirements (see 3.4 for details).</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.1		<p>The practice reviews are conducted under the responsibility of the full-time employees of the Quality Assurance Department (QAD) of the HKICPA which report to the Practice Review Committee (PRC). The PRC is the committee responsible for exercising the powers and duties given to the HKICPA as the regulator of auditors in Hong Kong under Sections 32A to 32I of the PAO. The QAD is headed by a Director who is supported by professional and administrative review staff. Under Section 32D of PAO, the PRC may determine the practice and procedure to be observed in relation to practice reviews; issue instructions to any reviewer on any matter relating to practice reviews or a particular practice review, or perform any other thing as considered necessary. The PRC has also prepared for reviewers a reviewer's manual which determines the procedures reviewers should adopt with respect to practice reviews.</p> <p>The results of the practice reviews carried out on practice units by the QAD are reported to the PRC.</p> <p>The HKICPA's practice review programme identifies deficiencies in quality control and audit work of the practice subject to review. Where deficiencies are identified, the practice will be required to produce an action plan or specific remedial action to address the deficiencies. If a deficiency is sufficiently serious or remedial action is not taken or is not effective, disciplinary action may be taken against the practice. The power of exercising disciplinary actions by the HKICPA against members or member practices is set out in the PAO.</p> <p>For details of the practice review process, refer to 1.5 below.</p>	
1.2	(b) the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms;	The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and continuing professional development (CPD) fees.	<p>No.</p> <p><i>The funding of the operation of the HKICPA is mainly dependent on its members and students, and the amount of subscription fees is determined by the Council. The Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the EC equivalence criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.3	(c) the quality assurance system shall have adequate resources;	<p>There is a team of full-time reviewers reporting to the Director of QAD. The time allocated for reviews varies depending on the nature and size of the practice and its client base.</p> <p>Details of arrangements for on-site inspection, findings and recommendations coming out from the practice reviews are discussed amongst the team of reviewers and the Director of QAD.</p>	<p>Yes *</p> <p><i>The HKICPA has a full team of reviewers who conduct the practice reviews.</i></p>
1.4	(d) the persons who carry out quality assurance reviews shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;	<p>All the reviewers of the QAD are qualified accountants with experience in auditing and are required to undergo regular technical training and updates. The reviewers have an audit background and have been engaged in learning and development activities to keep them up to date with professional standards and to enhance their skills in dealing with practices in a fair and sensitive manner.</p>	<p>Yes *</p> <p><i>All reviewers are qualified CPAs with a background in auditing and regular professional training and update are required.</i></p>

\* To note: if the HKICPA were independent, it would be compliant with the requirements.

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.5	<p>(e) the selection of reviewers for specific quality assurance review assignments shall be effected in accordance with an objective procedure designed to ensure that there are no conflicts of interest between the reviewers and the statutory auditor or audit firm under review;</p>	<p>The reviewers of QAD have a cooling off period whereby they will not perform a review of the firm where they were employed by before joining the HKICPA.</p> <p>The practice reviews include the following major processes:</p> <p><u>(i) Selection of practice for practice review visit</u></p> <p>All the practice units defined in the PAO below are subject to the Practice Review by the HKICPA unless they are not carrying out audit or assurance work:</p> <p>a) A firm of (practising) certified public accountants, practising accountancy pursuant to the PAO;</p> <p>b) A (practising) certified public accountant, practising accountancy on its own account pursuant to the PAO; or</p> <p>c) A corporate practice pursuant under the PAO.</p> <p>The QAD selects the practices for review primarily based on risk factors including the public interest profile of audit clients. The selection of practices is identified from a desktop review of practices' responses in the practice review self-assessment questionnaire<sup>(1)</sup> and other relevant information. Practices with regulated or significant public interest entity clients (but not listed entities) are given priority for site visit reviews. A number of practices are selected for site visit reviews on a random basis to ensure that all practices will have a reasonable chance of being selected. For details of frequency of review of different practices, please refer to 1.9 below.</p> <p><u>ii) Notification to audit firms</u></p> <p>Practices selected for practice review visits are normally advised of the proposed visit date several weeks in advance. The QAD will agree the visit date with the practice before the issue of formal notification and request for key documents. The site visit will normally be scheduled for six weeks after the formal notification.</p> <p><u>(iii) Preliminary assessment of submitted key documents</u></p> <p>Practices will be requested to provide certain information and a client list for preliminary assessment by the reviewers. The reviewers will carry out preliminary assessment on the key documents and notify the audit firm of the list of audit engagements selected for the on-site review.</p>	<p>Yes * (see page 53)</p> <p><i>The reviewers should be independent of the audit practices and there is a cooling off period before a practitioner can act as an HKICPA reviewer for the firm he/she left.</i></p> <p><i>The HKICPA is authorised by the PAO to conduct practice reviews of the audit practices (including firms undertaking audits of listed entities) in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</i></p>

(1) As stipulated in paragraph 3 of the Appendix of Statement in 1.401 (March 2006) Practice Review – Review and Conduct of Members, all practice units are required to complete the practice review self-assessment questionnaire on an annual basis. The questionnaire will collect three main categories of information about a practice unit: i) organisation and management of the practice unit; ii) quality control policies and procedures established by the practice unit; and iii) client profile of the practice unit.

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.5		<p><u>(iv) Scope of review</u></p> <p>The scope of practice review includes: (a) obtaining an understanding of the practice's system of quality control; (b) assessing the effectiveness of the system of quality control in achieving compliance with Hong Kong Standard on Quality Control 1 (HKSQC 1); and (c) assessing compliance with professional standards in the operation of quality control procedures and the conduct of audit work.</p> <p>The detail and extent of review that the reviewers will need to carry out varies from practice to practice depending on a number of factors including the size of the practice and the nature of the client bases. However, the work typically carried out during the on-site visit includes:</p> <ul style="list-style-type: none"> <li>(a) interviewing different levels of personnel to assess the practice's culture and commitment to quality;</li> <li>(b) reviewing the documented quality control procedures and checking how they are applied in practice;</li> <li>(c) reviewing audit methodology and procedures to ensure they are up to date and include reference to current professional standards and relevant application guidance for staff;</li> <li>(d) reviewing selected engagement files to evaluate the application of audit procedures, the design and selection of audit working response to assessed risk; the basis for key audit judgements and conclusions, and the adequacy of audit evidence and documentation;</li> <li>(e) communication of findings from the practice review to the practice; and</li> <li>(f) providing practical advice to the practice on possible improvements in efficiency of the audit process and to address weaknesses that have been identified by the reviewers.</li> </ul> <p>Opening and exit meetings will be held among the practice review reviewers and the representatives of the practice.</p>	



## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.6	<p>(f) the scope of the quality assurance review, supported by adequate testing of selected audit files, shall include an assessment of compliance with applicable auditing standards and independence requirements, of the quantity and quality of resources spent, of the audit fees charged and of the internal quality control system of the audit firm;</p>	<p>The scope of practice review includes obtaining an understanding of the practice's system of quality control, assessing compliance of policies and procedures with HKSQC 1 and reviewing the conduct of audit work. See details in 1.5 above.</p> <p>HKSQC 1 requires the practice to establish a system of quality control designed to provide it with reasonable assurance that the practice and its personnel comply with professional standards, and regulatory and legal requirements (including ethical and independence requirements), and that reports issued by the practice or engagement partner are appropriate in the circumstances.</p> <p>HKSQC 1 also requires the practices to assess the integrity of a client during the process of acceptance and continuance of client relationships and specific engagements by considering whether the client is aggressively concerned with maintaining the firm's fees as low as possible. In addition, HKSQC 1 requires the practice to establish policies and procedures to monitor workload and availability of resources to enable the individuals to have sufficient time to adequately discharge their responsibilities.</p> <p>The current revamped practice review programme places greater emphasis on addressing areas of significant public interest, such as audits of public listed companies, and other public interest entities such as banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools. The review process has been revised to focus on risk – in the selection of practice units and specific audit engagements for review. The practice review focuses on inspecting practice units that are engaged in auditing higher profile, public interest, predominately listed entities and adopts risk-based inspection procedures.</p>	<p>Yes * (see page 53)</p> <p><i>The scope of HKICPA's practice reviews includes the review of firm's policies and procedures of internal quality controls according to HKSQC1 (which also covers the review of audit fees and time spent on the engagement) as well as the quality of audit engagements.</i></p> <p><i>The practice reviews are conducted on a risk-based approach.</i></p>
1.8	<p>(g) the quality assurance review shall be the subject of a report which shall contain the main conclusions of the quality assurance review;</p>	<p>Matters identified during the practice reviews are fully discussed with the practices. Subsequent to the on-site review, HKICPA will issue a draft report summarising findings and recommendations in relation to the review to the practice. The practice is asked to provide a formal written response to matters raised in the draft report. The response from the practice will be reviewed and submitted together with the reviewer's report to the PRC for consideration. The QAD is responsible for drawing conclusions on the review and making recommendations to the PRC for consideration. The PRC, having regard to the report and any response by the practice to the matters raised in the report, may act under the power given by the PAO to:</p> <p>(a) conclude a practice review with no follow-up action required ("direct closed");</p> <p>(b) make recommendations and specific requests to a practice (e.g. submission of a status report) to ensure appropriate follow-up action is taken to address weaknesses and shortcomings that have been identified by the review ("required follow-up action");</p> <p>(c) instruct that another visit is required ("required follow-up visit"); or</p> <p>(d) make a complaint to initiate a disciplinary action.</p> <p>The PRC sends each practice a formal notification of its decision. A final report will be issued to each audit firm upon completion of the review. The QAD monitors the progress of follow-up action undertaken by the practices at the direction of the PRC.</p>	<p>Yes * (see page 53)</p> <p><i>The HKICPA establishes a reporting mechanism to ensure matters identified from the practice reviews are communicated with the practices and appropriate steps have been taken in addressing the matters being raised.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.9	(h) quality assurance reviews shall take place at least every six years;	<p>The frequency of review varies from different practices as follows:</p> <p>(i) Big Four firms – subject to practice review annually. It recognises the predominance of listed and other public interest entities in Big Four client portfolios.</p> <p>(ii) Practices with a significant number of listed clients – subject to a full review at least once every three years and an interim review during the three-year cycle. From 2011, practices with more than 20 listed clients will receive an additional interim review. The interim reviews focus on key changes in systems and procedures, action taken following the previous practice review, current auditing and accounting issues, and review of completed listed company audit engagements.</p> <p>(iii) Other practices with listed clients – subject to review at least once every three years.</p> <p>(iv) Other practices – the frequency of review is based on risk profiles and random selection.</p>	<p>Yes * (see page 53)</p> <p><i>In order to meet the EC equivalence requirement, the quality assurance review for CPA firms that audit entities listed on the EEA regulated markets shall take place at least every six years.</i></p> <p><i>The HKICPA carries out practice reviews of CPA firms with listed clients (including clients listed on EEA regulated markets) at least every three years (and annually for Big Four firms) – so in terms of the frequency of review of listed entities audits, the EC equivalence requirement should be met.</i></p>
1.10	(i) the overall results of the quality assurance system shall be published annually;	<p>The overall results of the practice review are provided to the individual practices which are generally not publicly disclosed. However, there is an annual report issued by the QAD of HKICPA which summarises the activities and findings of the practice review programme which is made public on the HKICPA website.</p> <p>The common issues found under the practice review programme are also communicated through the following channels:</p> <ul style="list-style-type: none"> <li>• Forums hosted by the QAD which go through the quality assurance annual report and discuss common issues identified from the practice review.</li> <li>• Key findings identified from reviews of practices with listed clients are reported in the HKICPA Financial and Auditing Alert.</li> <li>• Findings from the practice review had been used by HKICPA's technical team in providing relevant support for HKICPA's members through ongoing training sessions.</li> </ul> <p>In addition, the HKICPA's activities are made public in HKICPA's monthly newsletter, technical update, monthly magazine and annual report.</p>	<p>Yes * (see page 53)</p> <p><i>The activities and outcomes of the HKICPA practice reviews are published annually on its website and common issues are communicated via other public channels.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.11	<p>(j) recommendations of quality reviews shall be followed up by the statutory auditor or audit firm within a reasonable period. If the recommendations referred to in point (j) are not followed up, the statutory auditor or audit firm shall, if applicable, be subject to the system of disciplinary actions or penalties referred to in Article 30.</p>	<p>The results of practice reviews carried out on practice units by the QAD are reported to the PRC which is the committee responsible for exercising the powers given to the HKICPA by the PAO. Where deficiencies in quality control and audit work of practices are identified, the practice will be required to produce an action plan to address the deficiencies. In addition to proposed action plans, the practice may be required to take specific remedial action.</p> <p>The PRC, having regard to the report and any response by the practice to the matters raised in the report, may act under the power given by the PAO to:</p> <ul style="list-style-type: none"> <li>(a) conclude a practice review with no follow-up action required;</li> <li>(b) make recommendations and specific requests to a practice (e.g. submission of a status report) to ensure appropriate follow-up action is taken to address weaknesses and shortcomings that have been identified by the review;</li> <li>(c) instruct that another visit is required; or</li> <li>(d) make a complaint to initiate a disciplinary action.</li> </ul> <p>The effectiveness of remedial action will be assessed by the QAD of HKICPA, by review of submitted information or further site visit. If a deficiency is sufficiently serious or remedial action is not taken or is not effective, the PRC could raise a complaint to the HKICPA Council, which shall determine whether to refer the complaint to the Disciplinary Panels to consider taking disciplinary actions against the practice.</p> <p>Section 33 of the PAO requires the set up of two Disciplinary Panels:</p> <ul style="list-style-type: none"> <li>• <u>Disciplinary Panel A</u> consists of not fewer than 18 lay persons appointed by the Chief Executive of the HKSAR government of whom one is appointed by the Chief Executive to be the Disciplinary Committee Convenor and another to his alternate.</li> <li>• <u>Disciplinary Panel B</u> consists of not fewer than 12 certified public accountants appointed by the HKICPA's Council of whom not fewer than six are holders of practising certificates.</li> </ul> <p>When a complaint is referred to the Disciplinary Panels, a Disciplinary Committee will be constituted to deal with the complaint by directing the Disciplinary Committee Convenor to appoint five independent persons selected from the two panels as follows:</p> <ul style="list-style-type: none"> <li>• one person appointed by the Disciplinary Committee Convenor from Disciplinary Panel A to be the chairman of the Disciplinary Committee;</li> <li>• two persons appointed by the Disciplinary Committee Convenor from Disciplinary Panel A; and</li> <li>• two persons from Disciplinary Panel B of whom one is the holder of a practising certificate.</li> </ul>	<p>No.</p> <p><i>A mechanism is established to ensure the practice review results and recommendations are communicated to the practices and appropriate steps are taken to address the matters raised.</i></p> <p><i>The enforcement powers as a result of the practice reviews are given to the PRC (which reports to the HKICPA Council) and the Disciplinary Committee of the HKICPA, subject to the fact that the composition of the PRC presents a gap to meet the EC/IFIAR criteria in relation to the (perceived) objectivity and independence of the quality assurance programme (see 3.4).</i></p> <p><i>The EC requirements state that the disciplinary mechanism must have independent oversight. Article 32(5) of EC Directive 2006/43/EC requires that the system of public oversight shall have the right, where necessary, to conduct investigations in relation to statutory auditors and audit firms, and the right to take appropriate action.</i></p> <p><i>A gap is identified in the current disciplinary mechanism in relation to the independent oversight, since complaints against the HKICPA's members or member practices are made either by the PRC as a result of practice review findings or by the Professional Conduct Committee (PCC) which is mainly composed of practising CPAs and has the power to dismiss complaints it considers not pursuable, to adjudicate complaints and to issue formal letters of disapproval, or to recommend that the HKICPA Council refer more serious complaints to the Disciplinary Panels. There is currently no independent public oversight body which has specific oversight of the PCC and the ability to enforce disciplinary actions against the auditors. Also, the members of Disciplinary Panel B are selected by the HKICPA Council, and 2 out of 5 persons of each Disciplinary Panel to be constituted are from Disciplinary Panel B. In addition, matters can be referred to the Disciplinary Panel by the HKICPA Council only.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.11		<p>The Disciplinary Committee Convenor shall not be appointed as a member of a Disciplinary Committee.</p> <p>A Disciplinary Committee is set up to deal with formal complaints concerning allegations of misconduct by members, member practices or registered students pursuant to section 34 of the PAO and by-law 34 of the Professional Accountants By-laws. The proceedings of the Disciplinary Committee are governed by Part V of the PAO and the Disciplinary Committee Proceedings Rules.</p> <p>The Disciplinary Committee considers whether a prima facie case is established against the member, member practice or registered student, and, if so, whether a hearing of the complaint is necessary. A hearing may not be necessary if the complaints are admitted or the Disciplinary Committee considers the matter can be disposed of by consent order. Disciplinary hearings are normally conducted in public unless the Disciplinary Committee determines that, in the interests of justice, a hearing or any part of it shall be held in private.</p> <p>If the Disciplinary Committee is satisfied that a complaint referred to it under Section 34 of the PAO (including, without reasonable excuse, failure or neglect to comply with any direction with which the practice was required by the Practice Review Committee to comply) is proved, the Disciplinary Committee may in its discretion make the following orders according to the disciplinary powers of the Disciplinary Committee set out in Section 35 of the PAO:</p> <ul style="list-style-type: none"> <li>• an order that the name of the certified public accountant be removed from the register, either permanently or for such period as it may think fit;</li> <li>• an order that the certified public accountant be reprimanded;</li> <li>• an order that the certified public accountant pay a penalty not exceeding HK\$500,000 to the HKICPA;</li> <li>• an order that the certified public accountant pay the costs and expenses of proceedings;</li> <li>• an order that the practising certificate issued to the certified public accountant be cancelled; and</li> <li>• an order that a practising certificate shall not be issued to the certified public accountant either permanently or for such period as the Disciplinary Committee may think fit.</li> </ul> <p>The order of the Disciplinary Committee is published in (1) the HKICPA journal – "APLUS"; (2) a press release; (3) the HKSAR Gazette (removal orders only); and on (4) the HKICPA website.</p>	<p><i>In order to be EC compliant, whilst certain investigation and enforcement activities could be carried out by the professional body, an independent oversight body must have the ultimate right to investigate, and the right to enforce sanctions (in practice, this means that the sanction of removal of registration has to be within the ultimate responsibility of the independent oversight body).</i></p> <p><i>It is a matter of judgement as to whether these penalties are effective, proportionate and dissuasive. The low number of enforcement actions (in relation to the number of registered auditors and audits) suggests that they are dissuasive, and the fact that an auditor can be removed from the register or have their ability to practice removed is effective at removing a threat to systemic audit quality.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
1	Quality assurance systems		
1.12	<p>2. The Commission may, in accordance with the procedure referred to in Article 48(2), adopt implementing measures in order to enhance public confidence in the audit function and to ensure uniform application of points (a), (b) and (e) to (j) of paragraph 1. Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 48(2a). None have been adopted to date.</p>		
2	Systems of investigations and penalties (Article 30 of SAD)		
2.1	<p>1. Member States shall ensure that there are effective systems of investigations and penalties to detect, correct and prevent inadequate execution of the statutory audit.</p>	<p><u>Investigations by the FRC</u></p> <p>In 2007, the HKSAR Government set up the FRC which is an independent statutory body established under the Financial Reporting Council Ordinance (FRCO). FRC is a body totally independent of the HKICPA that mainly conducts independent investigations into possible auditing and reporting irregularities in relation to listed entities in Hong Kong, and to enquire into possible non-compliances with accounting requirements on the part of listed entities.<sup>(2)</sup></p>	<p>Yes <sup>*</sup> (see page 53)</p> <p><i>The FRC and HKICPA have established effective systems of investigations of audit practices.</i></p> <p><i>The HKICPA is authorised to enforce a range of disciplinary actions on the practices if a deficiency identified from the practice review is sufficiently serious, or remedial action is not satisfactorily taken or is not effective, or misconduct of the member or member practices is identified.</i></p>

<sup>(2)</sup> Prior to establishing the FRC, powers of investigation vested with a number of different parties who were often hampered by their inability to require assistance from all necessary sources. The HKICPA could only exercise its investigatory powers over its own members - its membership does not include listed entities or the majority of individuals (non-accountants) serving on their boards of directors. The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) could only deal with listed entities and directors, but not their auditors. Establishing the FRC with statutory powers of investigation over all relevant parties was seen as an important step in addressing the problem.

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
2	Systems of investigations and penalties		
2.1		<p>Investigation and enquiry may be initiated by complaints from the public or referrals from other regulators such as the Securities and Futures Commission (SFC) or the Stock Exchange of Hong Kong (SEHK), or the FRC may initiate investigations or enquiries of complaints on its own initiative. Investigation of potential "relevant irregularities" may be initiated if the FRC believes that there are "circumstances suggesting" or "reasonable cause to believe" that there is or may be an irregularity committed by (i) an auditor in respect of an audit; or (ii) a reporting accountant in respect of the preparation of an accountant's report. The FRC has two operating arms, the Audit Investigation Board (AIB) and the Financial Reporting Review Committee (FRRRC) to conduct investigations or enquiries.</p> <p>According to Sections 25 to 28 of the FRCO, the AIB may compel any party it considers it has relevant information to cooperate with its investigations by issuing a "requirement". Typically, auditors are required to produce the audit working papers in relation to a listed entity if that audit is being investigated.</p> <p>Upon completion of an enquiry or an investigation, a report is prepared and adopted by the Council of the FRC. The Council of FRC may decide to publish the entire report or a part of it. A report will not be published if the case is referred to other regulators for disciplinary actions (e.g. HKICPA). However, upon the completion of disciplinary proceedings by other regulators, the FRC may still decide to publish an enquiry or investigation report if it considers that the publication is in the interests of the investing public or in the public interest.</p> <p>Any auditing or reporting irregularities identified by the FRC will be referred to the HKICPA for follow-up action under HKICPA's disciplinary process. Any non-compliance relevant to the Listing Rules will be referred to SFC or the SEHK for follow-up action. The FRC may require listed entities to remove any non-compliance identified or revise its financial statements to correct such compliance, however, is not empowered to discipline or prosecute.</p> <p>The FRC's investigatory and enquiry power is confined to the listed sector because of the broader public interest associated with such cases. The investigation of possible irregularities of auditors and accountants outside this scope continues to be undertaken by the HKICPA under the PAO.</p> <p>The FRC is not empowered to discipline or prosecute. Such power remains with the appropriate relevant regulatory body, for example, the HKICPA for professional accountants, and the SEHK/SFC for listed entities and their directors.</p> <p><u>Investigations into misconduct of members or member practices by the HKICPA</u></p> <p>The investigation proceedings of HKICPA are governed by Part VA of the PAO.</p> <p>Section 42B of the PAO requires to set up two Investigation Panels:</p> <ul style="list-style-type: none"> <li>• <u>Investigation Panel A</u> shall consist of not fewer than 18 lay persons appointed by the Chief Executive of HKSAR Government of whom one shall be appointed by the Chief Executive to be the Investigation Committee Convenor and another to be his alternate;</li> </ul>	

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
2	Systems of investigations and penalties		
2.1		<ul style="list-style-type: none"> <li>• <u>Investigation Panel B</u> shall consist of not fewer than 12 certified public accountants appointed by the Council of whom not fewer than six shall be holders of practising certificates.</li> </ul> <p>The Council of HKICPA will consider constituting an Investigation Committee when it becomes aware of a matter which gives the Council a reasonable suspicion or belief that a member or member practice has not followed professional standards issued by the HKICPA or has committed other improper acts and the powers of an Investigation Committee are required to facilitate the consideration by the Council of whether to make a referral to the Disciplinary Panels.</p> <p>An Investigation Committee investigates the conduct of a member or member practice of the HKICPA and reports to the Council whether, in its opinion, were a complaint that the member or practice has not followed professional standards issued by the Institute or has committed other improper acts made under section 34(1) of the PAO, the member or member practice would have a case to answer. <sup>(3)</sup></p> <p>The investigation process is as follows:</p> <ol style="list-style-type: none"> <li>1. An Investigation Committee comprises five independent persons: three members including the chairman from Investigation Panel A, which comprises no fewer than 18 lay persons appointed by Government; and two members (at least one of whom must hold a practising certificate) from Investigation Panel B, which comprises no fewer than 12 members of the Institute appointed by the Council.</li> <li>2. The Investigation Committee conducts its investigation and reports to the Council.</li> <li>3. The Council considers the report of the Investigation Committee and decides whether to refer the matter to the Disciplinary Panels or take other appropriate actions.</li> </ol> <p>For the power and types of disciplinary actions on members or member practices of the HKICPA, please refer to 1.11 above.</p>	

<sup>(3)</sup> Following the commencement of operations by the FRC in July 2007, the responsibility for investigation of matters involving listed entities has been assumed by the FRC. Accordingly, the HKICPA is only responsible for investigations of non-listed entities and those involving listed entities which commenced before July 2007.

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
2	<b>Systems of investigations and penalties</b>		
2.2	<p>2. Without prejudice to Member States' civil liability regimes, Member States shall provide for effective, proportionate and dissuasive penalties in respect of statutory auditors and audit firms, where statutory audits are not carried out in conformity with the provisions adopted in the implementation of this Directive.</p>	<p>Based on the practice reviews, where corrective action is required to be taken, the PRC has a range of options available that will ensure the follow-up action requested is relevant, appropriate and proportionate to the issues involved and the size and nature of the practice unit.</p> <p>The order of penalties is at the discretion of the Disciplinary Committee in accordance with Section 35 of the PAO. For details, please refer to 1.11 above.</p>	<p>Yes * (see page 53)</p> <p><i>Any disciplinary action or penalties imposed on the practices (and the practising CPAs) have undergone a process of fact finding, evaluation and hearing (if necessary), subject to the fact that the current disciplinary mechanism in Hong Kong is not EC compliant. See 1.11 for details.</i></p> <p><i>The form of penalties taken will be assessed dependent on the gravity of violations or deficiencies.</i></p>
2.3	<p>3. Member States shall provide that measures taken and penalties imposed on statutory auditors and audit firms are appropriately disclosed to the public. Penalties shall include the possibility of the withdrawal of approval.</p>	<p>Disciplinary actions against the audit firms and individual practising CPAs are publicised in HKICPA magazine and on the HKICPA website. Disciplinary hearings are also open to the public.</p> <p>The range of disciplinary actions is set out in Section 35 of the PAO. Please refer to 1.11 above for details.</p>	<p>Yes * (see page 53)</p> <p><i>Disciplinary actions imposed on the practices and the practising CPAs are disclosed to the public.</i></p>



## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
3	Principles of public oversight (Article 32 of SAD)		
3.1	Article 32 SAD	<p>The HKICPA is incorporated by the Professional Accountants Ordinance. It is the only statutory licensing body of accountants in Hong Kong responsible for professional training, development and regulation of the accountancy profession.</p> <p>The HKICPA's duties on public oversight of auditors are as follows:</p> <ol style="list-style-type: none"> <li>i. registering accountants and issuing practising certificates to professional accountants who have satisfied the professional qualification requirements under the PAO;</li> <li>ii. setting codes of ethics and standards of accounting and auditing;</li> <li>iii. regulating the quality of entry to the profession through its qualification programme and related courses;</li> <li>iv. providing continuing education and other services to members;</li> <li>v. conducting audit quality reviews (or practice reviews);</li> <li>vi. oversight of remedial action taken by audit firms for deficiencies identified during audit quality reviews;</li> <li>vii. conducting investigation and remedial/ disciplinary actions for complaints against or misconduct of its members; and</li> <li>viii. promoting the accountancy profession both in Hong Kong and overseas.</li> </ol> <p>Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.</p>	<p>Yes * ( see page 53)</p> <p><i>The responsibilities and powers of the HKICPA are clearly set out in the PAO.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
	<b>3</b>	<b>Principles of public oversight</b>	
<b>3.2</b>	<p>1. Member States shall organise an effective system of public oversight for statutory auditors and audit firms based on the principles set out in paragraphs 2 to 7.</p>	<p>The PAO provides the statutory power to the HKICPA to exercise its authorities and duties for audit oversight. Specifically,</p> <ul style="list-style-type: none"> <li>• Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.</li> <li>• Sections 22 to 28F of the PAO set out the authority of the HKICPA for registration of auditor/audit firms and Sections 29 to 30 set out the requirements for issuing a practising certificate to professional accountants who have satisfied the professional qualification requirements under the PAO.</li> <li>• Sections 32A to 32I of the PAO set out the statutory powers and duties given to the HKICPA as the regulator of auditors in Hong Kong to implement the practice review programme of the practice units and to ensure the auditors/audit practices are in compliance with applicable auditing, professional and independence standards.</li> <li>• Sections 33 to 38 of the PAO and By-law 34 and 35 of the Professional Accountants By-laws set out the powers of the HKICPA to deal with complaints concerning allegations of misconduct of members, member practices or registered students and enforce disciplinary sanctions that the Disciplinary Committee considers appropriate to the circumstances. Disciplinary proceedings are governed by Part V of the PAO and the Disciplinary Committee Proceedings Rules.</li> </ul>	<p><i>No – in terms of the funding model and the governance structure of the HKICPA.</i></p> <p><i>See 3.4 and 3.8 below.</i></p>
<b>3.3</b>	<p>2. All statutory auditors and audit firms shall be subject to public oversight.</p>	<p>The HKICPA is incorporated by the PAO and works in public interest. Sections 7 and 8 of the PAO set out the objects and the powers of HKICPA.</p> <p>All the practice units defined in the PAO below are subject to practice review by the HKICPA unless they are not carrying out audit or assurance work:</p> <ol style="list-style-type: none"> <li>A firm of certified public accountants (practising) practising accountancy pursuant to the PAO;</li> <li>A certified public accountant (practising) practising accountancy on its own account pursuant to the PAO; or</li> <li>A corporate practice pursuant under the PAO.</li> </ol> <p>The Big Four firms are reviewed annually due to the degree of public interest that there is a predominance of listed and other public interest entities in their client portfolios. Apart from listed companies, practices with other public interest entities, such as banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools, are given priority for review.</p>	<p><i>No.</i></p> <p><i>All the practice units defined in the PAO are subject to practice review by the HKICPA. However, on the basis that the current governance structure and funding model of the HKICPA do not appear to satisfy the EC requirements (see 3.4, 3.8, 3.9), the statutory auditors and audit firms are not subject to independent public oversight as required by EC.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
3	Principles of public oversight		
3.3			<p><i>In the EU, all statutory auditors must be subject to public oversight regardless of whether or not they are performing listed entity audits. The SAD does not mandate that the actual inspectors cannot be from a professional body or indeed seconded from audit firms, provided that they are under the oversight of the independent oversight body.</i></p> <p><i>Of the 28 EEA states who have notified their inspection systems to the EC:</i></p> <p><i>Nine - inspection by independent oversight body</i></p> <p><i>Eleven - some inspection by independent oversight body, some by professional bodies under independent oversight body supervision</i></p> <p><i>Eight – all inspection by professional bodies under independent oversight body supervision.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
3	Principles of public oversight		
3.4	<p>3. The system of public oversight shall be governed by nonpractitioners who are knowledgeable in the areas relevant to statutory audit. Member States may, however, allow a minority of practitioners to be involved in the governance of the public oversight system. Persons involved in the governance of the public oversight system shall be selected in accordance with an independent and transparent nomination procedure.</p>	<p><u>Governing structure of the HKICPA</u></p> <p>The governing body is the Council of the HKICPA which is responsible for making decisions on overall strategy, policy and direction and oversight of the HKICPA's operation and governance. It is also the decision-making body on matters stipulated in the PAO. Sections 17 to 18B of the PAO set out the powers of the Council.</p> <p>The Council currently consists of 22 non-executives who are volunteers and not compensated. The combination of these members are from within and outside the accounting profession as follows:</p> <ul style="list-style-type: none"> <li>• 14 certified public accountants directly elected by the HKICPA's membership including the immediate past president who sits on the Council to allow for continuity.</li> <li>• Two certified public accountants co-opted by the Council to round out skills.</li> <li>• Two ex-officio member from HKSAR Government.</li> <li>• Four lay members who are prominent business leaders appointed by the HKSAR Government to provide independent views and advice.</li> </ul> <p>The Council applies strict rules to prohibit a Council or committee member from taking part in any discussion or decisions on matters in which he or she has a real or apparent conflict of interest.</p> <p><u>Funding source</u></p> <p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees and income from examination and continuing professional development (CPD) fees.</p> <p>Regarding the funding source of the FRC, please refer to 3.8 below.</p> <p><u>Inspection staff member</u></p> <p>The practice reviews are conducted under the responsibility of the QAD headed by a Director who is supported by professional and administrative review staff. All reviewers of the QAD are employed by the HKICPA working solely in QAD. They are all qualified accountants and are required to undergo regular technical training and updates. To ensure independence, the reviewers have a cooling off period whereby they will not perform a review of the firm where they were employed before joining the HKICPA.</p>	<p>No.</p> <p><b>Governing structure of the HKICPA:</b> EC Directive 2006/43/EC defines 'non-practitioner' as follows: "any natural person who, for at least three years before his or her involvement in the governance of the public oversight system, has not carried out statutory audits, has not held voting rights in an audit firm, has not been a member of the administrative or management body of an audit firm and has not been employed by, or otherwise associated with, an audit firm."</p> <p><i>This creates a gap in relation to the governance of the audit oversight system, given that the membership of the Council of the HKICPA currently consists of approximately one third practising CPAs (8 out of 22 total members are practising CPAs in audit firms). Whilst enough other Council members may from time to time be 'non-practitioners' such that they form a majority, the current constitution of the Council does not guarantee that this will be the case. Any change (for example, replacement of a current 'non-practitioner' member with a recently retired audit partner) could upset this balance.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
3	Principles of public oversight		
3.4		<p><u>Practice Review Committee (PRC)</u></p> <p>Regarding the quality assurance programme of the HKICPA, the results of the practice reviews carried out on the practice units by the QAD are reported to the PRC which is the committee responsible for exercising the powers and duties given to the HKICPA as the regulator of auditors in Hong Kong under Sections 32A to 32I of the PAO. By law, at least two thirds of the Committee must hold practising certificates. The practising members of the Committee are drawn from the full spectrum of audit firms, representing small practices through Big Four firms. Non-practising members are also included in the Committee to bring an additional perspective to Committee decisions on the quality of work carried out by the practices subject to review. The composition of the Committee is reviewed by the Nomination Committee of the HKICPA every year to ensure a balanced composition.</p>	<p><i>This gap is particularly relevant given the EC requirement that the system of public oversight <u>shall be mainly governed by non-practitioners</u>.</i></p> <p><b>Composition of the Practice Review Committee:</b> <i>the Committee membership mainly comprises practising members, drawn from the full spectrum of audit firms. This creates a gap in relation to the (perceived) objectivity and independence of the quality assurance programme, which is operated by the HKICPA's own Quality Assurance Department, which in turn reports to the Committee.</i></p> <p><b>Source of funding of HKICPA:</b> <i>the funding of HKICPA is dependent on its members and students, and the amount of subscription fees is determined by the Council of which the Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the EC criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
3	Principles of public oversight		
3.5	<p>4. The system of public oversight shall have the ultimate responsibility for the oversight of:</p> <ul style="list-style-type: none"> <li>(a) the approval and registration of statutory auditors and audit firms;</li> <li>(b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing; and</li> <li>(c) continuing education, quality assurance and investigative and disciplinary systems.</li> </ul>	<p>See 3.1 above for duties of the HKICPA.</p> <p>See 2.1 above for FRC's investigation responsibilities.</p>	<p>No.</p> <p><i>The relevant responsibilities of the HKICPA are set out in the PAO and the the FRC's investigation power is set out in the FRC Ordinance. However, given that the HKICPA is not independent under EC, there is currently no independent oversight body in Hong Kong which has the ultimate responsibility for the oversight of these activities.</i></p> <p><i>The EC requirements state that certain activities including the administrative maintenance of registration of statutory auditors and audit firms, proposing new - or changes to - professional standards, and organising continuing education can be delegated and taken up by a professional body. This is provided that there is an independent oversight body which has the ultimate right to: enforce the decision of the professional body to withdraw an individual and/or firm's registration as a result of sanctions; approve any professional standards proposed by the professional body; enforce the professional body to report on their exercises; direct the professional body, if it does not think that the professional body is acting appropriately.</i></p>
3.6	<p>5. The system of public oversight shall have the right, where necessary, to conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action.</p>	<p>The HKICPA is empowered under the PAO to conduct investigations when the Council becomes aware of a matter which gives the Council a reasonable suspicion or belief that a member or a member practice has not followed professional standards issued by the HKICPA or has committed other improper acts. Sections 42B to 42E of PAO set out the appointment and powers of the Investigation Committee.</p> <p>In addition, in 2007, the FRC was established by the HKSAR Government which is charged with investigating possible non-compliances with financial reporting standards and audit deficiencies in relation to listed entities in Hong Kong. The investigation and enquiries power of the FRC are set out in the Financial Reporting Council Ordinance.</p> <p>For details, refer to 2.1 above.</p>	<p>Yes * (see page 53)</p> <p><i>The investigation responsibilities are taken up by both the HKICPA and the FRC.</i></p>

## 3.2 Hong Kong - EC gap analysis (cont'd)

	EC Equivalence requirements	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the EC requirements?
3	Principles of public oversight		
3.7	<p>6. The system of public oversight shall be transparent. This shall include the publication of annual work programmes and activity reports.</p>	<p>The overall results of practice review are provided to the individual practices which are generally not publicly disclosed. However, there is an annual report issued by the QAD which summarises the activities and findings of the practice review programme which is made public on the HKICPA website.</p> <p>The common issues found under the practice review programme were also communicated through various channels. For details, please refer to 1.10 above.</p> <p>The final results of practice review are reported to the PRC which reaches its own decisions on practices' compliance with professional standards and the appropriate follow-up action. The activities and operations of the PRC are subject to scrutiny by the Council of HKICPA and the Standards and Quality Accountability Board (SQAB). The SQAB oversees the performance of the HKICPA's practice review programme and ensures that the QAD activities are carried out in accordance with the strategies and policies determined by the Council and in the public interest.</p>	<p>Yes * (see page 53)</p> <p><i>The activities and outcome of the HKICPA practice reviews are annually published on its website and common issues are communicated via other public channels.</i></p>
3.8	<p>7. The system of public oversight shall be adequately funded. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms.</p>	<p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and continuing professional development ("CPD") fees.</p> <p><u>Funding of the FRC</u></p> <p>The operation of the FRC is currently funded jointly and equally by four parties, namely, the Hong Kong Government's Companies Registry Trading Fund, the Securities and Futures Commission (SFC), the Hong Kong Exchanges and Clearing Limited and the HKICPA. The four parties have signed a Memorandum of Understanding under which they have agreed to contribute as follows:</p> <ul style="list-style-type: none"> <li>- HK\$5 million each (a one-off total of HK\$20 million) to establish a Reserve Fund;</li> <li>- HK\$4 million each (a total of HK\$16 million) for recurring expenses of the FRC in 2010;</li> <li>- Contributions for the recurring expenses will be adjusted for inflation from 2011 to 2014.</li> </ul>	<p>No.</p> <p><i>The funding of HKICPA is mainly dependent on its members and students, and the amount of subscription fees is determined by the Council of which the Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the EC criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>





# 3.3 Hong Kong - IFIAR gap analysis

## Analysis of Hong Kong audit oversight system versus the requirements for gaining regulatory equivalence of the membership of IFIAR

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.1	<p><b>IFIAR Principle 4:</b> Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p> <p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities.</p>	<p>The Hong Kong Institute of Certified Public Accountants (HKICPA) is incorporated by the Professional Accountants Ordinance (PAO) which sets out its statutory obligations. It is the only statutory licensing body of accountants in Hong Kong responsible for professional training, development and regulation of the accountancy profession.</p> <p>In 1992, the HKICPA introduced a Practice Review programme under the authority and powers granted by the PAO with the objective of enhancing the quality of work of the HKICPA members engaged in audit and related assurance activities.</p> <p>The Practice Review programme forms an important element in the overall scheme of audit regulation in Hong Kong. The practice review covers the provision of audit and other related assurance services in Hong Kong by firms, corporate practices and individual practising certificate holders (i.e. practice units). The programme aims to assess whether a practice unit has an adequate system of quality control to ensure work quality is maintained in every assurance and related service engagement. The Practice Review programme was revised in 2006 in light of international developments and increasing expectations of regulation and monitoring of auditors. The revised programme places greater emphasis on addressing areas of significant public interest, such as audits of public listed companies and the review process has been revised to focus on risk – in the selection of practice units and specific audit engagements for review. The practice reviews focus on practice units that are engaged in auditing public interest entities of a higher profile, predominantly listed entities.</p>	<p>No.</p> <p><i>The practice reviews are conducted by the full-staff employees of the Quality Assurance Department of the HKICPA following the instructions of the Practice Review Committee (PRC) and in turn report to the Committee. Also, the results of the practice reviews are reported to the PRC. The composition of the PRC which comprises mainly practising members presents a gap in relation to the (perceived) objectivity and independence of the quality assurance programme that are basic principles for an independent public oversight body, in terms of the IFIAR requirements (see 3.4 and 3.9 for details).</i></p>

## 3.3 Hong Kong – IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.1		<p>The practice reviews are conducted under the responsibility of the full-time employees of the Quality Assurance Department (QAD) of the HKICPA which report to the Practice Review Committee (PRC). The PRC is the committee responsible for exercising the powers and duties given to the HKICPA as the regulator of auditors in Hong Kong under Sections 32A to 32I of the PAO. The QAD is headed by a Director who is supported by professional and administrative review staff. Under Section 32D of PAO, the PRC may determine the practice and procedure to be observed in relation to practice reviews; issue instructions to any reviewer on any matter relating to practice reviews or a particular practice review, or perform any other thing as considered necessary. The PRC has also prepared for reviewers a reviewer's manual which determines the procedures reviewers should adopt with respect to practice reviews.</p> <p>The results of the practice reviews carried out on practice units by the QAD are reported to the PRC</p> <p>The HKICPA's practice review programme identifies deficiencies in quality control and audit work of the practice subject to review. Where deficiencies are identified, the practice will be required to produce an action plan or specific remedial action to address the deficiencies. If a deficiency is sufficiently serious or remedial action is not taken or is not effective, disciplinary action may be taken against the practice. The power of exercising disciplinary actions by the HKICPA against members or member practices is set out in the PAO.</p> <p>For details of the practice review process, refer to 1.5 below.</p>	
1.2	<p><b>IFIAR Charter:</b> Funding should be free of undue influence by the profession.</p> <p><b>IFIAR Principle 2 explanatory material:</b> The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p>	<p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and continuing professional development (CPD) fees.</p>	<p>No.</p> <p><i>The funding of the operation of the HKICPA is mainly dependent on its members and students, and the amount of subscription fees is determined by the Council. The Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the IFIAR criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.3 Hong Kong – IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.3	<p><b>IFIAR Principle 5 explanatory material:</b> In order for audit regulators to be effective, it is a prerequisite that there is sufficient staff of appropriate competence. This also means that adequate arrangements for consultation and discussion amongst inspectors are in place.</p>	<p>There is a team of full-time reviewers reporting to the Director of QAD. The time allocated for reviews varies depending on the nature and size of the practice and its client base. Details of arrangements for on-site inspection, findings and recommendations coming out from the practice reviews are discussed amongst the team of reviewers and the Director of QAD.</p>	<p>Yes *</p> <p><i>The HKICPA has a full team of reviewers who conduct the practice reviews.</i></p>
1.4	<p><b>IFIAR Principle 5 explanatory material:</b> The persons carrying out the reviews of quality assurance systems of audit firms should have appropriate professional training and relevant experience in auditing and financial reporting, and training in regulatory quality assurance reviews. This also means that adequate arrangements for consultation and discussion amongst inspectors are in place. New inspectors should be subject to proper supervision and appropriate training.</p>	<p>All the reviewers of the QAD are qualified accountants with experience in auditing and are required to undergo regular technical training and updates. The reviewers have an audit background and have been engaged in learning and development activities to keep them up to date with professional standards and to enhance their skills in dealing with practices in a fair and sensitive manner.</p>	<p>Yes *</p> <p><i>All reviewers are qualified CPAs with a background in auditing and regular professional training and updates are required.</i></p>

\* To note: if the HKICPA were independent, it would be compliant with the requirements.

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.5	<p><b>IFIAR Principle 8:</b> Audit regulators should, as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</p> <p><b>IFIAR Principle 8 explanatory material:</b> The recurring inspections should be conducted pursuant to a process comprising the selection of the audit firms to inspect, appointment of inspection teams with appropriate expertise and competence, notification to the audit firm, advance documentation request, notification of selection of audit engagements for review, meetings with management, and on-site inspection arrangements.</p> <p>The inspection process should be subject to appropriate internal quality control within the audit regulator to ensure high quality and consistency.</p>	<p>The reviewers of QAD have a cooling off period whereby they will not perform a review of the firm where they were employed by before joining the HKICPA.</p> <p>The practice reviews include the following major processes:</p> <p><u>(i) Selection of practice for practice review visit</u></p> <p>All the practice units defined in the PAO below are subject to the Practice Review by the HKICPA unless they are not carrying out audit or assurance work:</p> <p>a) A firm of (practising) certified public accountants, practising accountancy pursuant to the PAO;</p> <p>b) A (practising) certified public accountant, practising accountancy on its own account pursuant to the PAO; or</p> <p>c) A corporate practice pursuant under the PAO.</p> <p>The QAD selects the practices for review primarily based on risk factors including the public interest profile of audit clients. The selection of practices is identified from a desktop review of practices' responses in the practice review self-assessment questionnaire<sup>(1)</sup> and other relevant information. Practices with regulated or significant public interest entity clients (but not listed entities) are given priority for site visit reviews. A number of practices are selected for site visit reviews on a random basis to ensure that all practices will have a reasonable chance of being selected. For details of frequency of review of different practices, please refer to 1.7 below.</p> <p><u>ii) Notification to audit firms</u></p> <p>Practices selected for practice review visits are normally advised of the proposed visit date several weeks in advance. The QAD will agree the visit date with the practice before the issue of formal notification and request for key documents. The site visit will normally be scheduled for six weeks after the formal notification.</p> <p><u>(iii) Preliminary assessment of submitted key documents</u></p> <p>Practices will be requested to provide certain information and a client list for preliminary assessment by the reviewers. The reviewers will carry out preliminary assessment on the key documents and notify the audit firm of the list of audit engagements selected for the on-site review.</p>	<p>Yes * (see page 74)</p> <p><i>The reviewers should be independent of the audit practices and there is a cooling off period before a practitioner can act as an HKICPA reviewer for the firm he/she left.</i></p> <p><i>The HKICPA is authorised by the PAO to conduct practice reviews of the audit practices (including firms undertaking audits of listed entities) in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</i></p>

(1) As stipulated in paragraph 3 of the Appendix of Statement in 1.401 (March 2006) Practice Review – Review and Conduct of Members, all practice units are required to complete the practice review self-assessment questionnaire on an annual basis. The questionnaire will collect three main categories of information about a practice unit: i) organisation and management of the practice unit; ii) quality control policies and procedures established by the practice unit; and iii) client profile of the practice unit.

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.5		<p><u>(iv) Scope of review</u></p> <p>The scope of practice review includes: (a) obtaining an understanding of the practice's system of quality control; (b) assessing the effectiveness of the system of quality control in achieving compliance with Hong Kong Standard on Quality Control 1 (HKSQC 1); and (c) assessing compliance with professional standards in the operation of quality control procedures and the conduct of audit work.</p> <p>The detail and extent of review that the reviewers will need to carry out varies from practice to practice depending on a number of factors including the size of the practice and the nature of the client bases. However, the work typically carried out during the on-site visit includes:</p> <ul style="list-style-type: none"> <li>(a) interviewing different levels of personnel to assess the practice's culture and commitment to quality;</li> <li>(b) reviewing the documented quality control procedures and checking how they are applied in practice;</li> <li>(c) reviewing audit methodology and procedures to ensure they are up to date and include reference to current professional standards and relevant application guidance for staff;</li> <li>(d) reviewing selected engagement files to evaluate the application of audit procedures, the design and selection of audit working response to assessed risk; the basis for key audit judgements and conclusions, and the adequacy of audit evidence and documentation;</li> <li>(e) communication of findings from the practice review to the practice; and</li> <li>(f) providing practical advice to the practice on possible improvements in efficiency of the audit process and to address weaknesses that have been identified by the reviewers.</li> </ul> <p>Opening and exit meetings will be held among the practice review reviewers and the representatives of the practice.</p>	

## 3.3 Hong Kong – IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.6	<p><b>IFIAR Principle 8:</b> Audit regulators should as a minimum, conduct recurring inspections of audit firms undertaking audits of public interest entities in order to assess compliance with applicable professional standards, independence requirements and other laws, rules and regulations.</p> <p><b>IFIAR Principle 10:</b> Audit regulators should ensure that inspections include effective procedures for both firm-wide and file reviews.</p> <p><b>IFIAR Principle 10 explanatory material:</b> The risk-based inspection approach should also be reflected in both firm-wide and audit file inspection procedures. The firm-wide procedures should address the audit firm's quality control system as reflected in the firm's organisation, policies and procedures. ISQC 1 or similar standards should be used as a benchmark in performing firm-wide procedures. The inspection process should also include adequate testing of selected audit files in order both to determine the effectiveness of the firm's quality control system and to assess compliance with applicable laws, rules and professional standards.</p>	<p>The scope of practice review includes obtaining an understanding of the practice's system of quality control, assessing compliance of policies and procedures with HKSQC 1 and reviewing the conduct of audit work. See details in 1.5 above.</p> <p>HKSQC 1 requires the practice to establish a system of quality control designed to provide it with reasonable assurance that the practice and its personnel comply with professional standards, and regulatory and legal requirements (including ethical and independence requirements), and that reports issued by the practice or engagement partner are appropriate in the circumstances.</p> <p>HKSQC 1 also requires the practices to assess the integrity of a client during the process of acceptance and continuance of client relationships and specific engagements by considering whether the client is aggressively concerned with maintaining the firm's fees as low as possible. In addition, HKSQC 1 requires the practice to establish policies and procedures to monitor workload and availability of resources to enable the individuals to have sufficient time to adequately discharge their responsibilities.</p> <p>The current revamped practice review programme places greater emphasis on addressing areas of significant public interest, such as audits of public listed companies, and other public interest entities such as banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools. The review process has been revised to focus on risk – in the selection of practice units and specific audit engagements for review. The practice review focuses on inspecting practice units that are engaged in auditing higher profile, public interest, predominately listed entities and adopts risk-based inspection procedures.</p>	<p>Yes * (see page 74)</p> <p><i>The scope of HKICPA's practice reviews includes the review of firm's policies and procedures of internal quality controls according to HKSQC1 (which also covers the review of audit fees and time spent on the engagement) as well as the quality of audit engagements.</i></p> <p><i>The practice reviews are conducted on a risk-based approach.</i></p>

## 3.3 Hong Kong – IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.7	<p><b>IFIAR Principle 9:</b> Audit regulators should ensure that a risk-based inspections programme is in place.</p> <p><b>IFIAR Principle 9 explanatory material:</b> Audit regulators should have a process for assessing risks in the audit environment and audit risks in individual regulated firms and their audit engagements. Audit regulators should have a process for taking into account their risk assessment in allocating their inspection resources and in the inspection approaches they adopt. These processes should be commensurate with the size and complexity of the audit firms and their clients. Audit regulators should have an established minimum cycle regarding the frequency of inspections.</p>	<p>The selection of a practice for practice review is based on their risk profiles, primarily from information obtained from the electronic self-assessment questionnaire and other relevant sources. Apart from listed companies, practices with other public interest clients, for example, banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools, are given priority for reviews.</p> <p>The frequency of review varies from different practices:</p> <ul style="list-style-type: none"> <li>(i) Big Four firms – subject to practice review annually. It recognises the predominance of listed and other public interest entities in Big Four client portfolios.</li> <li>(ii) Practices with a significant number of listed clients – subject to a full review at least once every three years and an interim review during the three-year cycle. From 2011, practices with more than 20 listed clients will receive an additional interim review. The interim reviews focus on key changes in systems and procedures, action taken following the previous practice review, current auditing and accounting issues, and review of completed listed company audit engagements.</li> <li>(iii) Other practices with listed clients – subject to review at least once every three years.</li> <li>(iv) Other practices – the frequency of review is based on risk profiles and random selection.</li> </ul> <p>The reviews focus on the practice's own quality control procedures and how the practice ensures the quality of its own work. The reviews place emphasis on risk areas and key judgements in audit assignment reviews.</p> <p>The detail and extent of review work to be carried out varies from practice to practice depending on the size of the practice and the nature of the client base.</p>	<p>No.</p> <p><i>In respect of the frequency of inspections, the HKICPA has established a minimum cycle regarding the frequency of inspections of CPA firms that audit listed entities (i.e. at least every three years; and annually for Big Four firms). However according to the current HKICPA practice review system, there is no clear minimum cycle regarding the frequency of inspection of audit firms that do not audit listed entities – the frequency of review is based on risk profiles and random selection, therefore not all the audit practices are regularly inspected.</i></p>

## 3.3 Hong Kong – IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.8	<p><b>IFIAR Principle 11:</b> Audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm.</p> <p><b>IFIAR Principle 11 explanatory material:</b> Audit regulators should have a process that ensures that criticisms or potential defects in an audit firm's quality control systems and issues related to an audit firm's performance of audits that are identified during an inspection are reported to the audit firm.</p> <p>Audit regulators' reporting processes should include the preparation and issuance of a draft inspection report, a process for the audit firm to respond, and the preparation and issuance of a final inspection report.</p>	<p>Matters identified during the practice reviews are fully discussed with the practices. Subsequent to the on-site review, HKICPA will issue a draft report summarising findings and recommendations in relation to the review to the practice. The practice is asked to provide a formal written response to matters raised in the draft report. The response from the practice will be reviewed and submitted together with the reviewer's report to the PRC for consideration. The QAD is responsible for drawing conclusions on the review and making recommendations to the PRC for consideration. The PRC, having regard to the report and any response by the practice to the matters raised in the report, may act under the power given by the PAO to:</p> <ul style="list-style-type: none"> <li>(a) conclude a practice review with no follow-up action required ("direct closed");</li> <li>(b) make recommendations and specific requests to a practice (e.g. submission of a status report) to ensure appropriate follow-up action is taken to address weaknesses and shortcomings that have been identified by the review ("required follow-up action");</li> <li>(c) instruct that another visit is required ("required follow up visit"); or</li> <li>(d) make a complaint to initiate a disciplinary action.</li> </ul> <p>The PRC sends each practice a formal notification of its decision. A final report will be issued to each audit firm upon completion of the review. The QAD monitors the progress of follow-up action undertaken by the practices at the direction of the PRC.</p>	<p>Yes * (see page 74)</p> <p><i>The HKICPA establishes a reporting mechanism to ensure matters identified from the practice reviews are communicated with the practices and appropriate steps have been taken in addressing the matters being raised.</i></p>



## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.10	<p><b>IFIAR Principle 3 explanatory material:</b> Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.</p>	<p>The overall results of the practice review are provided to the individual practices which are generally not publicly disclosed. However, there is an annual report issued by the QAD of HKICPA which summarises the activities and findings of the practice review programme which is made public on the HKICPA website.</p> <p>The common issues found under the practice review programme are also communicated through the following channels:</p> <ul style="list-style-type: none"> <li>• Forums hosted by the QAD which go through the quality assurance annual report and discuss common issues identified from the practice review.</li> <li>• Key findings identified from reviews of practices with listed clients are reported in the HKICPA Financial and Auditing Alert.</li> <li>• Findings from the practice review had been used by HKICPA's technical team in providing relevant support for HKICPA's members through ongoing training sessions.</li> </ul> <p>In addition, the HKICPA's activities are made public in HKICPA's monthly newsletter, technical update, monthly magazine and annual report.</p>	<p>Yes * (see page 74)</p> <p><i>The activities and outcomes of the HKICPA practice reviews are published annually on its website and common issues are communicated via other public channels.</i></p>
1.11	<p><b>IFIAR Principle 4:</b> Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p>	<p>The results of practice reviews carried out on practice units by the QAD are reported to the PRC which is the committee responsible for exercising the powers given to the HKICPA by the PAO. Where deficiencies in quality control and audit work of practices are identified, the practice will be required to produce an action plan to address the deficiencies. In addition to proposed action plans, the practice may be required to take specific remedial action.</p> <p>The PRC having regard to the report and any response by the practice to the matters raised in the report may act under the power given by the PAO, to:</p> <ol style="list-style-type: none"> <li>conclude a practice review with no follow-up action required;</li> <li>make recommendations and specific requests to a practice (e.g. submission of a status report) to ensure appropriate follow-up action is taken to address weaknesses and shortcomings that have been identified by the review;</li> <li>instruct that another visit is required; or</li> <li>make a complaint to initiate a disciplinary action.</li> </ol>	<p>No.</p> <p><i>A mechanism is established to ensure the practice review results and recommendations are communicated to the practices and appropriate steps are taken to address the matters raised.</i></p> <p><i>The enforcement powers as a result of the practice reviews are given to the PRC (which reports to the HKICPA Council) and the Disciplinary Committee of the HKICPA, subject to the fact that the composition of the PRC presents a gap to meet the EC/IFIAR criteria in relation to the (perceived) objectivity and independence of the quality assurance programme (see 3.4).</i></p>

## 3.3 Hong Kong – IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
1	Quality assurance systems		
1.11	<p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should at a minimum be responsible for the system and conduct of recurring inspection of audit firms undertaking audits of public interest entities. Audit regulators should have the authority and ability to enforce inspection findings and recommendations. The audit regulator should have comprehensive enforcement arrangements such as fines, suspensions and the removal of an auditor's or audit firm's licence or registration.</p> <p><b>IFIAR Principle 11 explanatory material:</b> In addition, audit regulators should have a process for ensuring that audit firms satisfactorily address inspection findings that were reported to the audit firm by the audit regulator.</p>	<p>The effectiveness of remedial action will be assessed by the QAD of HKICPA, by review of submitted information or further site visit. If a deficiency is sufficiently serious or remedial action is not taken or is not effective, the PRC could raise a complaint to the HKICPA Council which shall determine whether to refer the complaint to the Disciplinary Panels to consider taking disciplinary actions against the practice.</p> <p>Section 33 of the PAO requires the set up of two Disciplinary Panels:</p> <ul style="list-style-type: none"> <li>• <u>Disciplinary Panel A</u> consists of not fewer than 18 lay persons appointed by the Chief Executive of the HKSAR government of whom one is appointed by the Chief Executive to be the Disciplinary Committee Convenor and another to his alternate.</li> <li>• <u>Disciplinary Panel B</u> consists of not fewer than 12 certified public accountants appointed by the HKICPA's Council of whom not fewer than six are holders of practising certificates.</li> </ul> <p>When a complaint is referred to the Disciplinary Panels, a Disciplinary Committee will be constituted to deal with the complaint by directing the Disciplinary Committee Convenor to appoint five independent persons selected from the two panels as follows:</p> <ul style="list-style-type: none"> <li>• one person appointed by the Disciplinary Committee Convenor from Disciplinary Panel A to be the chairman of the Disciplinary Committee;</li> <li>• two persons appointed by the Disciplinary Committee Convenor from Disciplinary Panel A; and</li> <li>• two persons from Disciplinary Panel B of whom one is the holder of a practising certificate.</li> </ul> <p>The Disciplinary Committee Convenor shall not be appointed as a member of a Disciplinary Committee.</p> <p>A Disciplinary Committee is set up to deal with formal complaints concerning allegations of misconduct by members, member practices or registered students pursuant to section 34 of the PAO and by-law 34 of the Professional Accountants By-laws. The proceedings of the Disciplinary Committee are governed by Part V of the PAO and the Disciplinary Committee Proceedings Rules.</p>	<p><i>The IFIAR requirements state that the disciplinary mechanism must have independent oversight. IFIAR Principle 4 requires that the audit regulator should have the right to investigate and impose sanctions.</i></p> <p><i>A gap is identified in the current disciplinary mechanism in relation to the independent oversight, since complaints against the HKICPA's members or member practices are made either by the PRC as a result of practice review findings or by the Professional Conduct Committee (PCC) which is mainly composed of practising CPAs and has the power to dismiss complaints it considers not pursuable, to adjudicate complaints and to issue formal letters of disapproval, or to recommend that the HKICPA Council refer more serious complaints to the Disciplinary Panels (see 2.4). There is currently no independent public oversight body which has specific oversight of the PCC and the ability to enforce disciplinary actions against the auditors. Also, the members of Disciplinary Panel B are selected by the HKICPA Council, and 2 out of 5 persons of each Disciplinary Panel to be constituted are from Disciplinary Panel B. In addition, matters can be referred to the Disciplinary Panel by the HKICPA Council only.</i></p> <p><i>In order to be IFIAR compliant, whilst certain investigation and enforcement activities could be carried out by the professional body, an independent oversight body must have the ultimate right to investigate, and the right to enforce sanctions (in particular, the sanction of removal of registration has to be within the ultimate responsibility of the independent oversight body).</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	<i>Is the existing HK system compliant with the IFIAR requirements?</i>
1	Quality assurance systems		
1.11		<p>The Disciplinary Committee considers whether a prima facie case is established against the member, member practice or registered student, and, if so, whether a hearing of the complaint is necessary. A hearing may not be necessary if the complaints are admitted or the Disciplinary Committee considers the matter can be disposed of by consent order.</p> <p>Disciplinary hearings are normally conducted in public unless the Disciplinary Committee determines that, in the interests of justice, a hearing or any part of it shall be held in private.</p> <p>If the Disciplinary Committee is satisfied that a complaint referred to it under Section 34 of the PAO (including, without reasonable excuse, failure or neglect to comply with any direction with which the practice was required by the Practice Review Committee to comply) is proved, the Disciplinary Committee may in its discretion make the following orders according to the disciplinary powers of the Disciplinary Committee set out in Section 35 of the PAO:</p> <ul style="list-style-type: none"> <li>• an order that the name of the certified public accountant be removed from the register, either permanently or for such period as it may think fit;</li> <li>• an order that the certified public accountant be reprimanded;</li> <li>• an order that the certified public accountant pay a penalty not exceeding HK\$500,000 to the HKICPA;</li> <li>• an order that the certified public accountant pay the costs and expenses of proceedings;</li> <li>• an order that the practising certificate issued to the certified public accountant be cancelled; and</li> <li>• an order that a practising certificate shall not be issued to the certified public accountant either permanently or for such period as the Disciplinary Committee may think fit.</li> </ul> <p>The order of the Disciplinary Committee is published in (1) the HKICPA journal – "APLUS"; (2) a press release; (3) the HKSAR Gazette (removal orders only); and on (4) the HKICPA website.</p>	<p><i>It is a matter of judgement as to whether these penalties are effective, proportionate and dissuasive. The low number of enforcement actions (in relation to the number of registered auditors and audits) suggests that they are dissuasive, and the fact that an auditor can be removed from the register or have their ability to practice removed is effective at removing a threat to systemic audit quality.</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
2	<b>Systems of investigations and penalties</b>		
2.1	<p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should have comprehensive enforcement powers which include the capability to ensure that their inspection findings or recommendations are appropriately addressed; these enforcement powers should include the ability to impose a range of sanctions including, for example, fines and the removal of an audit licence and/or registration.</p>	<p><u>Investigations by the FRC</u></p> <p>In 2007, the HKSAR Government set up the FRC which is an independent statutory body established under the Financial Reporting Council Ordinance (FRCO). FRC is a body totally independent of the HKICPA that mainly conducts independent investigations into possible auditing and reporting irregularities in relation to listed entities in Hong Kong, and to enquire into possible non-compliances with accounting requirements on the part of listed entities.<sup>(2)</sup></p> <p>Investigation and enquiry may be initiated by complaints from the public or referrals from other regulators such as the Securities and Futures Commission (SFC) or the Stock Exchange of Hong Kong (SEHK), or the FRC may initiate investigations or enquiries of complaints on its own initiative. Investigation of potential "relevant irregularities" may be initiated if the FRC believes that there are "circumstances suggesting" or "reasonable cause to believe" that there is or may be an irregularity committed by (i) an auditor in respect of an audit; or (ii) a reporting accountant in respect of the preparation of an accountant's report. The FRC has two operating arms, the Audit Investigation Board (AIB) and the Financial Reporting Review Committee (FRRC) to conduct investigations or enquiries.</p> <p>According to Sections 25 to 28 of the FRCO, the AIB may compel any party it considers it has relevant information to cooperate with its investigations by issuing a "requirement". Typically, auditors are required to produce the audit working papers in relation to a listed entity if that audit is being investigated.</p> <p>Upon completion of an enquiry or an investigation, a report is prepared and adopted by the Council of the FRC. The Council of FRC may decide to publish the entire report or a part of it. A report will not be published if the case is referred to other regulators for disciplinary actions (e.g. HKICPA). However, upon the completion of disciplinary proceedings by other regulators, the FRC may still decide to publish an enquiry or investigation report if it considers that the publication is in the interests of the investing public or in the public interest.</p>	<p>Yes * (see page 74)</p> <p><i>The FRC and HKICPA have established effective systems of investigations of audit practices.</i></p> <p><i>The HKICPA is authorised to enforce a range of disciplinary actions on the practices if a deficiency identified from the practice review is sufficiently serious, or remedial action is not satisfactorily taken or is not effective, or misconduct of the member or member practices is identified.</i></p>

<sup>(2)</sup> Prior to establishing the FRC, powers of investigation vested with a number of different parties who were often hampered by their inability to require assistance from all necessary sources. The HKICPA could only exercise its investigatory powers over its own members - its membership does not include listed entities or the majority of individuals (non-accountants) serving on their boards of directors. The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) could only deal with listed entities and directors, but not their auditors. Establishing the FRC with statutory powers of investigation over all relevant parties was seen as an important step in addressing the problem.

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
2	Systems of investigations and penalties		
2.1		<p>Any auditing or reporting irregularities identified by the FRC will be referred to the HKICPA for follow-up action under HKICPA's disciplinary process. Any non-compliance relevant to the Listing Rules will be referred to the SFC or the SEHK for follow-up action. The FRC may require listed entities to remove any non-compliance identified or revise its financial statements to correct such compliance, however, is not empowered to discipline or prosecute.</p> <p>The FRC's investigatory and enquiry power is confined to the listed sector because of the broader public interest associated with such cases. The investigation of possible irregularities of auditors and accountants outside this scope continues to be undertaken by the HKICPA under the PAO.</p> <p>The FRC is not empowered to discipline or prosecute. Such power remains with the appropriate relevant regulatory body, for example, the HKICPA for professional accountants, and the SEHK for listed entities and their directors.</p> <p><u>Investigations into misconduct of members or member practices by the HKICPA</u></p> <p>The investigation proceedings of HKICPA are governed by Part VA of the PAO.</p> <p>Section 42B of the PAO requires to set up two Investigation Panels:</p> <ul style="list-style-type: none"> <li>• <u>Investigation Panel A</u> shall consist of not fewer than 18 lay persons appointed by the Chief Executive of HKSAR Government of whom one shall be appointed by the Chief Executive to be the Investigation Committee Convenor and another to be his alternate;</li> <li>• <u>Investigation Panel B</u> shall consist of not fewer than 12 certified public accountants appointed by the Council of whom not fewer than six shall be holders of practising certificates.</li> </ul> <p>The Council of HKICPA will consider constituting an Investigation Committee when it becomes aware of a matter which gives the Council a reasonable suspicion or belief that a member or member practice has not followed professional standards issued by the HKICPA or has committed other improper acts and the powers of an Investigation Committee are required to facilitate the consideration by the Council of whether to make a referral to the Disciplinary Panels.</p>	

### 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	<i>Is the existing HK system compliant with the IFIAR requirements?</i>
2	Systems of investigations and penalties		
2.1		<p>An Investigation Committee investigates the conduct of a member or member practice of the HKICPA and reports to the Council whether, in its opinion, were a complaint that the member or practice has not followed professional standards issued by the Institute or has committed other improper acts made under section 34(1) of the PAO, the member or member practice would have a case to answer. <sup>(3)</sup></p> <p>The investigation process is as follows:</p> <ol style="list-style-type: none"> <li>1. An Investigation Committee comprises five independent persons: three members including the chairman from Investigation Panel A, which comprises no fewer than 18 lay persons appointed by Government; and two members (at least one of whom must hold a practising certificate) from Investigation Panel B, which comprises no fewer than 12 members of the Institute appointed by the Council.</li> <li>2. The Investigation Committee conducts its investigation and reports to the Council.</li> <li>3. The Council considers the report of the Investigation Committee and decides whether to refer the matter to the Disciplinary Panels or take other appropriate actions.</li> </ol> <p>For the power and types of disciplinary actions on members or member practices of the HKICPA, please refer to 1.11 above.</p>	

<sup>(3)</sup> Following the commencement of operations by the FRC in July 2007, the responsibility for investigation of matters involving listed entities has been assumed by the FRC. Accordingly, the HKICPA is only responsible for investigations of non-listed entities and those involving listed entities which commenced before July 2007.

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
2	Systems of investigations and penalties		
2.4	<p><b>IFIAR Principle 4 explanatory material:</b> Audit regulators should have adequate and appropriate mechanisms for enabling information to be brought to their attention by third parties and for then dealing with such information, such as through complaints procedures or through whistle blowing arrangements. These mechanisms should act in a timely and effective manner and their results followed up through an appropriate system of investigations and penalties in relation to cases of inadequate or noncompliant execution of an audit.</p>	<p>The HKICPA is responsible for regulating the conduct of its members. Accordingly, it deals with complaints concerning the ethical and professional conduct of members, member practices and registered students. Such complaints may arise from matters brought to the attention of the HKICPA by external parties, such as the FRC, Market Misconduct Tribunal, Office of the Commissioner of Insurance, Official Receiver and the SFC. They may also come from members, clients of members, the public or be matters which originate within the HKICPA itself.</p> <p>The HKICPA has no authority to deal with complaints against a person, firm, or body corporate which is not a HKICPA member or a HKICPA registered student. Complaints must be in writing and be adequately supported by adequate evidence indicating that a member, member practice, or registered student of HKICPA has not followed professional standards issued by the HKICPA or has committed other improper acts.</p> <p>The complaints against HKICPA members, member practices and registered students are dealt with by the Professional Conduct Committee of the HKICPA (PCC) supported by the HKICPA's compliance department. The PCC comprises both certified public accountants and lay members.</p> <p>Investigation of complaints concerning possible auditing and reporting irregularities or non-compliances with financial reporting requirements relating to listed entities is outside the jurisdiction of the HKICPA as all such investigations are handled by the FRC. For details of FRC's investigation power, please refer to 2.1 above.</p> <p>The HKICPA's investigation process of complaints is as follows:</p> <ol style="list-style-type: none"> <li>1. The HKICPA carries out an initial assessment of the adequacy of the supporting evidence to determine whether its member, member practice or registered student has failed to follow professional standards issued by the HKICPA or has committed other improper acts.</li> <li>2. On the conclusion of HKICPA enquiries, the compliance department will submit a report on its findings and conclusions to the PCC for its consideration of whether to: <ol style="list-style-type: none"> <li>a. dismiss complaints where the matter is outside the HKICPA's jurisdiction or where there is inadequate evidence to show a prima facie case of an alleged offence;</li> <li>b. issue formal letters of disapproval (Disapproval Letters) to adjudicate minor complaints; or</li> <li>c. Refer more serious complaints to the HKICPA Council for its consideration of whether to refer the matter to the Disciplinary Panels.</li> </ol> </li> </ol>	<p>No</p> <p><i>A mechanism of complaints and system of investigations and penalties has been established.</i></p> <p><i>However the PCC's role represents a gap as there is no independent public oversight body which has specific oversight of the PCC and the ability to enforce disciplinary actions against the auditors (see 1.11).</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
2	Systems of investigations and penalties		
2.4		<p>3. The PCC may request information and explanations relating to any complaint from any party, where necessary and may direct any other course of action in relation to dismissed or minor complaints as it may think fit.</p> <p>4. The HKICPA will inform all parties to a complaint as to the dismissal or adjudication of the complaint by the PCC and as to the procedure for lodging an appeal against the decision of the PCC.</p> <p>5. The time required for completing a complaint varies among cases and is affected by factors such as the complexity of the issues involved and the extent of correspondence with the relevant parties in the enquiry process.</p> <p>Where the Council of HKICPA concludes that a complaint is sufficiently serious to warrant the referral of the matter to the Disciplinary Panels, a Disciplinary Committee will be constituted to deal with the complaints. For details, please refer to 1.11 above.</p>	
3	Principles of public oversight		
3.1	<p><b>IFIAR Principle 1:</b> The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation.</p>	<p>The HKICPA is incorporated by the Professional Accountants Ordinance. It is the only statutory licensing body of accountants in Hong Kong responsible for professional training, development and regulation of the accountancy profession.</p> <p>The HKICPA's duties on public oversight of auditors are as follows:</p> <ol style="list-style-type: none"> <li>i. registering accountants and issuing practising certificates to professional accountants who have satisfied the professional qualification requirements under the PAO;</li> <li>ii. setting codes of ethics and standards of accounting and auditing;</li> <li>iii. regulating the quality of entry to the profession through its qualification programme and related courses;</li> <li>iv. providing continuing education and other services to members;</li> <li>v. conducting audit quality reviews (or practice reviews);</li> <li>vi. oversight of remedial action taken by audit firms for deficiencies identified during audit quality reviews;</li> <li>vii. conducting investigation and remedial/ disciplinary actions for complaints against or misconduct of its members; and</li> <li>viii. promoting the accountancy profession both in Hong Kong overseas.</li> </ol> <p>Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.</p>	<p>Yes * ( see page 74)</p> <p><i>The responsibilities and powers of the HKICPA are clearly set out in the PAO.</i></p>



## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.2	<p><b>IFIAR Principle 1 explanatory material:</b> The legal framework for audit oversight should set forth the audit regulator's mandate and responsibilities, and provide the regulator with adequate powers and authority that enable the regulator to perform its audit oversight duties, including powers to address, through inspection and enforcement, compliance with the requirements for the authorisation/registration of auditors/audit firms and compliance with applicable auditing, professional and independence standards.</p>	<p>The PAO provides the statutory power to the HKICPA to exercise its authorities and duties for audit oversight. Specifically,</p> <ul style="list-style-type: none"> <li>• Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.</li> <li>• Sections 22 to 28F of the PAO set out the authority of the HKICPA for registration of auditor/audit firms and Sections 29 to 30 set out the requirements for issuing a practising certificate to professional accountants who have satisfied the professional qualification requirements under the PAO.</li> <li>• Sections 32A to 32I of the PAO set out the statutory powers and duties given to the HKICPA as the regulator of auditors in Hong Kong to implement the practice review programme of the practice units and to ensure the auditors/audit practices are in compliance with applicable auditing, professional and independence standards.</li> <li>• Sections 33 to 38 of the PAO and By-law 34 and 35 of the Professional Accountants By-laws set out the powers of the HKICPA to deal with complaints concerning allegations of misconduct of members, member practices or registered students and enforce disciplinary sanctions that the Disciplinary Committee considers appropriate to the circumstances. Disciplinary proceedings are governed by Part V of the PAO and the Disciplinary Committee Proceedings Rules.</li> </ul>	<p>No – in terms of the funding model and the governance structure of the HKICPA.</p> <p>See 3.4 and 3.8 below.</p>
3.3	<p><b>IFIAR Principle 1 explanatory material:</b> Audit regulators should have a mandate to work in the public interest and protect investors by seeking to improve audit quality. The responsibilities and powers of audit regulators should, at a minimum, require independent oversight of the audits of public interest entities.</p>	<p>The HKICPA is incorporated by the PAO and works in public interest. Section 7 and 8 of the PAO sets out the objects and the powers of HKICPA.</p> <p>All the practice units defined in the PAO below are subject to practice review by the HKICPA unless they are not carrying out audit or assurance work:</p> <ol style="list-style-type: none"> <li>A firm of certified public accountants (practising) practising accountancy pursuant to the PAO;</li> <li>A certified public accountant (practising) practising accountancy on its own account pursuant to the PAO; or</li> <li>A corporate practice pursuant under the PAO.</li> </ol> <p>The Big Four firms are reviewed annually due to the degree of public interest that there is a predominance of listed and other public interest entities in their client portfolios. Apart from listed companies, practices with other public interest entities, such as banks, insurance companies, securities brokers, insurance brokers, entities receiving government subvention, solicitors and schools, are given priority for review. Please refer to 1.7 for details.</p>	<p>No.</p> <p>All the practice units defined in the PAO are subject to practice review by the HKICPA. However, on the basis that the current governance structure and funding model of the HKICPA do not appear to satisfy the IFIAR requirements (see 3.4, 3.8, 3.9), the statutory auditors and audit firms are not subject to independent public oversight as required by IFIAR.</p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.3			<p><i>In the EU, all statutory auditors must be subject to public oversight regardless of whether or not they are performing listed entity audits. The SAD does not mandate that the actual inspectors cannot be from a professional body or indeed seconded from audit firms, provided that they are under the oversight of the independent oversight body.</i></p> <p><i>Of the 28 EEA states who have notified their inspection systems to the EC:</i></p> <p><i>Nine - inspection by independent oversight body</i></p> <p><i>Eleven - some inspection by independent oversight body, some by professional bodies under independent oversight body supervision</i></p> <p><i>Eight – all inspection by professional bodies under independent oversight body supervision.</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.4	<p><b>IFIAR Charter:</b> Member must be independent of the profession, and engaged in audit regulatory functions in the public interest.</p> <p><b>IFIAR Principle 2:</b> Audit regulators should be operationally independent.</p> <p><b>IFIAR Principle 2 explanatory material:</b> Independence means the ability to undertake regulatory activity and to take and enforce decisions without external interference by those regulated. The audit regulator should be operationally independent from external political interference and from commercial, or other sectoral interests, in the exercise of its functions and powers, including not being controlled in its governance by audit practitioners. The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p> <p><b>IFIAR Principle 5:</b> Audit regulators should ensure that their staff is independent from the profession and should have sufficient staff of appropriate competence.</p>	<p><u>Governing structure of the HKICPA</u></p> <p>The governing body is the Council of the HKICPA which is responsible for making decisions on overall strategy, policy and direction and oversight of the HKICPA's operation and governance. It is also the decision-making body on matters stipulated in the PAO. Sections 17 to 18B of the PAO set out the powers of the Council.</p> <p>The Council currently consists of 22 non-executives who are volunteers and not compensated. The combination of these members are from within and outside the accounting profession as follows:</p> <ul style="list-style-type: none"> <li>• 14 certified public accountants directly elected by the HKICPA's membership including the immediate past president who sits on the Council to allow for continuity.</li> <li>• Two certified public accountants co-opted by the Council to round out skills.</li> <li>• Two ex-officio member from HKSAR Government.</li> <li>• Four lay members who are prominent business leaders appointed by the HKSAR Government to provide independent views and advice.</li> </ul> <p>The Council applies strict rules to prohibit a Council or committee member from taking part in any discussion or decisions on matters in which he or she has a real or apparent conflict of interest.</p> <p><u>Funding source</u></p> <p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees and income from examination and continuing professional development (CPD) fees.</p> <p>Regarding the funding source of the FRC, please refer to 3.8 below.</p> <p><u>Inspection staff member</u></p> <p>The practice reviews are conducted under the responsibility of the QAD headed by a Director who is supported by professional and administrative review staff. All reviewers of the QAD are employed by the HKICPA working solely in QAD. They are all qualified accountants and are required to undergo regular technical training and updates. To ensure independence, the reviewers have a cooling off period whereby they will not perform a review of the firm where they were employed before joining the HKICPA.</p>	<p>No.</p> <p><i>The IFIAR charter requires that membership shall be confined to regulatory agencies that are independent of the profession (including audit firms, professional bodies and bodies or entities associated with the profession), which means, a majority of the relevant governing body should be non-practitioners (with an appropriate cooling off period for former auditors); and the funding should be free of undue influence by the profession. The funding model of the HKICPA does not appear to be free of undue influence by the profession, also the HKICPA, being a professional body, does not satisfy the IFIAR charter which requires that member must be independent of the profession.</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.4	<p><b>IFIAR Principle 5 explanatory material:</b> Audit regulators should have arrangements in place to ensure that inspection staff members are independent of the profession. These arrangements will, as a minimum, include ensuring that staff members should not be practising auditors or employed by or affiliated with an audit firm, and that the arrangements are not controlled in any form by a professional body.</p>	<p><u>Practice Review Committee (PRC)</u></p> <p>Regarding the quality assurance programme of the HKICPA, the results of the practice reviews carried out on the practice units by the QAD are reported to the PRC which is the committee responsible for exercising the powers and duties given to the HKICPA as the regulator of auditors in Hong Kong under Sections 32A to 32I of the PAO. By law, at least two thirds of the Committee must hold practising certificates. The practising members of the Committee are drawn from the full spectrum of audit firms, representing small practices through Big Four firms. Non-practising members are also included in the Committee to bring an additional perspective to Committee decisions on the quality of work carried out by the practices subject to review. The composition of the Committee is reviewed by the Nomination Committee of the HKICPA every year to ensure a balanced composition.</p>	<p><i>This gap is particularly relevant given IFIAR's requirement that the audit regulator should be operationally independent from external political interference and from commercial or other sectoral interests in exercise of its functions and powers, including <u>not being controlled in its governance by audit practitioners.</u></i></p> <p><b>Composition of the Practice Review Committee:</b> <i>the Committee membership mainly comprises practising members, drawn from the full spectrum of audit firms. This creates a gap in relation to the (perceived) objectivity and independence of the quality assurance programme, which is operated by the HKICPA's own Quality Assurance Department, which in turn reports to the Committee.</i></p> <p><b>Source of funding of HKICPA:</b> <i>the funding of HKICPA is dependent on its members and students, and the amount of subscription fees is determined by the Council of which the Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the IFIAR criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.7	<p><b>IFIAR Principle 3:</b> Audit regulators should be transparent and accountable.</p> <p><b>IFIAR Principle 3 explanatory material:</b> The audit regulator should have public accountability in the use of its powers and resources to ensure that the audit regulator maintains its integrity and credibility. Further, the decisions and actions of the audit regulator should be subject to appropriate scrutiny and review, including appeal to a higher authority. Transparency should include the publication of annual work plans and activity reports, including the outcome of inspections either in the aggregate or on a firm-by-firm basis.</p>	<p>The overall results of practice review are provided to the individual practices which are generally not publicly disclosed. However, there is an annual report issued by the QAD which summarises the activities and findings of the practice review programme which is made public on the HKICPA website.</p> <p>The common issues found under the practice review programme were also communicated through various channels. For details, please refer to 1.10 above.</p> <p>The final results of practice review are reported to the PRC which reaches its own decisions on practices' compliance with professional standards and the appropriate follow-up action. The activities and operations of the PRC are subject to scrutiny by the Council of HKICPA and the Standards and Quality Accountability Board (SQAB). The SQAB oversees the performance of the HKICPA's practice review programme and ensures that the QAD activities are carried out in accordance with the strategies and policies determined by the Council and in the public interest.</p>	<p>Yes * (see page 74)</p> <p><i>The activities and outcome of the HKICPA practice reviews are annually published on its website and common issues are communicated via other public channels.</i></p>
3.8	<p><b>IFIAR Charter:</b> Funding should be free of undue influence by the profession.</p> <p><b>IFIAR Principle 2 explanatory material:</b> The audit regulator should have a stable source of funding, which is secure and free from influence by auditors and audit firms and sufficient to execute its powers and responsibilities.</p>	<p>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and continuing professional development ("CPD") fees.</p> <p><u>Funding of the FRC</u></p> <p>The operation of the FRC is currently funded jointly and equally by four parties, namely, the Hong Kong Government's Companies Registry Trading Fund, the Securities and Futures Commission (SFC), the Hong Kong Exchanges and Clearing Limited (HKEx) and the HKICPA. The four parties have signed a Memorandum of Understanding under which they have agreed to contribute as follows:</p> <ul style="list-style-type: none"> <li>- HK\$5 million each (a one-off total of HK\$20 million) to establish a Reserve Fund;</li> <li>- HK\$4 million each (a total of HK\$16 million) for recurring expenses of the FRC in 2010;</li> <li>- Contributions for the recurring expenses will be adjusted for inflation from 2011 to 2014.</li> </ul>	<p>No.</p> <p><i>The funding of HKICPA is mainly dependent on its members and students, and the amount of subscription fees is determined by the Council of which the Council members are voted by the members and about one third of the Council members are practising CPAs (see 3.4 for governance structure of HKICPA). Therefore it does not appear to meet the IFIAR criteria of being completely free from any possible undue influence by auditors and audit firms as required.</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.9	<p><b>IFIAR Principle 6:</b> Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements. Audit regulators should maintain the highest standards of ethical conduct to provide the public with confidence in the objectivity of their decisions. Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff and ensure that appropriate arrangements are in place to protect confidential information from public dissemination.</p>	<p>The Council is the governing body of the HKICPA and consists wholly of volunteers – non-executive members who are not compensated. The Council is responsible for making decisions on overall strategy, policy and direction and oversight of the HKICPA's operation and governance. It is also the decision-making body on matters stipulated in the PAO. Members of the Council include CPAs elected by the members of HKICPA, ex-officio members from the HKSAR Government and lay members who are prominent business leaders appointed by the government. The combination of these members from within and outside the accounting profession gives the Council a balanced perspective from which to debate the issues it faces. The Council applies strict rules to prohibit a Council or committee member from taking part in any discussions or decision on matters in which he or she has a real or apparent conflict of interest.</p> <p>Regarding the practice review programme led by the QAD, the results of the practice review are required to be reported to the PRC, a committee of the HKICPA with responsibility to the Council for exercising the statutory powers and duties given to the HKICPA as the regulator of auditors in Hong Kong. The PRC is a crucial element in enabling the HKICPA to operate a robust but fair system of audit regulation that meets the expectation of local and international stakeholders. The membership of PRC is made up primarily of practising members. The inclusion of non-practising members could ensure the impartiality of PRC decisions on the quality of work carried out by the practices subject to practice review. The practising members of the PRC are drawn from the full spectrum of audit firms, representing small practices through to the Big Four, ensuring that there is sufficient and relevant knowledge of the audit profession to be drawn on.</p> <p>All PRC members are required to give undertakings regarding confidentiality of information that they have access to during the course of Committee work and there is careful monitoring to ensure any potential conflicts of interest are identified and effectively managed.</p>	<p>No.</p> <p><i>Gaps identified in respect of the governance structure of the Council of the HKICPA and also the composition of the Practice Review Committee. See 3.4 above.</i></p>

## 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.10	<p><b>IFIAR Principle 7:</b> Audit regulators should make appropriate arrangements for cooperation with other audit regulators and, where relevant, other third parties. Taking into account the global nature of the financial markets, where necessary and relevant, cooperation and information sharing with other audit regulators and other third parties, including financial market regulators, is helpful to improve audit quality. Audit regulators should provide timely assistance to each other within reasonable limits. Arrangements should be in place for sharing information between audit regulators and other regulators (or between parts of the audit oversight system if it involves more than one body), and for protecting the confidentiality of such information.</p>	<p><u>Cooperation with domestic regulatory authorities</u></p> <p>There is a Memorandum of Understanding (MOU) in place between the FRC and the HKICPA dealing with referrals of matters from the HKICPA to FRC when the HKICPA becomes aware of issues that fall within the remit of the FRC; and the referral of cases from the FRC to HKICPA when an investigation results in a recommendation of disciplinary action.</p> <p>In addition, the FRC has signed a number of MOUs with other regulatory bodies including the HKEx, the SFC, the Hong Kong Monetary Authority and the Insurance Authority. The MOUs establish working arrangements and protocols between the signing parties.</p> <p>In Hong Kong, the HKICPA, the FRC and the HKEx carry out similar programmes of reviews of listed companies financial statements. The regulatory bodies regularly communicate with each other to share observations noted from reviews of listed company financial statements.</p> <p>In addition, Section 12 of the FRCO authorises the FRC to provide assistance and cooperation with the specified authorities under certain circumstances. If the FRC is of the opinion that certain conditions are satisfied, it may refer to or provide assistance to a specified authority on the authority's investigation or enquiry into, or dealing with, any case or complaint concerning a relevant irregularity or non-compliance in relation to a listed entity.</p> <p><u>Cross-border cooperation with overseas regulatory authorities</u></p> <p>We understand that the HKICPA is willing to engage and cooperate with other countries' audit regulators, including exchange of information with other audit regulators to the extent not prohibited the relevant laws and regulations.</p> <p>There are confidentiality and secrecy provisions in the PAO regarding information relating to audit inspections and disciplinary cases. Personal information is protected by Personal Data Privacy Ordinance in Hong Kong, and consent needs to be obtained before release of information. Certain audit entities might be subject to the State Secrets Law or relevant laws and regulations in Mainland China.</p> <p>In 2009, the HKICPA signed a MOU with the Ministry of Finance in the People's Republic of China ("China MOF") to facilitate cooperation between both parties in fulfilling their respective regulatory responsibilities.</p> <p>In 2007 and 2011, the HKICPA signed joint declarations with the China Auditing Standards Board and the Chinese Institute of CPAs (CICPA) on the ongoing convergence of Mainland and Hong Kong auditing standards and on the convergence of respective Code of Ethics for Professional Accountants.</p> <p>The HKICPA has also initiated various discussions with the Mainland regulatory authorities and overseas regulatory bodies to discuss standard setting, regulatory reform or cross-border oversight related matters.</p>	<p>Yes * (see page 74)</p> <p><i>There are a number of cooperative MOUs in place with domestic and overseas regulatory authorities.</i></p> <p><i>However the FRC cannot enter into MOUs with IFIAR members because it does not have inspection and follow-up powers and HKICPA cannot sign MOUs with IFIAR members because it is not independent of the profession.</i></p>

### 3.3 Hong Kong - IFIAR gap analysis (cont'd)

	IFIAR	Features of current Hong Kong audit oversight system	Is the existing HK system compliant with the IFIAR requirements?
3	Principles of public oversight		
3.10		In 2009, the FRC signed a MOU with China MOF which established a framework for investigative cooperation. The FRC could investigate, through the China MOF, potential auditing irregularities in relation to Mainland auditors of Hong Kong listed companies. Increased interaction with the Mainland authorities with regard to the exchange of views and knowledge is anticipated. Specifically, the FRC has established a system designed to foster cross-border cooperation on cases with the China MOF. The FRC and China MOF have been developing detailed work processes and guidelines to implement that scheme.	



## 4. Possible approaches to auditor oversight

# 4. Possible approaches to auditor oversight

## Analysis of possible approaches

This section includes several key decisions relevant to the system of auditor oversight. In each case, each of the options presented would at least meet the relevant IFIAR principles and/or for recognition of Hong Kong as meeting the standard for EC equivalence. However, adoption of some of the additional requirements imposed in the other jurisdictions in the comparator group may also be of interest, and we include an indication of some of the advantages and disadvantages of each approach.

Abbreviations used in the 'where applied' column are as follows:

- AU - Australia
- CA - Canada
- EC Equivalence - the requirements for a jurisdiction to be judged as 'equivalent' for the purpose of 'third country auditors' under EC law – i.e. applicable to the audits of companies incorporated outside the EEA with securities admitted to trading on an EEA regulated market
- EU - European Union – the requirements for an auditor based within the EEA
- SG - Singapore
- UK - United Kingdom
- US - United States

When comparing the requirements for EC Equivalence and the EU:

- The obligation to register with an EEA regulator as a 'third country auditor' stems from auditing a non-EEA incorporated entity with securities admitted to trading on an EEA regulated market. 'Equivalence' then means that the EEA regulator in question may rely on the third country regulator, rather than regulating the auditor directly.
- The EC Equivalence requirements are a subset of those which apply for EEA based auditors under the SAD. Compliance with the additional EU requirements is not required for a third country auditor.

### 4.1. Focus area: scope of regulation

**Overview:** We understand that the intended scope of the audit oversight brief in Hong Kong would extend to 'public interest listed companies' (see following page with definitions). A decision around the scope of audit regulation will affect both cost and resourcing and the timescale in which changes could be made. In preparing this comparative study, we have identified a number of alternative approaches, and we set out the possible advantages and disadvantages on page 99.

## 4.1 Possible approaches to auditor oversight - spotlight on public interest entity definitions

	EU (requirement)	UK	US	Canada	Australia	Singapore
Is there a definition of public interest entity?	<p><i>All statutory audits (whether of listed or unlisted companies) are subject to independent oversight (Article 32(2) SAD).</i></p> <p><i>SAD definition of PIE: listed companies, banks and insurance companies and other entities designated as PIEs by Member States (2 (13) SAD).</i></p> <p><i>Current EC audit reform proposals provide for a wider definition of public interest entities.</i></p>	<p>Yes. However, all audits are subject to independent oversight, whether of public interest entities or not.</p> <p>The FRC's Scope of Independent Inspection 2013/14 covers, in addition to listed companies:</p> <p>banks, insurers, private companies with &gt;£500m-£1000m turnover, UK investment funds and mutual 'with profits' life insurers with &gt;£1000m assets, private sector pension schemes with &gt;£1000m assets and/or 20,000 members and charities with &gt;£100m income.</p> <p>Source: Statutory Auditors (Transparency) Instrument 2008 issued by the Professional Oversight Board of the FRC under powers conferred by the Companies Act 2006.</p>	<p>No. However, auditor oversight legislation (Sarbanes-Oxley Act (SOX), Dodd-Frank Act) requires that the PCAOB oversee the audits of issuers and broker-dealers.</p>	<p>Yes. PIEs are defined as (i) a Listed Entity; and (ii) an entity (a) defined by regulation or legislation as a public interest entity or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of Listed Entities.</p> <p>Source: International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants para 290.25. Reaffirmed in Canadian Institute of Chartered Accountants (CICA) Exposure Draft on Independence.</p>	<p>Yes. PIEs are defined as a listed entity or any entity (a) defined by regulation or legislation as a public interest entity; or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.</p> <p>Source: Amendment to the Definition of Public Interest Entity in APES 110 Code of Ethics for Professional Accountants (issued December 2010).</p> <ul style="list-style-type: none"> <li>290.26: firms shall determine whether to treat additional entities, or certain categories of entities, as PIEs because they have a large number and wide range of stakeholders. Factors include a) the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders, e.g. financial institutions, such as banks and insurance companies and pension funds; b) size; c) number of employees.</li> <li>See 8.5.1 for more details.</li> </ul>	<p>Yes. The Accounting and Corporate Regulatory Authority (ACRA) has clarified that PIEs include: a) companies listed on / in the process of issuing debt or equity instruments for trading on the Singapore Exchange; b) entities in regulated financial industries (e.g. banks, insurance companies, funds, fund managers and securities / brokers / dealers); c) other entities which raise funds from the public (e.g. charities, Institutions of a Public Character (IPC) and religious organisations).</p> <p>Source: 'Clarification of Public Interest Entities' , (see ACRA's online Renewal of Certification of Registration guidance).</p>

# 4.1 Possible approaches to auditor oversight (cont'd)

## 4.1 Focus area: scope of FRC regulation

Possible approach	Where applied	Potential advantages	Potential disadvantages
<p><b>Public interest listed companies only:</b> The HK FRC's stated remit is in respect of those companies listed in Hong Kong that meet certain public interest criteria. <i>NB: EC equivalence only requires regulation of auditors of companies with securities admitted to trading on an EEA regulated market – it does not matter whether auditors of domestically listed companies or other companies are regulated.</i></p>	EC Equivalence	This approach focuses on the principal companies listed on the HK Stock Exchange. This allows the regulator to concentrate their efforts on the listed companies that are of most relevance to major investors and to the markets at large. This represents a proportionate way to oversee the listed securities market and ensure confidence is appropriately maintained.	Does not cover entities with listed debt or large private companies which may be of interest to the public's confidence in auditors and the financial markets. For example, very large private companies, significant public sector entities, charities and pension funds may all be out of scope, yet would be seen by many investors as important to their confidence in the markets and audit profession.
<p><b>All listed companies, all public interest companies:</b> Both IFIAR and the EC requirements applicable within the EEA require coverage of listed companies and a wider class of public interest entities. IFIAR and the EC include significant financial institutions. The UK goes further, applying Financial Reporting Council (FRC) regulation to large private companies, charities and pension funds. The US is in the process of applying the rules to unlisted broker-dealers.</p>	IFIAR, EU, UK, US, SG, AU, CA	This approach gives the regulator a wide remit; over both a wide range of companies and also a range of firms. Many mid-tier firms do not audit the largest listed companies, but would nevertheless benefit from independent regulatory oversight, which might in turn help them penetrate the larger company market. Further, the confidence of market participants is enhanced by the wider range of entities and firms subject to oversight, since the broader base may give a more representative population.	Scale of resource needed. For example, reviews of the audits of smaller investment entities with few investors audited by a small audit firm. The law of diminishing returns may well be seen to apply once the oversight regime moves beyond the larger, listed entities and those (whether listed or not) of public interest entities.
<p><b>'Public interest' companies only:</b> A possible hybrid approach would be to set the regulatory scope by reference to a definition of public interest that captures larger listed companies (in the UK, the FTSE 350 for example) and certain entities that would meet public interest criteria.</p>		This approach is intended to strike a balance between focusing only on the main listed companies, and instead extends this to other entities that have a bearing on investor confidence (in the markets, with regulators and auditors). It recognises that not every entity with listed securities is of interest to investors, but also that the public interest may be triggered by more than simply the nature of the funding model of the company.	An area requiring particular precision will be the definition of 'public interest' for the purposes of this approach. An excessively detailed and technical definition may bring unnecessary complexity and present an additional administrative burden in itself.

## 4.2 Possible approaches to auditor oversight

### 4.2 Focus area: registration: individuals vs. firms

**Overview:** One of the key areas of difference between regulatory regimes is the extent to which regulation reaches individual partners and staff of audit firms, as opposed to the regulation of firms. All of the regimes in the scope of this report have some form of individual registration requirement, but this may well be with a professional body rather than an independent oversight body.

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Regulation of firm only:</b> The IFIAR principles are not prescriptive as to the approach that must be adopted. Regulation of individuals does not appear to be a requirement, although in practice all regimes have some form of individual regulation.	IFIAR	Simplicity.	Inability to directly discipline individuals and/or prevent individuals who caused sanction of one firm from moving to another firm.
<b>Regulation focusing on firms with limited regulation of individuals:</b> Registration as a 'third country auditor' with the EC requires information about some or all partners within the firm.	EC Equivalence	This approach gives the regulator information about those in positions of responsibility for the audit, the ability to discipline those individuals and/or prevent individuals sanctioned for their actions from one firm becoming associated with another firm, but without the need for the regulator to directly police all accountants' compliance with professional obligations. Firms remain responsible for allocating suitably qualified individuals to audits; professional bodies remain responsible for assessing qualification.	A mechanism is needed to track information about individuals associated with firms and to keep that up-to-date, which may require an ongoing compliance regime as partners (and potentially other staff) join and leave firms rather than an annual updating process.
<b>Regulation of firms and individuals:</b> Canada requires both firms and individuals to register with the regulator. Most domestic regulatory regimes require details of some or all individuals within the firm (e.g. UK: 'Responsible Individuals' who can sign audit reports, US all partners and managers but not junior staff). Australian registration focuses on individuals.	EU, UK, CA, AU, SG, US	Ability to regulate at a granular level. Direct ability to sanction individuals.	Cost and complexity.

# 4.3 Possible approaches to auditor oversight

## 4.3 Focus area: registration, inspection and enforcement: approach to overseas auditors

**Overview:** Regulation of overseas auditors is a complex area. There are several different aspects to this:

- The conditions necessary for an overseas auditor to audit a listed company within the audit regulator's remit. Different approaches are taken by different regulators. For example, the PCAOB applies exactly the same regime to overseas auditors of SEC registrants as it does to domestic registrants. The EU has a 'third country auditor' regime applicable to auditors of non-EEA incorporated EEA listed entities – either by direct regulation or local regulation under an 'equivalent' audit regime. IFIAR has no particular requirements here as it does not cover the geographic scope of regulation, only the form of regulation once an audit is in scope.
- Co-operation between regulators in respect of group audits. Again, different approaches arise. For example, the EU will allow exchange of work papers and co-operation with an overseas regulator if that overseas regulator will co-operate 'the other way around'; the US requires either that the parent auditor procures co-operation of the subsidiary auditor or registration of the subsidiary auditor; some regimes are silent.
- Recognition of overseas qualifications for partners and staff.

*(Continued on the following page)*

## 4.3 Possible approaches to auditor oversight (cont'd)

### 4.3 Focus area: registration, inspection and enforcement: approach to overseas auditors - registration

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Regulation of overseas auditors in all cases</b>	US	Greatest ability to supervise overseas auditors of Hong Kong public interest listed companies.	Cost and complexity of regulating all overseas auditors.
<b>Regulation of overseas auditors unless there is an 'equivalent' audit regime:</b> EU allows non-EEA 'third country auditors' to audit non-EEA incorporated but EEA listed companies, but member states may decide not to regulate those that are subject to an 'equivalent' audit regulation regime.	EC Equivalence, EU, UK, CA	The public interest is safeguarded as all audits within the scope of the HK FRC's remit are regulated, but the costs of regulating those that are already regulated elsewhere are avoided.	Reliance on an overseas regulator who may have different standards for disciplinary action and sanctions.
<b>No regulation of overseas auditors:</b> IFIAR only deals with regulation of audits that are in scope; it does not mandate scope. (But note AU's mutual recognition agreement with New Zealand).	IFIAR, AU, SG	Simplicity.	Lack of protection of the public interest where there are significant inbound listings of entities incorporated in other jurisdictions.

### 4.3 Focus area: registration, inspection and enforcement: approach to overseas auditors – impact on group audits

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Regulation of all component auditors</b>		Greatest ability to inspect and discipline.	Cost and complexity. Overly complex when ISA 600 requires group auditor to take sole responsibility for audit.
<b>Regulation of component auditors unless parent auditor can enforce co-operation</b>	EU (partly), US	The public interest is safeguarded as all audits within the scope of the HK FRC's remit are regulated, but the costs of regulating those that are already regulated elsewhere are avoided.	Cost and complexity. Overly complex when ISA 600 requires group auditor to take sole responsibility for audit.
<b>No regulation of component auditors</b> (although there is a 'reciprocity' requirement to be met for member states to opt to disapply or modify registration requirements, under article 46.1 SAD)	IFIAR, EC Equivalence, UK, CA, SG	Simplicity. ISA 600 makes group auditor solely responsible for quality of the audit, including assessing competence of component auditors. Sanctioning of group auditor for failings of component auditors achieves audit quality.	Legal bars to co-operation (e.g. inability to obtain access to component auditors' working papers due to professional secrecy laws) may reduce effectiveness.

# 4.4 Possible approaches to auditor oversight

## 4.4 Focus area: Inspection – transparency

**Overview:** Most major audit regulatory regimes involve some form of public reporting of the outcome of inspection activity. This varies depending on the degree of granularity – the regime as a whole or individual firms – and whether there are more detailed private reports.

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Regime as a whole:</b> This is the minimum requirement for both EU auditors and EC equivalence as well as IFIAR membership.	IFIAR, EU, EC Equivalence, SG	Stakeholders have an overview of the quality of the audit regime in the jurisdiction.	Audit committees and shareholders have no insight into the quality of individual audit firms.
<b>Firm-by-firm reporting:</b> UK publishes a report on each of the larger firms, plus a combined report on smaller firms that carry out the audits of public interest entities. US and Canada publish reports on individual firms – in both cases, weaknesses aren't reported unless they remain unresolved for a period of time (US: a year, Canada: 180 days). AU – consolidated report currently, but note also new provision regarding deficiency reports.	UK, US, CA (in part), AU (new provision)	Audit committees and shareholders have insight into the quality of individual audit firms.  Publication of weaknesses (either immediately – UK – or delayed – US/Canada) acts as a deterrent.	Where the number of audits inspected is low, inappropriate conclusions may be drawn from a statistically insignificant population.  Publication of details of individual audits can risk information about individual clients' affairs being released as part of inspection reporting.
<b>Audit by audit reporting:</b> UK provides private reports on individual audits to audit committees.	UK	Audit committees have insight into the performance of their own audit to help inform their own assessment.	Cost and complexity.  Inappropriate conclusions (positive or negative) can be drawn from one-off issues.



# 4.5 Possible approaches to auditor oversight

## 4.5 Focus area: Inspection – delegation to professional bodies and/or staff of other audit firms

**Overview:** The degree of delegation of inspection varies from jurisdiction to jurisdiction. In some cases all inspection staff work for the regulator (e.g. in the UK all inspectors work for the FRC (public interest audit inspection) or a professional body (other audit inspection)); in other cases there is a differential approach (e.g. in the US the PCAOB has its own staff whereas the American Institute of CPAs (AICPA) regime for non-public entity audits relies on peer review). The EU currently allows some of the inspection work to be outsourced to firms under the supervision of inspection staff. The degree to which inspection can be delegated will affect resourcing and the time taken to implement any reforms.

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>No delegation of inspection (or delegation only to overseas inspectors who do not in turn delegate):</b>	US, AU	Highest perception of independence and rigour.  Lowest likelihood of conflicts of interest.	Resourcing can be a challenge, particularly where there are peaks and troughs in the inspection cycle.
<b>Delegation by type of audit:</b> e.g. UK and Singapore delegate inspections of non-public interest audits to professional bodies, but without the participation of firms. IFIAR Principles suggest no delegation of public interest audit inspection.	IFIAR, UK, CA, SG	Independence as well as rigour, but quicker to implement than no delegation.	Perceived lower quality and/or independence of delegated inspections.
<b>Delegation of some portions of inspections:</b> e.g. EU law (both for EEA auditors and under EC equivalence regime).	EU, EC Equivalence	Cost-effective.  Ability to manage changes in demand over the annual inspection cycle.	Perceived lack of rigour and independence.  Increased risk of conflicts of interest.

## 4.6 Possible approaches to auditor oversight

### 4.6 Focus area: Enforcement – type of disciplinary body

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Separate panel or tribunal</b>	AU (via Companies Auditors and Liquidators Disciplinary Board (CALDB)), UK (FRC but separate Conduct Committee and Disciplinary Tribunal), SG (Public Accountants Oversight Committee (PAOC) appoints a Complaints and Disciplinary panel, but is ultimately under ACRA)	Less susceptible to judicial review / appeal. Independence is both inherent and perceived.  Concept of 'natural justice' – the regulator is not both the prosecutor and the jury.	Can take longer to resolve.
<b>Regulator itself</b>	AU (via Australian Securities and Investments Commission (ASIC)'s enforceable undertakings), CA (Canadian Public Accountability Board (CPAB)), US (PCAOB)	Simple to administer and possibly lower cost.  Potentially speedier.	Although it may well actually be equally independent, there is not the same level of <i>perceived</i> independence. Greater possibility of appeal / judicial review.

*EC equivalence: the system of public oversight shall have the right, where necessary, to conduct investigations in relation to statutory auditors and audit firms (as defined in Article 45 'Third Country Auditors' - essentially those providing an audit report concerning the annual or consolidated accounts of a company incorporated outside the EEA whose transferable securities are admitted to trading on a regulated market of that Member State) and the right to take appropriate action. EU SAD: Member States will designate one or more competent authorities for the purposes of the tasks provided for in the SAD.*

### 4.6 Focus area: Enforcement – nature of penalty regimes

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Fines, censure and registration suspended/removed</b>	All	Simple and easily understood by all concerned and the market at large.	While dissuasive, these can have unintended and adverse consequences, notably disruption to the audit market. Potential lack of granularity to the penalty; it could be perceived - and act - as a 'catch all' mechanism.
<b>In addition, the ability to impose tailored restrictions</b> e.g. need to undergo training or independent monitoring	All to greater or lesser extent. UK and US appear to have most stated options regarding tailored solutions; SG - accounting firm and AU - individual required to give specific undertaking; CA – firm given direction on remedial action	Granular, tailored approach.  Less risk of market disruption.	Adds some complexity.  Requires more follow-up inspection / monitoring.

*Note: EU / EC equivalence not specified, just that penalties must be 'effective, proportionate, dissuasive'.*

# 4.7 Possible approaches to auditor oversight

## 4.7 Focus area: Standard setting – international convergence

**Overview:** All regimes have some form of independent standard setting and/or oversight of the standard-setting process. In many cases (with the notable exception of the US) the starting point for standards are internationally agreed standards.

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Use of international standards:</b> IFIAR, EU (once powers used - see section 8.1.5). EC equivalence will always accept, but does not necessarily require.	IFIAR, EU, EC Equivalence, UK (accounting) CA (accounting)	Global acceptance. Ease of application across group audits.	Lack of tailoring to respond to local needs.
<b>Use of international standards with supplementation</b>	UK (auditing and ethics), CA (auditing), US (private company audits), AU (accounting and auditing), SG	Global acceptance. Ease of application across group audits.	Need to communicate additional requirements to other group auditors.
<b>Development of own standards</b>	US public company audits	Ability to tailor to respond to local needs e.g. US standards relating to the audit of internal control under s404 SOX.	Complexity of group audits when referring work to component auditors in other jurisdictions.

# 4.8 Possible approaches to auditor oversight

## 4.8 Focus area: Funding models

**Overview:** There is no one generally accepted funding model. Models include one or a mix of:

- a levy on listed companies;
- a levy on professional bodies; and
- a levy directly on audit firms.

Costs of disciplinary investigations tend to be borne by the firm if it is sanctioned. Neither the EU/EC for domestic auditors/equivalence, nor the IFIAR principles, mandate any one funding model; rather, the funding model should be such that the oversight regime is sufficiently resourced and independent of the firms being regulated.

*(Continued on the following page)*

# 4.8 Possible approaches to auditor oversight (cont'd)

## 4.8 Focus area: Funding models

Possible approach	Where applied	Potential advantages	Potential disadvantages
<b>Levy on companies whose audits are regulated or a subset thereof</b>	US (in part), UK (in part)	<p>Easy to collect where there are other levies charged to such companies (e.g. a securities regulator levy or charge for accounting standard-setting).</p> <p>Independent of auditors who have little or no interest in the quantum of such fees.</p> <p>Ability to levy on parts of the population e.g. listed companies and public interest entities.</p>	<p>If there is no pre-existing collection mechanism, it may be costly to develop one.</p> <p>Larger population of payees (more audited entities than auditors) may increase collection costs.</p>
<b>Levy on professional bodies</b>	UK (in part)	Professional bodies tend to already have a mechanism to charge fees to member firms and individual practitioners, so no new collection mechanism is necessary.	Perceived influence of professional bodies on scale and scope of regulation.
<b>Levy on individual firms or practitioners</b>	US (in part), CA, SG	Ease of collection – non-payment results in immediate forfeiture of audit registration.	<p>If there is no pre-existing collection mechanism, it may be costly to develop one.</p> <p>Larger population of payees may increase collection costs.</p> <p>Perceived influence of firms or members on scale and scope of regulation.</p>
<b>Government subsidy</b>	UK (small element), AU	<p>Certainty – not dependent on (say) market capitalisation of audited entities or number of audit firms which tend to be used as basis to set levy based funding.</p> <p>Fully independent of influence by audited entities and auditors.</p>	Costs borne by the wider public purse rather than (directly or indirectly) those entities benefiting from audits.

# 4.9 Possible approaches to auditor oversight

## 4.9 Focus area: Continuing Professional Education

The requirements for audit partners and professional staff to undertake continuing professional education (CPE) are broadly similar across each of the jurisdictions. In Canada and Singapore the oversight bodies (CPAB and ACRA respectively) directly oversee CPE. In the UK it is delegated to the professional bodies subject to UK FRC oversight (the UK FRC inspects the professional bodies' own activity in this area). In Australia and the US professional bodies monitor CPE compliance.

## 5. Comparisons per jurisdiction, per function

# Spotlight on the role of oversight bodies and delegated functions

Oversight Body: Function:	EU requirements	IFIAR	UK (FRC)	US (PCAOB)	Canada (CPAB)	Australia (ASIC)	Singapore (ACRA)
Registration	<i>Delegation allowed (with oversight)</i>	<i>Delegation allowed (with oversight)</i>	Delegated to Recognised Supervisory Bodies (RSB) with oversight	Oversight body	Oversight body	Oversight body	Oversight body
Inspection	<i>Delegation allowed (but oversight body must retain right to inspect)</i>	<ul style="list-style-type: none"> <li>• <i>PIEs – cannot be delegated</i></li> <li>• <i>Non-PIEs – can be delegated</i></li> </ul>	<ul style="list-style-type: none"> <li>• PIEs – oversight body</li> <li>• Non-PIEs – delegated to RSBs with oversight</li> </ul>	Oversight body	<ul style="list-style-type: none"> <li>• Reporting issuers - oversight body</li> <li>• Non-publicly listed – delegated to CICA* with oversight</li> </ul>	Oversight body	<ul style="list-style-type: none"> <li>• PIEs – oversight body</li> <li>• Non-PIEs – oversight body with ICPAS</li> </ul>
Investigation	<i>Delegation allowed (but oversight body must retain right to investigate)</i>	<ul style="list-style-type: none"> <li>• <i>PIEs – cannot be delegated</i></li> <li>• <i>Non-PIEs – can be delegated</i></li> </ul>	<ul style="list-style-type: none"> <li>• PIEs – oversight body</li> <li>• Non-PIEs - delegated to RSBs with oversight</li> </ul>	Oversight body plus SEC	Oversight body	Oversight body	Oversight body
Enforcement	<i>Delegation allowed (but oversight body must retain right to take action)</i>	<ul style="list-style-type: none"> <li>• <i>PIEs – cannot be delegated</i></li> <li>• <i>Non-PIEs – can be delegated</i></li> </ul>	<ul style="list-style-type: none"> <li>• PIEs – oversight body</li> <li>• Non-PIEs - delegated to RSBs with oversight</li> </ul>	Oversight body plus SEC	Oversight body	Oversight body and independent board	Oversight body
Standard setting	<i>Delegation allowed (with oversight)</i>	N/A	Oversight body	<ul style="list-style-type: none"> <li>• Auditing and assurance – oversight body (public companies)/AICPA (non-public companies)</li> <li>• Financial reporting – Financial Accounting Standards Board (FASB)/SEC</li> <li>• Ethics – oversight body/AICPA</li> </ul>	Delegated to the Public Trust Committee (PTC), Auditing and Assurance Standards Board (AASB) and Accounting Standards Board (AcSB) with oversight	Standards are set by independent bodies (audit and accounting – Government; ethical – independent board established by the professional bodies)	<ul style="list-style-type: none"> <li>• Accounting - separate independent body</li> <li>• Audit – delegated to professional body with oversight</li> <li>• Ethics - oversight body</li> </ul>
Continuing professional education	<i>Delegation allowed (with oversight)</i>	N/A	Delegated to RSBs with oversight	Oversight body plus state boards of accountancy	Oversight body	Professional bodies	Oversight body



# 5.1 Registration

	EU (requirement)	UK	US	Canada	Australia	Singapore
Audit requirement scope	<p><i>All limited companies (public and private) other than small companies, dormant companies and certain subsidiaries guaranteed by an EU incorporated parent, together with the majority of financial institutions.</i></p> <p><i>Note: Third country equivalence is only relevant to audits of listed companies.</i></p>	<p>Audit requirements extend to a wide range of companies defined in the local law, broadly categorised as private and public companies.</p> <p>Exemption rules apply to small and dormant companies.</p>	<p>Registration with the PCAOB is required for the auditors of issuers and broker-dealers.</p> <p>Unlike other jurisdictions, in the US and Canada audits of private companies are driven by the need/desire of boards of directors, audit committees and management; whether for the company's own use, lending purposes, etc. Practising in this area is governed by state boards of accountancy and the AICPA.</p> <p>Generally, audits of Governmental entities are performed under Government Auditing Standards.</p>	<p>Unlike other jurisdictions, in the US and Canada audits of private companies are driven by the need/desire for boards of directors, audit committees, management to have such audits performed - whether for the company's own use, or for lending purposes or otherwise.</p>	<p>Audit requirements extend to a wide range of companies defined in the local law, broadly categorised as private and public companies.</p> <p>Exemption rules apply to small companies.</p>	<p>Audit requirements extend to a wide range of companies defined in the local law, broadly categorised as private and public companies.</p> <p>Exemption rules apply to Exempt Private Companies as defined in law (&lt;20 shareholders) and dormant companies.</p>

## 5.1 Registration (cont'd)

	EU (requirement)	UK	US	Canada	Australia	Singapore
Registration requirements	<i>All statutory auditors and audit firms shall be subject to public oversight.</i>	All 'statutory audits' as defined by the Companies Act must be undertaken by auditors 'registered' with an RSB. This includes the audits of companies, charities, pension funds, insurance companies, banks and regulated investment funds.	<p>Unlike other jurisdictions, US SOX and PCAOB (also known as 'the Board') rules provide that a firm must be registered with the PCAOB to prepare or issue, or to play a substantial role in the preparation or furnishing of, an audit report with respect to any issuer.</p> <p>In respect of non-issuer broker-dealers, financial statements filed with the Securities Exchange Commission (SEC) must be certified by a registered firm.</p> <p>The Board determines whether approval of the application for registration is consistent with the Board's responsibilities to protect the interests of investors and further the public interest.</p>	A public accounting firm that prepares an auditor's report with respect to the financial statements of a reporting issuer must be, as of the date of its auditor's report, (a) a participating audit firm – registered with CPAB, and (b) in compliance with any restrictions or sanctions imposed by the CPAB.	All 'statutory audits' as defined by local laws must be undertaken by a registered audit corporation or audit partner registered with ASIC – i.e. the oversight body.	All auditors must be registered with ACRA – i.e. the oversight body.
Is the registration body also the oversight body?	<i>Not necessarily.</i>	No.	Yes.	Yes.	Yes.	Yes.

## 5.2 Inspection

	EU (requirement)	UK	US	Canada	Australia	Singapore
Review frequency	<p><i>For auditors of public interest entities, inspections must take place at least every three years.</i></p> <p><i>Other statutory auditors (those that do not carry out audits of public interest entities) are reviewed every six years.</i></p>	<p>Largest four audit firms are subject to inspection on an annual basis.</p> <p>The other major firms that audit PIEs are reviewed on an extended cycle of up to three years.</p> <p>Auditors that do not audit public interest entities are reviewed at least every six years, depending on size.</p>	<p>PCAOB annual inspection for firms that audit more than 100 issuers. For others, at least once every three years.</p>	<p>Firms with 100 or more reporting issuer clients are inspected annually.</p> <p>Those with between 50 and 99 reporting issuer clients are inspected at least once every two years.</p> <p>Those with fewer than 50 reporting issuer clients are inspected at least once every three years.</p>	<p>ASIC inspection activity runs on an 18 month cycle and covers approx. 20 firms. The four large national firms are inspected every 18 months.</p> <p>The next 10 firms that audit 5% of listed entities are done on a two and a half year cycle. The remaining 72 smaller firms are inspected less frequently (three years on average).</p>	<p>Planned inspections on bi-annual basis for firms that undertake PIE audits.</p>
Inspection approach (risk focus) and grading	<p><i>The scope of the quality assurance review, supported by adequate testing of selected audit files, shall include an assessment of compliance with applicable auditing standards and independence requirements, of the quantity and quality of resources spent, of the audit fees charged and of the internal quality control system of the audit firm.</i></p>	<p>Risk-based. The model takes account of priority sectors determined annually. The majority of audits reviewed are drawn from those identified as higher risk.</p> <p>No overall grading, however individual audits are however graded by the Audit Quality Review Team (AQRT) and the results included in the public report.</p>	<p>The PCAOB's individual audits and focus areas are most often selected on a risk-weighted basis.</p> <p>No overall grading.</p>	<p>CPAB uses a number of risk analysis processes to identify higher-risk reporting issuer audits and allocates its inspection resources accordingly.</p> <p>No overall grading.</p>	<p>ASIC file selection process is risk based. IFIAR membership may also contribute to the areas of engagement file focus by ASIC, and its general approach.</p> <p>No overall grading.</p>	<p>Risk-based approach, with engagement reviews of public accountants plus, for accounting firms that audit PIEs, firm reviews too.</p> <p>No overall grading.</p>

## 5.2 Inspection (cont'd)

	EU (requirement)	UK	US	Canada	Australia	Singapore
<b>Annual report (or equivalent)</b>	<i>Reports should contain the main conclusions, and the overall results of the quality assurance system shall be published annually, as well as an annual work programme and activity reports.</i>	UK FRC publishes annual inspection reports including work programme and activity reporting.	The US PCAOB does not publish an annual inspection report (but may publish its findings as the Board deems appropriate).	Canada's inspection body publishes annual inspection reports including work programme and activity reporting.	The professional bodies are also required to conduct quality reviews of their members. Australia's Institute of Chartered Accountants in Australia (ICAA) has not done an audit quality review of the large firms for a number of years; its report focuses on smaller firms (but it did publish a report on the results of a November 2011 survey of larger firms). ASIC issues a consolidated public report every 18 months.	Singapore's ACRA, publishes annual inspection reports including work programme and activity reporting.
<b>Transparency of firm-specific reporting</b>	<i>The system of public oversight shall be transparent. This shall include the publication of annual work programmes and activity reports.</i>	The AQRT publishes individual reports on inspections of major firms; issues confidential reports on individual audits to the relevant firms (who are expected to confirm to the AQRT that they have provided copies to the directors of the audited entities concerned). AQRT will also provide copies of these letters directly to the chairmen of the relevant Audit Committee. Professional body reports are not published.	Part I is published (describes deficiencies observed by the PCAOB, but company names are withheld). If a firm fails to satisfactorily address any of the quality control criticisms within 12 months, portions of the formerly private Part II of the report discussing the particular criticism(s) are also made publicly available.	In Canada, the individual inspection report on the firm is not published.  However, if the weaknesses, deficiencies or recommendations are not satisfactorily addressed within 180 days, the Board can make the relevant portions of the final Inspection report (and the fact that they have not been addressed to the Board's satisfaction) public on its website.	In Australia, the individual firm inspection report is private.  However a recent change in law (June 2012) will allow inspectors to issue deficiency reports if auditors are not deemed to have taken appropriate action to remedy inspection findings in respect of future inspections.	In Singapore, the individual firm inspection report is private. ACRA wants the right to provide (portions of) a firm's report to relevant local regulators and, if an audit firm fails to make sufficient progress under a remediation plan, make non-publication of certain matters conditional on the firm making improvements within certain time periods.

## 5.2 Inspection (cont'd)

	EU (requirement)	UK	US	Canada	Australia	Singapore
<b>Operation and funding of the inspection process</b>	<i>The quality assurance process shall be independent of the reviewed statutory auditors and audit firms and be subject to independent public oversight.</i>	AQRT, part of the FRC – inspection of ‘major audits’ including listed companies, banks, insurance companies, large pension funds, large charities and the very largest private companies.  Professional bodies (under FRC oversight) inspect other audits.	PCAOB, overseen by the SEC	CPAB	ASIC	PAOC under ACRA
<b>Appeal process for inspection findings</b>		In the UK there is no formal complaint or appeals process for a firm or individual once an inspection of an audit or a firm has concluded.  Firms are requested to provide a written response to the AQRT report and this is included in the AQRT's public report on the firm.	Interim review by the SEC can be sought (and the report is then delayed until that review is complete).	The firm may petition for a review which can lead to arbitration.	No formal appeals process currently, however there is much interaction regarding comment letters before the reports are finalised. New from June 2012 onwards – if and when a deficiency report is issued, it will feature the relevant firm's comments in reply.	Any public accountant may appeal to the High Court within a period of, typically, 30 days after the service of the Oversight Committee's decision.
<b>Impact of failure to take remedial action</b>		Possible enforcement action.  <i>NB: Inspection reports already published in full.</i>	Publication of previously private portions of inspection report.  Possible enforcement action.	Publication of portions of inspection report.  Possible enforcement action.	Publication of deficiency report.	Possible enforcement action.

## 5.3 Investigations

	EU (requirement)	UK	US	Canada	Australia	Singapore
<b>Body and overview</b>	<i>Member states shall ensure that there are effective systems of investigations and penalties to detect, correct and prevent inadequate execution of the statutory audit.</i>	<p>Professional bodies can refer cases to the FRC; and/or the FRC can decide to investigate a matter.</p> <p>The FRC's Conduct Committee considers each case and decides whether or not it appears to give rise to serious public concern or to damage public confidence – if it does, it will ask the FRC's conduct division to investigate; if not it will refer the case on to the relevant professional body.</p> <p>Professional bodies will also launch their own disciplinary investigations and, if they believe they are of public interest, can refer them to the FRC Conduct Committee.</p>	<p>Both the PCAOB and the SEC have investigative responsibilities; as do the state boards of accountancy.</p> <p>The PCAOB may issue an order of formal investigation on the recommendation of the Director of Enforcement and Investigations/Director of Registration and Inspections/the Board's own initiative.</p>	<p>CPAB may issue an order for an Investigation if the Board considers that a Violation Event may have occurred.</p>	<p>ASIC is responsible for administering the Corporations Act in connection with auditor independence and audit quality. ASIC regulates both the audit and securities markets, like its Singapore equivalent.</p> <p>ASIC commences an investigation if it has reason to suspect one of the relevant provisions it administers has been contravened.</p> <p>It has broad powers, including the ability to examine people under oath or affirmation and to issue auditors with a notice to produce information which must be complied with, even if to do so would breach confidentiality.</p>	<p>Both the Complaints and Disciplinary Panel established under the PAOC, and the Institute of Certified Public Accountants of Singapore (ICPAS) Investigation Committee may initiate an investigation.</p> <p>PAOC can institute disciplinary proceedings in accordance with the Accountants Act.</p> <p>Note the oversight system is unusual as the same body oversees both companies and accountants (also the case in Australia); and can pursue both company directors and accountants in cases of fraud or a qualified audit report for example.</p>

## 5.4 Enforcement

	EU (requirement)	UK	US	Canada	Australia	Singapore
Range of penalties and sanctions available	<p><i>Member States shall provide for effective, proportionate and dissuasive penalties in respect of statutory auditors and audit firms. Penalties shall include the possibility of the withdrawal of approval.</i></p>	<p>Fines; censure; exclusion for a recommended period of time; practising certificate or registration or authorisation or licence can be withdrawn (or not reinstated for a certain amount of time).</p> <p>The firm may also be required to waive/repay client fees.</p>	<p>Fines; censure; directions on remedial actions to improve audit quality e.g., a provision to undertake training; suspension and/or cancellation / withdrawal of registration / membership.</p> <p>May also require the firm to: obtain an independent review and report on one or more engagements; engage an independent monitor to observe and report on the firm's compliance with the rules and provisions; engage someone to design policies to effectuate compliance.</p>	<p>Fines, censure, deregistration, sanctions and/or restrictions are possible investigation outcomes.</p> <p>The firm may ultimately lose the right to audit public companies.</p>	<p>Disciplinary proceedings; enforceable undertakings to, for example, undertake training or to engage an independent third party to assess compliance; have compliance reviews; censure; suspension and/or cancellation / withdrawal of registration.</p>	<p>PAOC can revoke the approval granted; suspend the body from providing public accountancy services; impose a penalty; censure; require the accounting firm to give certain undertakings.</p> <p>There is a stipulation of two years maximum for suspension / restriction of services.</p>
Disciplinary body		<p>Disciplinary Tribunal is appointed by a convenor, comprising either:</p> <ul style="list-style-type: none"> <li>• A lawyer, an accountant and a lay person; or</li> <li>• One or two lawyers, two accountants and one or two lay persons.</li> </ul> <p>Tribunal members are independent of the FRC. In all cases the chair is legally qualified.</p>	<p>PCAOB – i.e. the regulator.</p>	<p>CPAB – i.e. the regulator.</p>	<p>CALDB – the board is independent of ASIC. This is a civil, rather than criminal process, but the principle is the same as the criminal courts being independent of prosecuting authorities.</p>	<p>ACRA – i.e. the regulator.</p>

## 5.4 Enforcement (cont'd)

	EU (requirement)	UK	US	Canada	Australia	Singapore
Disclosure	<i>Member States shall provide that measures taken and penalties imposed on statutory auditors and audit firms are appropriately disclosed to the public.</i>	The Disciplinary Body publicises decisions around the commencement of investigations and tribunal and appeal tribunal reports, unless - in its opinion - publication would not be in the public interest (e.g. if publication could prejudice regulatory or criminal investigations).	In practice all aspects of the investigation are treated as confidential. Under SOX, if the PCAOB imposes a disciplinary sanction, it shall report this to the SEC; the appropriate State regulatory authority / foreign accountancy licensing board; then the public, once any stay on the imposition of such sanction has been lifted.	Upon inquiry to CPAB and on CPAB website. If CPAB were to impose sanctions upon an audit firm, there is a requirement to notify Canadian securities regulators and Audit Committees of the relevant clients.	The CALDB panel can publicise its decision and disclose sanctions and directions; in addition ASIC maintains a register of all its enforceable undertakings which are publicly available and free. Some investigation reports have been made available. Depending on the outcome and circumstances of the investigation, ASIC may make a media release.	Public Accountants removed from the Register due to disciplinary actions or failure of practice review under the Accountants Act would be gazetted; including individuals whose licences are suspended, cancelled or not renewed. No information is publicly available on the report, however PAOC will notify the firm concerned - and the person who made the complaint – of its decision.
Appeal process for enforcement action		Appeal against a Disciplinary Tribunal to an Appeal Tribunal on grounds of error in law, procedural irregularity, new evidence that could not reasonably have been available at the time of the original case or sanction manifestly unreasonable. Further appeal only possible by Judicial Review.	A party may file a motion for reconsideration of a final order issued by the Board. In terms of further recourse, appeal of the Board's decision can be made to the SEC. An additional appeal to the US Court of Appeals for the District of Columbia Circuit is also available following a decision by the SEC.	An appeal committee is appointed that includes licencees and public representatives to conduct hearings on appeals of decisions. The decision of the appeal committee, including the reasons for the decision, are provided in writing to each party together with a notice of each party's right to appeal the decision further.	Either party may seek a review of the merits (facts) of the decision in the Administrative Appeals Tribunal. Applications for review can also be made to the Federal Court under the Administrative Decisions (Judicial Review) Act 1977 on questions of law.	Any public accountant who is aggrieved by a decision of the Oversight Committee (whether on grounds of law or fact) may appeal to the High Court within a period of 30 days after the service of PAOC's decision on the public accountant.



## 5.5 Standard setting

	EU (requirement)	UK	US	Canada	Australia	Singapore
<p><b>Operation of the standard-setting process</b></p> <p><i>Member States are required to put in place ethical standards for public interest functions, integrity, objectivity, professional competence and due care; and independence rules on a threats and safeguards basis.</i></p> <p><i>EC has the option to adopt international auditing standards (in practice ISAs) but has not done so; until then, member states must set auditing standards.</i></p> <p><b>Stakeholders are consulted, albeit through different mechanisms, in all jurisdictions</b></p>		<p>The UK's FRC is the standard setter (prior to July 2012 this was done by subsidiary boards), inspection, monitoring, enforcement and oversight body.</p>	<p>The PCAOB operates its own standards setting function.</p> <p>Similarly to the UK, the PCAOB's functions also include registration, inspection and investigations / enforcement.</p>	<p>The Canadian Institute of Chartered Accountants (CICA) operates the standard setting body.</p> <p>For ethical, financial reporting and auditing and assurance standards different regulatory bodies have different functions and powers (see 8.4.5).</p> <p>To note: in Canada the discussions and voting in AcSB are held in private.</p>	<p>The Australian Professional and Ethical Standards Board (APESB) was established as an initiative of CPA Australia and the ICAA. The third professional body in Australia, the Institute of Public Accountants is also a member of the APESB.</p> <p>The AASB and the Australian Auditing and Assurance Standard Board (AUASB) are operated by the Australian Government. The Financial Reporting Council (FRC), whilst not a standard setting body, has oversight for them.</p>	<p>The PAOC assists ACRA in determining, prescribing and reviewing the codes of professional conduct and ethics for public accountants.</p> <p>The Accounting Standards Council (ASC) is responsible only for the formulation and promulgation of accounting standards.</p> <p>ICPAS's Auditing and Assurance Standards Committee (AASC), under the direct oversight of PAOC, develops Singapore's auditing and assurance standards.</p>
<p><b>Standard-setter(s) independent of the profession?</b></p>	N/A.	Yes.	Yes.	No (but subject to oversight as part of CPAB's strategic plan).	No - ethics (but with independent oversight). Yes - auditing and accounting.	Yes – ethics and accounting. No – auditing, but with independent oversight.

## 5.5 Standard setting (cont'd)

	EU (requirement)	UK	US	Canada	Australia	Singapore
<b>Convergence</b>	<p><i>Member states shall require the auditor to comply with international auditing standards adopted by the Commission.</i></p>	<p>Ethical standards are at least equivalent to IESBA's standards.</p> <p>Auditing Practices Board (APB) Ethical Standards impose some additional restrictions, but use the IESBA Code as their starting point.</p> <p>Accounting standards are either IFRS as adopted by the EU (converged with the standards of the IASB) or based on the EC accounting directives.</p> <p>Auditing standards are converged with IAASB standards but contain additional requirements ("pluses") where necessary to respond to local laws and regulations. There are no "minuses".</p> <p>All of these standards are developed by the FRC after consulting on the adoption of international standards.</p>	<p>PCAOB standards are not converged with the International Standards on Auditing (ISAs); however, the PCAOB does read and consider the ISAs. In addition, the PCAOB typically attends the International Auditing and Assurance Standards Board (IAASB) Consulting Advisory Group (CAG) meetings.</p> <p>Currently professional standards applicable to auditing public companies are being developed by staff at the PCAOB.</p> <p>The auditing standards of the AICPA are converged with the ISAs.</p> <p>US Generally accepted accounting principles (GAAP) remains not fully converged to IFRS.</p>	<p>IAASB - Canadian auditing standards were replaced with international auditing standards that were adopted as new Canadian Auditing Standards (CASs).</p> <p>International Accounting Standards Board (IASB) - Canadian reporting issuers are generally required to follow IFRS as issued by the IASB.</p> <p>Alignment with the IESBA: the PTC of the CICA monitors international developments with respect to the International Federation of Accountants (IFAC) Code of Ethics and developing responses to changes, on behalf of the Canadian CA profession, regarding any future changes to the Code of Ethics. While the principles of harmonised Rule 204 have generally been adopted, there may be some specific differences in some jurisdictions. N.B. Canada has some rules/standards for Independence that are more stringent than the IESBA code.</p>	<p>FRC issued strategic directive that AUASB should use, as appropriate, ISAs of the IAASB as a base from which to develop Australian Auditing Standards.</p> <p>There are Australian accounting standard equivalents to IFRS.</p> <p>The ethical professional standard issued by the APESB (APES 110) is essentially the same as the IESBA Code of Ethics.</p>	<p>Professional Standards converged with the standards issued by IESBA, IASB and IAASB, with such amendments as are necessary to serve the public interest in Singapore and to conform with Singapore's regulatory environment and statutory requirements.</p>

## 5.6 Funding models

	EU (requirement)	UK	US	Canada	Australia	Singapore
<b>Registration</b>		Statutory auditors performing a statutory audit must be registered with an RSB. These bodies operate as professional bodies and receive fees from their members. In addition to membership / subscription fees, they receive income from students, fines, etc.	The PCAOB is funded primarily through annual fees assessed in proportion to public companies' market capitalisation and on brokers and dealers based on their net capital located in and outside of the US. SOX also directs the Board to assess and collect registration and annual fees from each registered public accounting firm (sufficient to recover the costs of processing and reviewing applications and annual reports).	CPAB derives its revenue from Canadian reporting issuers. Each year, CPAB invoices the firms registered with it a fee, which they may, in turn, bill to their reporting issuer clients. The fee is designed to cover CPAB's annual operating costs and to provide a reasonable reserve for contingencies.	ASIC receives funding from the Australian Government.  The amount which ASIC receives in funding from the federal Government is not static and changes according to Government policy priorities and budgetary constraints.	ACRA is a statutory board under the Ministry of Finance (MOF).  Also, each accountant pays an annual membership; the amount is based on the size of the firm and its number of listed company audits.
<b>Inspection</b>	<i>Funding for the quality assurance and public oversight systems shall be secure and free from any possible undue influence by statutory auditors or audit firms.</i>  <i>The system of public oversight shall be adequately funded.</i>	The AQRT's costs are met by the individual RSBs with which the audit firms that are subject to inspection are registered. Its fixed costs are included in the FRC's core operating costs.	The PCAOB - see above	CPAB - see above	ASIC - see above	ACRA – as above

## 5.6 Funding models (cont'd)

	EU (requirement)	UK	US	Canada	Australia	Singapore
Investigation and enforcement		The FRC's Conduct Committee is responsible for both investigation and enforcement activities. The FRC is funded primarily via levies it charges the professional bodies - of which the audit and accounting firms are members, and preparers (i.e. companies themselves). Very little funding is provided by government.	The PCAOB - see 'registration'.	CPAB does not have a separate investigation body; funding is therefore ultimately from the revenue CPAB derives from Canadian reporting issuers (see previous page).	ASIC receives funding from the Australian Government. The amount varies according to policy priorities and budgetary constraints. The Government can also provide additional funding to ASIC for it to undertake specific projects.  The CALDB is an independent tribunal responsible for the discipline of auditors that is allocated funding by the Federal Government through ASIC's budget. There is no specific allocation to the CALDB from the Government - what CALDB receives out of ASIC's budget is dependent on its workload.	ACRA – see registration.
Standard setting	<i>No prescription as to funding of standard-setting.</i>	Funding is in line with a government scheme with contributions borne by those who use the standards by both public and private companies, public sector bodies, insurance companies and pension funds, the accountancy and actuarial professional bodies and the government (in the capacity as a preparer and auditor, not a subsidy).	The PCAOB - see 'registration'.	The Canadian Institute of Chartered Accountants (CICA) operates and funds the standard setting body.	The APESB is funded by the CPA Australia, the ICAA and the National Institute of Accountants.  The AASB and the Australian AUASB are primarily funded by the Australian Government.  The FRC is funded by the Australian Government.	ACRA and the ASC are under the purview of Ministry of Finance.

## 6. Hong Kong – five major jurisdictions gap analysis

# 6. Hong Kong – five major jurisdictions gap analysis

All of the jurisdictions studied meet IFIAR and EC Equivalence requirements.

Sections 1.1 and 3 of this report set out gaps between the current Hong Kong regulatory system and that required for:

- IFIAR membership; and
- recognition as EC equivalent – i.e. the standard needed such that Hong Kong auditors will not need to be separately regulated by EEA audit regulators in order to audit companies incorporated outside the EEA (e.g. in Hong Kong) with securities admitted to trading on an EEA regulated market.

We understand that these are the minimum requirements for any new system of Hong Kong regulation. This section of the report presents a summary of the additional changes (over and above those needed for IFIAR membership and EC equivalence) that would be needed to match the regulatory system in each of the jurisdictions in this study. Implementing additional changes to align with another country will not lessen the burden on a Hong Kong auditor wishing to audit a company based or listed in that jurisdiction (for example, registration with the PCAOB is required for all auditors of SEC registrants, no matter what the local regulatory regime is). Equally, EEA regulators cannot insist on implementation of additional requirements over and above the minimum for EC Equivalence before accepting an overseas auditor's report on an overseas entity.

## 6.1 Hong Kong – five major jurisdictions gap analysis - Registration

	UK	US	Canada	Australia	Singapore
<b>Summary of additional changes needed to match the registration regime in each jurisdiction</b>	Audit registration is also required for entities other than companies including charities, pension funds and limited liability partnerships.	Audit registration is also required for broker-dealers.	No substantial additional requirements.	No substantial additional requirements.	No substantial additional requirements.

## 6.2 Hong Kong – five major jurisdictions gap analysis - Inspection

	UK	US	Canada	Australia	Singapore
<b>Summary of additional changes needed to match the inspection regime in each jurisdiction</b>	Auditors of public interest entities (not just those with securities admitted to trading on an EEA regulated market) must be reviewed at least every three years.	Annual inspection for firms that audit more than 100 issuers.  For others, at least once every three years.	Inspections to be carried out: <ul style="list-style-type: none"> <li>• Every year for a firm with 100+ listed clients.</li> <li>• Every two years for firms with 50-99 listed clients.</li> <li>• Every three years for all other auditors.</li> </ul>	Inspections to be carried out: <ul style="list-style-type: none"> <li>• Every 18 months for the Big Four firms.</li> <li>• Every 30 months for non-Big Four firms which audit &gt;5% of listed companies.</li> <li>• Every three years for all other auditors.</li> </ul>	Inspections every two years for auditors of listed companies.



## 6.3 Hong Kong – five major jurisdictions gap analysis - Enforcement

	UK	US	Canada	Australia	Singapore
<b>Summary of additional changes needed to match the enforcement regime in each jurisdiction</b>	<p>Additional penalties include the possibility of fines determined by an independent tribunal which could be unlimited. The firm may also be required to waive/repay client fees.</p>	<p>Additional penalties include the possibility of fines of up to US\$15m and directions on remedial actions to improve audit quality e.g. a provision to undertake training.</p> <p>The PCAOB may also require the firm to: obtain an independent review and report on one or more engagements; engage an independent monitor to observe and report on the firm's compliance with the rules and provisions; engage someone to design policies to effectuate compliance.</p> <p>Note: the SEC may impose additional penalties.</p>	<p>Additional penalties include the possibility of unlimited fines and restrictions on registration.</p>	<p>As well as referral to the CALDB, disciplinary proceedings may result in enforceable undertakings to, for example, undertake training or engage an independent third party to assess compliance or have compliance reviews.</p>	<p>Additional penalties include fines of up to SG\$100k and the possibility of giving undertakings.</p>

## 6.4 Hong Kong – five major jurisdictions gap analysis – Standard setting

	UK	US	Canada	Australia	Singapore
<b>Summary of additional changes needed to match the standard-setting regime in each jurisdiction</b>	<p>Combined oversight of standard-setting, inspection, investigation and enforcement.</p> <p>Funding from a wide range of bodies including auditors, preparers and the wider accounting profession.</p>	<p>Combined oversight, standard-setting, inspection and enforcement.</p> <p>Funding from issuers and auditors.</p>	<p>No substantial additional requirements.</p>	<p>Auditing and accounting standards to be set by government funded bodies.</p>	<p>Independent accounting standard setter and independent oversight of audit standard setter.</p>

## 6.5 Hong Kong – five major jurisdictions gap analysis - CPE

	UK	US	Canada	Australia	Singapore
<b>Summary of additional changes needed to match the continuing professional education regime in each jurisdiction</b>	Independent oversight of the RSBs' activities in relation to CPE.	No substantial additional requirements.	Independent oversight body to operate CPE system.	No substantial additional requirements.	Independent oversight body to operate CPE system.

Typical oversight of CPE includes asking relevant professional bodies to provide copies of their curricula and checking that professional bodies have procedures to monitor compliance with CPE requirements. Neither IFIAR nor the EC equivalence requirements call for the oversight body to carry out direct monitoring of individuals' compliance or approve individual CPE suppliers or activities. For example, the UK FRC approves the CPE regulations of each of the six professional bodies, and the small (1-2 people) FRC team which inspects the professional bodies considers monitoring as part of its annual checks on each of the bodies.

## 7. Overview per jurisdiction

# 7.1 Snapshot – EU and UK

## EU

The European Union does not have a Europe-wide audit regulation system, but sets the framework which is the baseline for the audit regulation system across member states. The strengths of the EU regime are that it provides a common baseline:

- allowing audit regulators in one country to have confidence that component auditors in another country will be following a minimum set of requirements, which enhances confidence in the quality of group audits; and
- allowing securities regulators and investors in one member state to have confidence in audits carried out in another member state. This is important given that European law allows 'passporting' of prospectuses so that an entity eligible to list in one 'home' member state can list in all the other member states without a 'host' regulator being allowed to demand additional information or comfort around the issuer's prospectus and annual financial statements.

Arguably, the fact that this is a common baseline could also be a weakness of the system as there was inevitably some compromise between member states when the Statutory Audit Directive (SAD) was negotiated, which means that countries cannot impose super-equivalent requirements on issuers from other EU member states listing in their jurisdiction.

## UK

The biggest strengths of the UK system are:

- a proportionate and cost-effective system of regulation with a more sophisticated inspection, enforcement and oversight mechanism for public interest entities (listed companies and the more significant financial institutions, charities and pension funds) with a less sophisticated system for other entities;
- transparent regulation with firm-by-firm reporting and additional insights for the audit committees of individual entities whose audits have been selected for file review by the independent inspectors; and
- an increasingly joined-up form of regulation. Since 2003 the UK FRC has owned standard-setting, inspection and enforcement for issuers and auditors, with reforms in 2012 aimed to bring the various arms of the FRC closer together.

In common with other systems, the biggest potential weakness is the drawing of inappropriate conclusions from a small number of file reviews and the potential undermining of confidence where inspection reports focus only on areas where improvement is needed rather than commending areas of good practice.

## 7.2 Snapshot – US and Canada

### US

The PCAOB publishes its own assessment of its strengths and weaknesses.

The key strengths identified in its five-year strategic plan for FY 2012-2016 included:

- its independence and experience;
- its ability to analyse a large population of audit inspections of firms within the US and overseas of varying sizes; and
- close working with other regulators and standard-setters, including the SEC.

Conversely, the key weaknesses identified included:

- the non-public nature of disciplinary processes (until any adverse findings are published) and inspection reporting (unless weaknesses remain unresolved 12 months after the original inspection); and
- the timeliness of reporting.

### Canada

The strengths of the Canadian regime include:

- a strong relationship of mutual respect between the Canadian Public Accountability Board (CPAB) and the profession, resulting in firms taking CPAB's findings seriously;
- strong processes and people contributing towards audit quality; and
- a desire to be a leader internationally, with a strong commitment to IFIAR.

The one perceived significant weakness is the transparency of the inspection reporting. This is being addressed with a new protocol under development to allow audit committees some insight into the quality of their auditor if that file has been selected for inspection.

## 7.3 Snapshot – Australia and Singapore

### Australia

The key strengths of the Australian regime include:

- ASIC regulates both the market and auditors;
- proportionate regulation of firms by size and impact; and
- independence – funding by the federal government.

Areas for potential improvement include:

- formalisation of an appeal process for inspection to complement appeal process for enforcement from CALDB to AAT or federal courts.

### Singapore

The key strengths of the Singapore regime include:

- joined-up regulation of issuers and auditors, allowing the regulator to look at both the way financial statements are prepared and the way that they are audited;
- a risk-based proportionate system of inspections; and
- grading of firms which gives them an imperative to improve in areas of weakness.

Areas for potential improvement, drawing on the Accounting and Corporate Regulatory Authority (ACRA) recent consultation paper to review the Accountants Act, include:

- the key points of inspection findings are not published. However, ACRA wants the right to provide all or portions of a firm's reports to relevant local regulators such as the Monetary Authority of Singapore and the Singapore Exchange, and if an audit firm fails to make sufficient progress under a remediation plan, make non-publication of certain matters conditional on the firm making improvements within certain time periods; and
- ACRA is consulting on ways to improve ongoing monitoring, including annual information updates from audit firms and an obligation to implement remedial actions in response to identified inspection weaknesses.

## 8. Jurisdiction-specific, per function





## 8.1.1 EU - registration

- European law in respect of auditing and financial reporting applies to the EEA which comprises the member states of the European Union, (EU), plus Norway, Liechtenstein and Iceland. EU *directives* are binding upon the Member States (but not in principle directly upon entities or citizens) and require the Member States to adopt national legislation that ensures compliance with the directive; the directive is thus ‘transposed’ into national law. Whereas EU *regulations* are in principle directly applicable, creating rights and obligations for entities, citizens, the Member States and their authorities (but national secondary law is often required). Under the EEA Treaty, Norway, Liechtenstein and Iceland have agreed to apply EU legislation in certain areas which include statutory audit in their scope.
- A statutory audit is an audit of annual or consolidated accounts as required by EU law and can be carried out only by statutory auditors or audit firms which are approved by the Member State requiring the statutory audit.
- Each Member State designates competent authorities which shall be responsible for approving statutory auditors and audit firms. The competent authorities may be professional associations, provided that they are subject to a system of public oversight – a body independent of the profession (governed by non-practitioners) that will check that the competent authorities are operating in accordance with the law, have the right to carry out investigations and enforcement independently of competent authorities and be free from undue influence by the profession.
- In addition to the statutory audits of EEA incorporated entities, EU law requires that the financial statements of non-EEA incorporated (“third country”) issuers with securities admitted to trading on a regulated market in the EEA must be audited by a third-country auditor, registered in accordance with Article 45 or from a country deemed equivalent under Article 46. Registered third-country auditors must:
  - be of good repute;
  - have individuals who have educational qualifications at a level equivalent to a university degree, with both theoretical instruction and practical experience;
  - have passed exams which cover accounting, legal requirements relating to financial statements, accounting standards, financial analysis, risk management and internal control, auditing and professional skills, audit regulation and standards, ethics and independence and relevant company, insolvency, tax and commercial law, economics, mathematics and statistics and financial management;
  - have at least three years of practical experience; and
  - comply with equivalent ethical, independence and auditing standards (see section 8.1.5 of this report).
- The Commission allows auditors from seven ‘transitional’ jurisdictions to register on the basis of more limited information. These ‘transitional’ jurisdictions do not meet the requirements for ‘equivalence’ under Article 46 but are on a journey towards equivalence.
- The requirements for ‘equivalence’ are covered in section 2 (IFIAR-EC mapping) and require an inspection, oversight and enforcement regime equivalent to that required by European law (see the remainder of section 8.1). There are no standard setting requirements for equivalence, but the system of public oversight must have ultimate responsibility for standard setting.

## 8.1.2 EU - inspection

- The quality assurance system shall be organised in such a manner that it is independent of the reviewed statutory auditors and audit firms and subject to public oversight.
- The funding for the quality assurance system shall be adequate, secure and free from any possible undue influence by statutory auditors or audit firms. It should be resourced with staff with an appropriate professional education, experience in auditing and financial reporting, and specific training on quality assurance reviews.
- All statutory auditors must be subject to a quality assurance system. Inspections must be conducted at least every six years or, for auditors of public interest entities (those with securities admitted to trading, deposit takers (including banks) and insurance companies), at least every three years.
- The selection of reviewers for specific quality assurance review assignments shall be done using an objective procedure designed to ensure that there are no conflicts of interest between the reviewers and the statutory auditor or audit firm under review.
- The scope of the quality assurance review, supported by adequate testing of selected audit files, shall include an assessment of compliance with applicable auditing standards and independence requirements, of the quantity and quality of resources spent, of the audit fees charged and of the internal quality control system of the audit firm.
- The quality assurance review shall be the subject of a report which shall contain the main conclusions of the quality assurance review which must be published annually, along with an annual work programme and activity reports. These are of the system as a whole, not necessarily at an individual firm or audit level.
- Recommendations of quality reviews must be followed up by the auditor within a reasonable period. If they are not, the auditor will be subject to disciplinary actions or penalties in the same way as enforcement.

## 8.1.3/4 EU – investigation / enforcement

- Member States are required to ensure that there are effective systems of investigations and penalties to detect, correct and prevent inadequate execution of the statutory audit.
- Without prejudice to Member States' civil liability regimes, Member States have to provide for effective, proportionate and dissuasive penalties in respect of statutory auditors and audit firms, where statutory audits are not carried out in conformity with the provisions adopted in the implementation of the Statutory Audit Directive.
- Member States must provide that measures taken and penalties imposed on statutory auditors and audit firms are appropriately disclosed to the public. Penalties include the possibility of the withdrawal of approval.
- Member States must designate one or more competent authorities for the purposes of these investigation tasks.

## 8.1.5 EU – standard setting

- Ethical standards (including independence) and auditing standards:
  - If the current draft legislation goes through, new EU legislation will set principles and rules for independence. The European Commission has the power under the Statutory Audit Directive (SAD) to set standards for ethics and independence. These powers have not yet been used. Until they do so, the overarching provisions of the SAD apply which require member states to have rules on independence that are on a ‘threats and safeguards’ basis and to require those threats and safeguards to be documented in the audit working papers.
  - The SAD requires Member States to ensure that an auditor shall not carry out a statutory audit if there is any direct or indirect financial, business, employment or other relationship, including the provision of non-audit services (NAS), between the auditor or its network and the audited entity, from which an objective, reasonable and informed third party would conclude that the auditor’s independence is compromised. If the auditor’s independence is affected by threats, such as self-review, self-interest, advocacy, familiarity or trust or intimidation, the auditor must apply safeguards to mitigate those threats. If the significance of the threats compared to the safeguards is such that the auditor’s independence is compromised, the auditor shall not carry out the statutory audit.
  - The EC draft regulation proposed a near ban on the auditor providing NAS to PIEs it audits, with certain services being allowed subject to prior approval by the audit committee or the relevant national authority, depending on the services, as well as a cap, equal to 10 % of audit fees, on the related financial audit services that the auditor may provide to PIEs it audits. It currently appears that the European Parliament prefers the approach of a list of prohibited services that is consistent with global best practice. Indeed, the vote of the main European Parliament committee with regard to the audit proposals (JURI) in late April 2013 concluded on the following with regard to NAS, subject to the publication of the JURI report: a ‘black list’ of prohibited services (similar to the IESBA code) and a ‘white list’ of permitted services; no cap on financial related audit services or NAS; companies need to have a specific policy on NAS approved by shareholders and the board and communicated to the competent authority. See section 9 for more detail on the status of the audit reform proposals.
  - The European Commission has the power to adopt international auditing standards (likely to be those of the IAASB), but has not yet done so. Until that time, national standards are applicable. Under the proposed revisions to the SAD, international auditing standards will be used.
- Financial reporting standards:
  - The consolidated accounts of EEA incorporated listed companies (those with securities admitted to trading on an EEA regulated market) must be prepared on the basis of IFRS as adopted by the EU. These standards are those issued by the IASB subject to endorsement by the EC – there are occasional differences in effective dates and one minor ‘carve out’.
  - For other accounts (those of unlisted companies, and single company accounts of listed companies), accounts must be prepared using national GAAP which must, as a minimum, comply with the EU Fourth and Seventh Company Law Directives.
- In all three areas, the European Commission has the power to set, adopt or endorse standards, subject to an endorsement process involving a committee of Member State representatives and European Parliament and Council scrutiny. The costs of any activity will be borne by the Commission which is funded by taxpayers.

## 8.1.6 EU – funding model options

- Registration
  - Each Member State designates competent authorities which shall be responsible for approving statutory auditors and audit firms. The competent authorities may be professional associations, provided that they are subject to a system of public oversight.
- Inspection
  - Note SAD 29 1 b: *the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms;*
  - and SAD 32 7: *the system of public oversight shall be adequately funded. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms.*
- Standard Setting
  - Member states fund the European Commission - there is no specific funding for activities in this area.



## 8.2.1 UK - registration

- Under s475 of the UK Companies Act 2006 (CA06), a company's annual accounts for a financial year must be audited unless the company is classified as small or dormant or is exempt from the requirements because it is a non-profit-making company subject to public sector audit. There are no differences in treatment for private, publicly listed and public interest entities: they all must have an audit unless they fall into the categories described above.
- The audits of all UK incorporated entities with listed securities (both equity and debt) and other UK entities whose financial condition is considered to be of major public interest. A description of all such entities is published annually. It includes:
  - All UK incorporated companies with listed equity and/or listed debt.
  - All non-EEA incorporated companies with listed equity and/or debt audited by a UK Registered Auditor.
  - AIM or Plus-quoted companies incorporated in the UK with a market capitalisation in excess of £100m.
  - UK unquoted companies, groups of companies, limited liability partnerships or industrial and provident societies with Group turnover in excess of £500m.
  - UK incorporated banks not already included in any other category.
  - UK Building Societies.
  - Private sector pension schemes with either more than £1,000m of assets or more than 20,000 members.
  - Charities with incoming resources exceeding £100m.
  - Friendly Societies with total net assets in excess of £1,000m.
  - UK Open-Ended Investment Companies and UK Unit Trusts managed by a fund manager with more than £1,000m of UK funds under management.
  - Mutual Life Offices whose "With-Profits" fund exceeds £1,000m.



## 8.2.1 UK – registration (cont'd)

- A firm can only accept appointment as an auditor of a company incorporated in the UK if it is a registered auditor.
- The RSBs are professional bodies which can register auditors:
  - Association of Authorised Public Accountants
  - Association of Chartered Certified Accountants
  - Chartered Accountants Ireland
  - Institute of Chartered Accountants in England and Wales
  - Institute of Chartered Accountants of Scotland
- The Companies Act 2006 sets out the requirements for recognition as an RSB. RSBs must be approved by the Secretary of State (business minister) – his/her role has been legally delegated to the FRC. The RSBs must have rules which meet the requirements of the Companies Act. These include, amongst other things, the requirements for the RSB to be subject to oversight by the FRC, for the FRC to inspect major audits carried out by the RSBs members and the RSB to have regard to the findings of the FRC when approving renewal of audit registration, and for the RSB to require its members to abide by ethical and auditing standards set by the FRC. The FRC has small staff charged with this oversight role who inspect the RSB and check that it is operating within the terms of its approval. If it decides that it is not, it can request changes, fine the RSB or (in extreme cases) revoke the RSB's status – which would immediately render all auditors registered with that RSB ineligible to carry out statutory audits.
- A firm can apply for a review of a decision to reject registration. The Review Committee (of the RSB) has the same powers as the RSB's Registration Committee. An RSB's Appeal Committee can then allow the appeal; make a different decision; send the matter back to the RSB's Review Committee or dismiss the appeal.
- The effect of this is that most of the work on registration is carried out by the RSBs, but subject to ongoing oversight by the FRC.

## 8.2.1 UK – registration (cont'd)

- The FRC also supervises Recognised Qualifying Bodies (RQB) – professional bodies which can grant individuals the qualification necessary to become an audit partner:
  - Association of Chartered Certified Accountants
  - Association of International Accountants
  - Chartered Institute of Public Finance and Accountancy
  - Institute of Chartered Accountants in England and Wales
  - Chartered Accountants Ireland
  - Institute of Chartered Accountants of Scotland
- As with RSBs, The Companies Act 2006 sets out the requirements for recognition as RQB. RQBs must be approved by the Secretary of State (business minister) – his/her role has been legally delegated to the FRC. RQBs are responsible for determining the syllabus for professional education and practical experience to achieve the audit qualification, which must exceed the minimum set out in the EC Statutory Audit Directive. Again, the FRC has a small staff who inspect RQBs, review new syllabuses proposed by RQBs and consider whether examinations are carried out appropriately.

## 8.2.2 UK - inspection

- The FRC's AQRT is the UK's independent audit inspector which monitors the quality of the audits of listed and other major public interest entities and the policies and procedures supporting audit quality at the major audit firms in the UK.
- The Companies Act 2006 provides that the audits of all UK incorporated entities with listed securities (both equity and debt) and other UK entities whose financial condition is considered to be of major public interest are within the scope of AQRT's work. The FRC is required to publish each year a list of those other public interest entities, which gives it the legal right to inspect such firms. Other audits are subject to inspection by the relevant RSB; which means that firms carrying out both major and non-major audits are inspected twice.
- There are currently nine audit firms undertaking more than 10 audits within AQRT scope (major firms). These firms are subject to inspections which include a review of completed engagements and a review of their policies and procedures supporting audit quality. The largest four of these audit firms are subject to inspection on an annual basis and the other major firms on an extended cycle of up to three years. For those firms with 10 or fewer entities in AQRT scope the AQRT now delegates the inspections to the relevant RSB subject to oversight and supervision – this is a matter of contract between the FRC and the RSB and the FRC could revoke this delegation at will. In 2011-12 the AQRT conducted full scope inspections at eight audit firms and inspections at a further 11 firms which comprised a review of one listed or major public interest entity. During these inspections the AQRT reviewed approximately 100 audits.
- AQRT applies a risk-based approach in selecting individual audits for review, utilising a risk model covering listed and AIM entities. This model takes account of priority sectors which are determined annually. The majority of audits selected for review are drawn from those identified as higher risk within this risk model.
- Due to the scale of the UK audit market and the number of PIEs, the AQRT does *not* have a target of inspecting all relevant audits or audit partners over a defined period, but will have reviewed each firm (or supervised a delegated review of each firm) within three years.
- Reviews of individual audit engagements place emphasis on the appropriateness of key audit judgements made in reaching the audit opinion together with the sufficiency and appropriateness of the audit evidence obtained.
- A draft of the report is provided to the firm for comment and the AQRT will normally meet with the firm to discuss the comments.
- Individual firms are not graded by the AQRT, however individual audits are graded by the AQRT and the results are included in the public reports.
- There is no formal complaint or appeals process for a firm or individual once an inspection of an audit or a firm has concluded. Firms are requested to provide a written response to the AQRT report and this is included in the AQRT's public report on the firm.

## 8.2.2 UK – inspection (cont'd)

- The FRC has commented publicly that their inspection and reporting arrangements are among the most transparent of any audit regulator in the world, and that they contribute to achieving continuous improvement in the quality of UK auditing:
  - AQRT publishes an Annual Report (for 2011/12 this was published in June 2012) which provides an overview of its activities in the year to 31 March 2012 and the principal findings arising from its work.
  - Individual reports on the inspections of major firms are also published.
  - AQRT also issues confidential reports on individual audits reviewed to the relevant audit firms. A key element of its reporting arrangements is that firms are expected to provide copies of these reports to the directors of the audited entities concerned and confirm to AQRT that they have done so.
  - From 1 April 2013 AQRT will provide copies of these letters *directly* to the chairman of the Audit Committee of the audited entities concerned.

## 8.2.3 UK - investigation

- The FRC has investigation responsibility for public interest entities; it delegates this for non-public interest entities.
- The UK Financial Reporting Council can start a disciplinary investigation in one of two ways:
  - the professional bodies can refer cases to the FRC; and
  - the FRC may decide of its own accord to investigate a matter.
- The FRC's Conduct Committee will consider each case identified or referred to it and decide whether or not the criteria for an investigation are met. The Conduct Committee comprises a chair (drawn from the main FRC Board), an Executive Director (i.e. FRC staff), the rest of the non-executive members of the FRC Board (none of whom are auditors), the chairs of the monitoring and case management sub-committees, and other members appointed by the FRC. None of the members are practising auditors or officers of any professional body.
- A Member or Member Firm shall be liable to investigation under the Accountancy Scheme only where, in the opinion of the Conduct Committee:
  - (i) the matter raises or appears to raise important issues affecting the public interest in the UK; and
  - the matter needs to be investigated to determine whether there may have been an act of misconduct; or
  - (ii) it appears that the Member or Member Firm has failed to comply with any of his or its obligations.
- The Conduct Committee will consider whether it appears to give rise to serious public concern or to damage public confidence in the accountancy profession in the UK.
- The Conduct Committee is also entitled to consider all the circumstances of the matter including, but not limited to, its nature, extent, scale and gravity.

## 8.2.4 UK - enforcement

- The FRC deals with cases of potential misconduct which raise or appear to raise important issues affecting the public interest in the UK. All other cases of potential misconduct are dealt with by the professional bodies of which the individual or firm is a member.
- Where appropriate, the FRC can bring disciplinary proceedings against those whose conduct appears to have fallen short of the standard reasonably to be expected of members or member firms of the relevant professional body.
- The empowering legislation is the Accountancy Scheme - 18 October 2012.
- The Disciplinary Tribunal is able to impose the following sanctions on members and/or member firms:
  - Reprimand
  - Severe reprimand
  - Direction - The Tribunal may order a Member or Member Firm to comply with any direction that it considers, in its absolute discretion, appropriate. By way of example and without limitation to the Tribunal's general discretion, such direction may require a Member to undertake/implement education or training, to comply with particular requirements when practising (including restrictions on the nature of any work undertaken or clients represented)
  - Exclusion as a Member of one or more Participants and that the exclusion be for a recommended period of time
  - Fine - amount specified by the Tribunal
  - Waiver/repayment of client fees
  - Order the Member or Member Firm be ineligible for a prescribed period for a practising certificate or registration or authorisation or a licence (for the practice of an activity requiring such a certificate, registration, authorisation or licence)
  - Order that a Member's practising certificate or registration or authorisation or licence be withdrawn (for the practice of any activity requiring such a certificate, registration, authorisation or licence). The Tribunal may recommend that such a certificate, registration, authorisation or licence not be reinstated for a specific period of time.

## 8.2.4 UK – enforcement (cont'd)

- The Disciplinary Tribunal may make public announcements where it considers it is appropriate to do so in achieving its objectives and at its sole discretion.
- The Disciplinary Tribunal will publicise the following types of decision unless, in its opinion, publication would not be in the public interest:
  - decisions to commence an investigation;
  - decisions about whether to bring formal complaints or whether to close a case at the end of an investigation;
  - the reports of disciplinary tribunals; and
  - the reports of appeal tribunals.
- Accordingly, whilst each decision is taken on its own merits and on a case-by-case basis, there is a presumption that the above decisions will be published.
- The following are examples of factors that may indicate that publication would not be in the public interest:
  - publication could prejudice criminal or other regulatory investigations or proceedings;
  - publication could prejudice other investigations or any future disciplinary action it may wish to take; and
  - publication could have an impact on the national, regional or local economy disproportionate to the gravity of the issues under consideration and the overall circumstances.
- There is an Appeals Tribunal which may hear appeals from the tribunal in limited circumstances. Appeals against a Disciplinary Tribunal to an Appeal Tribunal are on grounds of error in law, procedural irregularity, new evidence that could not reasonably have been available at the time of the original case or sanction manifestly unreasonable. Further appeal is only possible by judicial review.
- Members of the Disciplinary and Appeals Tribunals are drawn from a panel maintained by a 'convener' – a senior individual independent of the investigation process. The panel includes accountants, lawyers and other suitable lay persons (who are neither accountants nor lawyers). Tribunals will always be chaired by a lawyer (for an appeals tribunal a former judge or Queen's Counsel), and either (a) two other members - a lay person and an accountant or (b) four other members – either one lay person, one lawyer and two accountants or two lay people and two accountants. Neither the convener nor tribunal members can be office holders or staff of professional bodies (nor have held such a role within the last year), individuals who have been previously subject to an adverse tribunal finding (or where there is an ongoing appeal), or members of the FRC board or other FRC committee.

## 8.2.5 UK – standard setting

- The Financial Reporting Council is, since 1 July 2012, the standard setter, inspection, monitoring, enforcement and oversight body. Prior to that date it had subsidiary boards responsible for standard setting which were separate from those responsible for conduct (inspection, oversight and enforcement).
- The FRC sets the operational standards for auditors (“International Standards on Auditing (UK and Ireland)”) and independence standards for auditors (“APB Ethical Standards”). They also set the accounting standards for all but the consolidated accounts of companies with securities admitted to trading on an EEA regulated market (who must use IFRS as adopted by the EU as a matter of EU law) and those that have chosen to voluntarily adopt IFRS as adopted by the EU.
- In addition, professional bodies set certain standards (for the ICAEW, the Audit Regulations) which implement the minimum requirements of EU law on auditing, and ethical standards in areas other than independence (for the ICAEW, the Code of Ethics). In practice:
  - the scope for variation in auditing regulations is limited as they must be approved by the FRC and the only reason they are set by the professional bodies is due to the different structures of each of those bodies – for example, the audit regulations contain quite detailed administrative instructions on registration processes.
  - the scope for variation in ethical requirements is also limited as the FRC must approve them and they would like compliance with the IESBA Code of Ethics as a minimum. The reason why professional bodies set these standards is that they are also applicable to other accountancy services not regulated by the FRC (e.g. tax advice, reviews of audit-exempt financial statements) and, in some cases, to accountants in business.
- Taken together, the ICAEW Code of Ethics and APB Ethical Standards meet or exceed the requirements of the IESBA Code of Ethics.
- International Standards on Auditing (UK and Ireland) consist of the IAASB’s standards plus additional “plus” requirements and guidance to respond to UK law and regulation plus a handful of quality points. There are no “minuses”.
- Accounting standards are either IFRS as adopted by the EU (converged with the standards of the IASB) or based on the EC accounting directives.
- UK GAAP has historically not been substantively different from IFRS but has not specifically converged in all areas. The FRC has recently released two new accounting standards which will apply by 2015:
  - FRS 101 is IFRS with reduced disclosures and may be adopted by subsidiaries; and
  - FRS 102 is a replacement for UK GAAP and is based largely on IFRS for SMEs, with amendments to align with the requirements of EU law plus some additional changes and additional requirements for specialised industries plus legacy treatments permitted by EU law.
- Standard setting is funded by a levy on preparers and professional bodies (as representatives of users).



## 8.2.6 UK – funding model options

- The FRC is funded primarily via levies which it charges the professional bodies of which the audit and accounting firms are members and preparers (i.e. companies themselves).
- AQRT's costs are met by the individual RSBs with which the audit firms that are subject to inspection are registered. Its fixed costs are included in the FRC's core operating costs.
- The FRC produces an annual budget and plan which gives an analysis of their planned activity, associated costs and hence sources of funding.
- These costs are passed on to companies and to the professional bodies; the latter then pass those costs on to their members, such that the large firms (in particular) end up paying reasonably sizeable fees to those bodies (and indirectly to the FRC).
- Very little funding is provided by government.
- The FRC's 2011/12 budget showed that the FRC had budgeted costs of £22.8m, of which £19.4m related to accounting, audit and corporate governance.
- That £19.4m broke down as £12.2 m core operating costs, £2.8m audit inspection and £4.4m disciplinary.
- The £12.2m was funded by: £0.6m from reserves, £6.4m from preparers, £4.7m from accountancy bodies (and hence, ultimately, firms) and just £0.5m from government.
- The £2.8m was met by the individual RSBs that the firms were registered with (and was passed on to the firms).
- The £4.4m was again funded by the accountancy professional bodies.
- Thus, of the relevant £19.4m, £0.5m came from government, £0.6m from FRC reserves, £6.4m from preparers.
- The remaining £11.9m came from the accountancy bodies/RSBs (and hence the audit and accounting firms).
- In addition, there were then the activities the RSBs did themselves (registration, inspection and enforcement – the latter two generally of 'non listed' entities) – which, again, the firms picked up from the levies charged by the RSBs.
- Funding for standard setting is in line with a government scheme with contributions borne by those who use the standards by both public and private companies, public sector bodies, insurance companies and pension funds, the accountancy and actuarial professional bodies and the government (in the capacity as a preparer and auditor, not a subsidy).



## 8.3.1 US - registration

- Different standards apply to publicly listed entities (set by PCAOB), to private companies and not-for-profit entities (set by AICPA) and to governmental entities (set by the Government Accountability Office).
- Public companies that meet a certain threshold are required to have an audit of internal control over financial reporting, in addition to a financial statement audit; this does not apply to private companies.
- The term 'public interest entity' is not used in PCAOB standards. However, auditor oversight legislation (Sarbanes-Oxley Act, Dodd-Frank Act) requires that the PCAOB oversee the audits of issuers and broker-dealers.
- The term 'issuer' as defined in the Securities Exchange Act of 1934 is used for 'publicly listed company' and PCAOB includes the same definition of issuer. The definition applies to a company which *'has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn...'* therefore the concept encompasses a company intending or applying to be listed.
- The Sarbanes-Oxley Act (SOX) created and empowered the PCAOB, which is overseen by the SEC, for which the empowering legislations are Securities Act of 1933 and Securities Exchange Act of 1934. SEC oversight includes appointment of PCAOB Board members, approval of the Board's rules, standards and budget, among other responsibilities.
- Registration of auditors of issuers is exercised by the PCAOB.
- SOX and PCAOB Rules provide that a firm must be registered to prepare or issue, or to play a substantial role in the preparation or furnishing of, an audit report with respect to any issuer. The definitions of 'issuer' and 'substantial role' are important for consideration.
- In respect of non-issuers:
  - Non-issuer broker-dealers' financial statements filed with the SEC must be certified by a registered firm.
- Registration with the PCAOB is on a firm basis and it does not require registration on an individual basis.
- Non U.S. firms that audit US issuers or broker-dealers are subject to PCAOB registration requirements.

## 8.3.2 US - inspection

- PCAOB is responsible for performing inspections.
- In certain jurisdictions, the PCAOB will work with local audit inspection bodies.
- The PCAOB inspects registered public accounting firms to assess compliance with the SOX, the rules of the Board, the rules of the SEC and professional standards, in connection with the firm's performance of audits, issuance of audit reports and related matters involving U.S. companies, other issuers, brokers and dealers.
- The PCAOB annually inspects PCAOB registered firms that audit more than 100 public companies. Firms that audit fewer public companies are inspected at least once every three years. The PCAOB also can inspect a registered firm that does not issue audit reports, but that plays a substantial role in public company audits by performing work used by another firm in an audit.
- The PCAOB oversees the inspection function; the staff of the Division of Registration and Inspections carries out the inspection functions. The SEC, in accordance with SOX, oversees the PCAOB.
- The Division of Registration and Inspections is led by a Director, a Senior Deputy Director and seven Deputy Directors. Per the 2011 PCAOB Annual Report, more than 60 percent of the 690 PCAOB staff work in registration and inspections.
- If the Board determines that an application is materially inaccurate or incomplete it can request additional information or provide the applicant with written notice of a hearing, which will specify the proposed grounds for disapproval. If the Board requests more information and this is received, the Board treats the supplemented application as if it were a new one.

## 8.3.2 US – inspection (cont'd)

- The PCAOB inspections are performed at the firm level (rather than the individual level) as their processes are designed to assess the compliance by each firm with applicable laws, rules and professional standards during the period covered by an inspection.
- Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Except in the case of audits of very small companies, an inspection does not cover the entire engagement.
- The PCAOB inspection process was designed and performed to provide a basis for assessing the degree of compliance by the Firm with applicable requirements related to auditing issuers. This process includes reviews of components of selected issuer audits completed by a registered public accounting firm. These reviews are intended both to identify deficiencies, if any, in those components of the audits and to determine whether the results of those reviews indicated deficiencies in the design or operation of a registered public accounting firm's system of quality control over audits. In addition, the inspection includes reviews of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.
- After the conclusion of the inspection fieldwork and after receiving 'comment form' responses, a PCAOB inspection report is prepared. The contents of this report are:
  - Part I, the public portion of an inspection report, describes audit deficiencies observed by the PCAOB.
  - If the inspection identifies quality control criticisms, the inspection report includes a Part II. Part II is not made public when the report is released. Part II contains the PCAOB's views on areas in which a firm should improve the quality controls over its audit practice. If a firm fails to address any of the quality control criticisms to the Board's satisfaction within 12 months, portions of Part II of the report discussing the particular criticism(s) are made publicly available.
- In terms of appeal process, an interim review by the SEC can be sought (and the report is not issued until that review is complete).
- The PCAOB does not publish a comprehensive annual inspection report of all its inspection observations, but under Rule 4010, Board Public Reports, "the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate."

## 8.3.3 US - investigation

- The PCAOB has investigative responsibility in connection with auditors of publicly listed companies (or “issuers”). The SEC also has investigative authority with respect to auditors of such companies. Similarly, Boards of Accountancy in each state of the United States generally have investigative authority with respect to accountants and accounting firms that are licenced in their respective jurisdictions.
- The following pertain specifically to the PCAOB, which has statutory authority to initiate informal inquiries and investigations.
- Under PCAOB Rule 5100 with respect of the commencement of an Informal Inquiry:
  - The Director of Enforcement and Investigations may undertake an informal inquiry where it appears that, or to determine whether, an act or practice, or omission to act, by a registered public accounting firm, any associated person of that firm, or both, may violate:
    - (1) any provision of the Act;
    - (2) the Rules of the Board;
    - (3) the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act; or
    - (4) professional standards.
- Under PCAOB Rule 5101 with respect of commencement of Investigations, upon the recommendation of the Director of Enforcement and Investigations or the Director of Registration and Inspections, or upon the Board's own initiative, or otherwise, the Board may issue an order of formal investigation when it appears that an act or practice, or omission to act, by a registered public accounting firm or any person associated with a registered public accounting firm may violate the rules and provisions set out in PCAOB Rule 5100 as above.

## 8.3.4 US - enforcement

- The PCAOB has responsibility for disciplining auditors of publicly listed companies pursuant to PCAOB Rule 5200(a) – Grounds for Commencement of Disciplinary Proceedings.
- Sanctions under Rule 5200(a)(1) or Rule 5200(a)(2) if the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the SEC issued under the Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to the applicable limitations under Section 105(c)(5) of the Act, including:
  - (1) temporary suspension or permanent revocation of registration;
  - (2) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;
  - (3) temporary or permanent limitation on the activities, functions or operations of such firm or person (other than in connection with required additional professional education or training);
  - (4) a civil money penalty for each such violation, in an amount equal to (i) not more than \$100,000 for a natural person or \$2,000,000 for any other person; and (ii) in any case to which Section 105(c)(5) of the Act applies, not more than \$750,000 for a natural person or \$15,000,000 for any other person;
  - (5) censure;
  - (6) requiring additional professional education or training;
  - (7) requiring a registered public accounting firm to engage an independent monitor, subject to the approval of the Board, to observe and report on the firm's compliance with the rules and provisions set out in PCAOB Rule 5100 as before;
  - (8) requiring a registered public accounting firm to engage counsel or another consultant to design policies to effectuate compliance with the rules and provisions set out in PCAOB Rule 5100 as before;
  - (9) requiring a registered public accounting firm, or a person associated with such a firm, to adopt or implement policies, or to undertake other actions, to improve audit quality or to effectuate compliance with the rules and provisions set out in PCAOB Rule 5100 as before; and
  - (10) requiring a registered public accounting firm to obtain an independent review and report on one or more engagements.

## 8.3.4 US – enforcement (cont'd)

- Sanctions under Rule 5200(a)(3) or Rule 5200(a)(2) if the Board finds, based on all of the facts and circumstances, that a registered public accounting firm, or a person associated with such a firm, has failed to comply with an accounting board demand, has given false testimony or has otherwise failed to cooperate in an investigation, the Board may impose such disciplinary or remedial sanctions as it determines appropriate:
  - the sanctions described in subparagraphs (1) - (5) of paragraph (a) of this Rule as above;
  - requiring a registered public accounting firm to engage a special master or independent monitor, appointed by the hearing officer, to monitor and report on the firms' compliance with an accounting board demand or with future accounting board demands; or
  - authorising the hearing officer to retain jurisdiction to monitor compliance with an accounting board demand or with future account board demands and to rule on future disputes, if any, related to such demands.
- Sanctions are given to registered public accounting firms and/or associated person(s).
- In general, each party pays its own legal fees and costs.
- Publicity is pursuant to Sarbanes Oxley section 105(c)(7)(d) under which, if the PCAOB imposes a disciplinary sanction, it shall report the sanction to:
  - the Commission;
  - any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licenced or certified; and
  - the public (once any stay on the imposition of such sanction has been lifted).
- The information reported as above shall include the name of the sanctioned person; a description of the sanction and the basis for its imposition; and such other information as the Board deems appropriate.
- A party may file a motion for reconsideration of a final order issued by the Board. In terms of further recourse, appeal of the Board's decision can be made to the SEC. An additional appeal to the US Court of Appeals for the District of Columbia Circuit is also available following a decision by the SEC.
- In April 2013 the PCAOB announced that benefits may be available to firms and individuals who offer 'extraordinary cooperation' in PCAOB investigations. Extraordinary cooperation is voluntary and timely action beyond compliance with legal or regulatory obligations, including self-reporting of rule violations before they come to a regulator's attention, taking remedial action and providing substantial assistance to the PCAOB's investigation. This could result in reduced charges or sanctions and in exceptional cases no sanction at all; extraordinary cooperation may also be noted in announcements of PCAOB disciplinary action.
- The SEC may also sanction auditors, in addition to PCAOB sanctions.



## 8.3.5 US – standard setting

- Responsible bodies for setting ethical standards are the PCAOB and AICPA; for financial reporting standards the FASB and SEC; for auditing and assurance standards the PCAOB for public companies and the AICPA Auditing Standards Board for non-public companies.
- The Standard setting function of the PCAOB is set up as follows:
  - The Chief Auditor is in charge of the Standard Setting function. He reports to the Board of the PCAOB.
  - The Office of the Chief Auditor also includes one Deputy Chief Auditor/Deputy Division Director, and two Deputy Chief Auditors. In addition, there are approximately 15-20 additional professionals in the Office of the Chief Auditor.
- The following steps are taken during the process for setting Professional Standards:
  1. Prior to issuing an exposure draft of a standard, the staff of the PCAOB may seek input on a particular topic through the following:
    - Standing Advisory Group meetings (consists of approximately 25-40 members from issuers, investor groups, the accounting profession, academics and others and meets typically twice a year).
    - Investor Advisory Group meetings (consists of approximately 20-30 representatives of investor groups and typically meets once a year).
    - In addition, in some cases, the PCAOB issues a concept release for public comment. Such a release seeks public input on general potential direction of a standard
    - The PCAOB may also seek input from the SEC, which is required to approve all standards of the PCAOB.
  2. PCAOB votes to approve the issuance of an exposure draft for public comment at a public Board meeting (comment periods are typically between 60-90 days).
  3. PCAOB considers the public comments received
  4. PCAOB adopts a standard, typically during an open Board meeting
  5. PCAOB submits the standard to the SEC for approval
  6. SEC issues the standard for a second public comment period (this is not required but typically takes place) (the second public comment period is typically 30 days)

## 8.3.5 US – standard setting (cont'd)

- The following steps are taken during the process for setting Professional Standards (cont'd)
  7. SEC considers public comments and decides whether to approve the final standard
  8. Final standard (if applicable) goes into effect
- The following should be noted with regards to convergence of Professional Standards with Ethics Standards Board for Accountants, the International Accounting Standards Board and the International Auditing and Assurance Standards Board:
  - PCAOB standards are not converged with the International Standards on Auditing (ISAs); however, the PCAOB does read and consider the ISAs.
  - The auditing standards of the AICPA are generally converged with the ISAs.
  - PCAOB typically attends the IAASB Consulting Advisory Group (CAG) meetings.
  - Professional standards applicable to auditing public companies are developed by staff at the PCAOB.
  - US GAAP remains not fully converged to IFRS.

## 8.3.6 US – funding model options

- The PCAOB is funded primarily through annual fees assessed on public companies in proportion to their market capitalisation and on brokers and dealers based on their net capital located in and outside of the United States (referred to as accounting support fees). In addition, SOX directs the Board to assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.
- PCAOB Rules 2103 and 2202 require the payment of those fees and provide that the Board will from time to time announce the amount of the fees.
- The PCAOB's annual report describes the accounting support fees and the fees charged to accounting firms (for 2013 the PCAOB budget suggests that it will assess \$234m in accounting support).
- The PCAOB budget details are as follows:

	PCAOB's Division of Registration and Inspections	PCAOB's Office of The Chief Auditor	PCAOB's Division of Enforcement and Investigations
2013	\$127.0m	\$9.4m	\$20.9m



## 8.4.1 Canada - registration

- 'Reporting issuer' is a term defined in the provincial securities acts, and there may be slight differences in the definition from one Act to another. However, a reporting issuer is generally an entity that has raised capital from the public and that must file annual audited financial statements with a securities commission.
- There are no audit requirements for private companies unless required by a user (e.g. banks, etc.). For public companies there is an audit requirement.
- Public Interest Entity is defined as (i) a Listed Entity; and (ii) an entity (a) defined by regulation or legislation as a public interest entity or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of Listed Entities.
- Overall registration functions are exercised by the CPAB with some functions exercised by CICA (for example, partners must be CICA members).
- A public accounting firm that prepares an auditor's report with respect to the financial statements of a reporting issuer must be, as of the date of its auditor's report, (a) a participating audit firm, and (b) in compliance with any restrictions or sanctions imposed by the CPAB.
- Registration body is operated and funded by CPAB.
- Registration is on both firm and individual basis.
- In terms of foreign firms, while they will be subject to CPAB oversight, and overseas firms and/or individuals are subject to the same requirements as local member firms / individuals, CPAB will consider entering into reciprocal arrangements with independent oversight bodies in other jurisdictions. CPAB has several of these arrangements.
- CPAB has requested some registrants who do not currently audit a Canadian reporting issuer (RI) to deregister as CPAB does not want to administer firms that are currently not performing audits of Canadian RIs.
- If the Board proposes not to invite an applicant firm to become a participating audit firm, it provides it with written notice. The applicant firm may then elect to withdraw. If it does not, it may file a petition for a review proceeding. The Board may grant the applicant firm provisional status as a participating audit firm pending the outcome of the review proceeding (and terminate that provisional status if it finds against it).

## 8.4.2 Canada - inspection

- Under Canadian Securities Administrators Rule 52-108, accounting firms that audit reporting issuers must be participants in CPAB's oversight programme.
- CPAB has entered into memoranda of understanding with provincial accounting oversight bodies (Chartered Accountants (CAs) and Certified General Accountants (CGAs)) under which those bodies will carry out inspections of smaller firms on behalf of CPAB (therefore the auditors will be subject to the reviews performed by the provincial accounting oversight bodies for not publicly listed companies).
- CPAB has entered into a protocol with the PCAOB in the U.S. whereby CPAB has agreed that it will review all firms that are registered with the PCAOB at least once every three years.
- Firms with 100 or more reporting issuer clients are inspected annually, those with between 50 and 99 reporting issuer clients are inspected at least once every two years and those with fewer than 50 reporting issuer clients are inspected at least once every three years.
- Inspection is on both firm basis and individual basis.
- During 2011, CPAB's 33-member inspection staff was supported by seven contract consultants who primarily specialise in the areas of taxation, IFRS, information technology, Generally Accepted Accounting Principles (GAAP) and valuations.
- Inspections based on CSQC 1 quality control for firms that perform audits and reviews of financial statements, and other assurance engagements.
- There is no requirement of mandatory rotation of audit firms. The auditors are allowed to provide non-audit services unless those services are prohibited under the independence rules.
- Whilst the guidelines for the inspection team to follow are not public, in our experience they would cover a risk model, methodology, reporting, quality assurance.
- The inspection covers both the system of quality control and specific engagements of reporting issuers, and CPAB gives each firm a report on each file inspected, as well as an overall report on the firm as a whole. Audit firms are not graded – all findings are confidential and cannot be shared outside of the firm, however CPAB will raise comments on (a) particular file(s). Comments are grouped into two categories, with responses required for one category of comments.
- The overall report will, in most cases: (i) include a number of recommendations arising from deficiencies related to engagement performance and other elements of quality control; (ii) these recommendations are applicable to either systemic/firm-wide processes or specific engagement files that were inspected; and (iii) include separately CPAB's top three to five recommendations that, when implemented, would improve audit quality.
- The individual inspection report on the firm is not published and is not accessible by the public. However an audit firm may inform the audit committee of an audit client whether it has implemented/intends to implement all of the Board's recommendations, if any, included in the Board's final inspection report; and may provide a copy of any recommendations that it does not intend to implement and its reasons for non-implementation.

## 8.4.2 Canada – inspection (cont'd)

- Within 30 days after receipt of the draft Inspection report, the firm must submit a response to each recommendation in the draft report, indicating whether it accepts the recommendation, or if not, why not. The Board may then take such action with respect to the draft Inspection report as it considers appropriate, including adopting the draft report as the final report, preparing a revised draft report, or continuing or supplementing the Inspection before issuing a final report.
- CPAB's Inspection Body publishes an annual inspection report.
- CPAB's recommendations must be implemented by the audit firm within 180 days of the date of the inspection report.
- If the weaknesses, deficiencies or recommendations are not satisfactorily addressed, the Board can make the relevant portions of the final Inspection report (and the fact that they have not been addressed to the Board's satisfaction) public on its website.
- Failure to implement the recommendations to CPAB's satisfaction would give rise to disciplinary action being placed on the audit firm in the form of a Requirement, Restriction or Sanction.
  - Disciplinary action starts with a Requirement, which limits the scope of the audit work the firm can undertake until the identified deficiencies have been corrected, within a specified timeframe.
  - In more serious cases, or should the Requirement not be sufficient, then CPAB would place a Restriction on the firm. This elevates the disciplinary measure that requires action by the firm and includes notifying the relevant provincial securities regulators that CPAB has placed a Restriction on the firm.
  - The third level of discipline, for more serious situations, is a Sanction, which, in addition to the securities regulators, requires the Audit Committees of reporting issuer clients of the firm to be notified.
  - Requirements, Restrictions or Sanctions take effect immediately unless the firm requests a review proceeding.
- Depending on the severity of the finding, the deadline for implementing CPAB's recommendations may be less than 180 days. This is particularly true where there may be a potential restatement of financial statements as a result of CPAB findings.
- In all cases, before disciplinary measures are lifted, CPAB follows up to ensure that the recommendations have been implemented satisfactorily.
- The firm may, within 15 days of receiving notification of the Board's intention, file with the Secretary of the Board a petition for a review. In the event of a dispute, the Board or the relevant participating audit firm may, by written notice to the other, require the dispute to be settled by arbitration. An arbitration award made in accordance with the dispute resolution procedure is final and binding on the parties and there is no subsequent appeal or judicial review.

## 8.4.3 Canada - investigation

- The Board may issue an order for an Investigation if the Board considers that a Violation Event\* may have occurred. In an Investigation order, members of the Board's staff may be designated to issue Board demands and Board requests to, and otherwise request the cooperation of, any person to the extent that the information sought is relevant to the matters described in the Investigation order. The Board shall provide to the participating audit firm a copy of the Board's Investigation order, subject to receiving from the firm signed consent to such limits on dissemination as the Board may require.
- In Canada, there is only one audit regulator (CPAB). There are not separate bodies for Registration, Investigations, Enforcement, etc.
- Investigations, and any documents, testimony or other information prepared or received by or specifically for the Board in connection with such Investigations, shall be confidential in the hands of the Board, provided however that the Board shall, if it considers it appropriate, disclose such information: (i) to professional regulatory authorities having jurisdiction over the participating audit firm or its designated professionals; and (ii) to securities regulators and the Superintendent of Financial Institutions Canada, provided only that disclosure shall not be made of any specific information relating to the business, affairs or financial condition of any client of the participating audit firm except to the extent such disclosure may be authorised by applicable law; and when making such disclosure the Board shall inform the recipient that the information is confidential.
- Deregistration, sanctions and/or restrictions are possible investigation outcomes (see 8.4.2 and 8.4.4)

*\* Defined as (i) an act or practice, or omission to act, in violation of the Rules or Professional Standards that may have an effect on the provision of audit services to reporting issuers, (ii) a failure to supervise appropriately a person with a view to preventing violations of the Rules or Professional Standards, and such person has committed an act or omitted to act in violation of the Rules or Professional Standards that may have an effect on the provision of audit services to reporting issuers, (iii) a failure to cooperate with the terms of an Inspection or Investigation; or (iv) a failure to comply with the terms of any requirement, restriction or sanction imposed by the Board.*



## 8.4.4 Canada - enforcement

- Empowering legislation for enforcement is Canadian Securities Administrators Rule 52-108.
- Sanctions include fines, public censures, suspension and/or cancellation of registration, directions on remedial actions.
- If CPAB were to impose sanctions upon an audit firm, the firm would be required to notify the Canadian securities regulators and the Audit Committees of its reporting issuer audit clients. In the most extreme case, CPAB could declare that an audit firm is not a participant in good standing, meaning that firm could no longer audit public companies in Canada.
- The Board shall disclose publicly to anyone who inquires and on its website the name of a participating audit firm that is subject to any continuing restriction or sanction with respect to which the firm is required, pursuant to Canadian Securities Administrators Rule 52-108, to notify both securities regulators and the audit committees of its reporting issuer audit clients of the restriction or sanction. Disclosure by the Board shall not precede the date by which the firm shall have been required to make such notifications. In making disclosure under this Rule, the Board shall not disclose the identity of any individual specifically identified in a continuing restriction or sanction, provided that the foregoing shall not preclude the naming of a participating audit firm even if the names of one or more individuals are included in the firm's name.
- There is no concept of a disciplinary tribunal. Requirements, restrictions and sanctions are proposed by the management of CPAB.
- To the extent that individuals are found to have engaged in professional misconduct, those individuals would be subject to the disciplinary actions of the respective Professional Conduct Committee of the provincial licensing bodies.
- Hearings are conducted in public.
- An appeal committee is appointed that includes licencees and public representatives to conduct hearings on appeals of decisions.
- The party's right to appeal is explicitly addressed in a written response along with the decision of the adjudicative decision, including the reasons for the decision. The decision of the appeal committee, including the reasons for the decision, are provided in writing along with a notice of each party's right to appeal the decision further.

## 8.4.5 Canada – standard setting

CICA operates and funds the standard setting, subject to CPAB oversight (see sections 1 and 5 of CPAB’s Strategic Plan 2013-15 and CPAB rules 301 and 303). For ethical, financial reporting and auditing and assurance standards different regulatory bodies have different functions and powers as set out below:

	Ethical standards	Auditing and Assurance Standards	Accounting Standards
Responsible body and comment on convergence	<p>The Public Trust Committee (PTC) of the CICA monitors international developments with respect to the IFAC Code of Ethics and developing responses to changes, on behalf of the Canadian CA profession, regarding any future changes to the Code of Ethics.</p> <p>Note: Canada has some rules/standards for independence that are more stringent than the IESBA code.</p>	<p>The AASB, overseen by the Auditing and Assurance Standards Oversight Council (AASOC).</p> <p>Note: Canadian auditing standards were replaced with international auditing standards that were adopted as new Canadian Auditing Standards (CASs).</p>	<p>The AcSB for Canadian companies and not-for-profit organisations. Also has responsibility for an Emerging Issues Committee (EIC).</p> <p>The Public Sector Accounting Board (PSAB) for the public sector.</p> <p>The Accounting Standards Oversight Council (AcSOC) oversees and provides input to both AcSB and PSAB.</p> <p>Note: Canadian reporting issuers are generally required to follow IFRS as issued by the IASB.</p>
Structure and staffing	<p>PTC reports to the CICA Board through the profession’s Council of Senior Executives (CSE).</p> <p>The PTC comprises eight members, consisting of a Chair appointed by the CSE, who is normally a member of the CSE, two additional members of the CSE, and five members at large including at least two public representatives. There must be at least one member from each of the four regions. The PTC is empowered to:</p> <ul style="list-style-type: none"> <li>- initiate, review and commission research, and consult with appropriate parties within and outside the profession;</li> <li>- authorise committees, task forces, etc. that it establishes to do the same; and</li> <li>- adopt harmonised independence standards for Chartered Accountants and ensure they are kept up to date.</li> </ul>	<p>AASOC comprises not fewer than nine and not more than 12 volunteer voting members, a majority of whom are not Chartered Accountants. AASOC membership consists of senior members from business, finance, government, the accounting and legal professions and regulators, amongst others. The members have a broad perspective of the complex issues facing auditors. There are currently 11 voting members. Non-voting members are the members from Canada (currently two) on the International Auditing and Assurance Standards Board (IAASB); the Chair of the AASB; the Vice-President, Standards; and the Director, Auditing and Assurance Standards of the CICA.</p> <p>Members of the AASB are volunteers appointed by AASOC. The AASB is supported by a staff consisting of a Director, six principals and one administrative assistant. Consultants are also engaged on an as-needed basis.</p>	<p>AcSOC normally comprises not fewer than 20 and not more than 25 volunteer voting members.</p> <p>The AcSOC membership consists of senior members from business, finance, government, academia, the accounting and legal professions, regulators, the financial analyst communities, amongst others.</p> <p>The AcSB consists of nine voting members from a variety of backgrounds. The Chair is a full-time position; the remaining members are part-time volunteers. Members are appointed by the Accounting Standards Oversight Council, which ensures that the AcSB has an appropriate balance of competencies and experience to meet its objectives.</p> <p>PSAB consists of a maximum of 12 members and a Chair. The Vice-President, Standards, and the Director, Public Sector Accounting are non-voting members of the Board. PSAB’s standards are developed by the people who prepare, audit and use government financial statements and reports — i.e., those who will be governed by the standards.</p>

## 8.4.5 Canada – standard setting (cont'd)

	Ethical standards	Auditing and Assurance Standards	Accounting Standards
Overview of standard setting process	<p>The purpose of the PTC is to improve protection of the public through the promotion of further national harmonisation of the profession's policies and practices in the area of self-regulation. It aims to achieve this purpose by:</p> <ul style="list-style-type: none"> <li>- recommending policies and strategies to uphold the public's confidence and trust in the profession;</li> <li>- monitoring international developments in the area of ethics;</li> <li>- reviewing, on behalf of the profession, and responding to any proposed changes to independence standards;</li> <li>- monitoring the development and renewal of the profession's harmonised rules of professional conduct;</li> <li>- monitoring the development and renewal of the profession's disciplinary and practice inspection processes;</li> <li>- identifying matters which have or may have impact on the public's trust and confidence in the profession in order to research and address them;</li> <li>- communicating and promoting any recommendations relating to improving the public's confidence in the profession to the CSE, and ultimately to those charged with governance of the profession; and</li> <li>- approving the terms of reference of committees or task forces created under its auspices.</li> </ul> <p>The structure of the PTC is intended to assist the profession in identifying and addressing issues through a consultative and timely process.</p>	<p>Much of the AASB's efforts, and related processes, are focused on providing input to the IAASB and deciding, with stakeholder input, whether there should be a modification of an ISA when it is adopted as a Canadian Auditing Standard (CAS) and, if so, what the modification should be. Accordingly, the due process followed in developing a CAS to adopt an ISA differs, in some respects from that used for domestic AASB projects.</p> <p>With regard to adopting these standards, the AASB applies the following process:</p> <ol style="list-style-type: none"> <li>1. Develop a project strategy</li> <li>2. Review material presented at the IAASB meetings and consider possible Canadian modifications to draft ISAs for adoption as CASs</li> <li>3. Approve an exposure draft</li> <li>4. Re-exposure considerations</li> <li>5. Approve a standard</li> <li>6. Basis for conclusions</li> </ol>	<p>The AcSB follows a rigorous set of procedures, known as due process, based on research, discussion and consultation, in developing and adopting standards.</p> <p>The AcSB discussions and voting are held in private. The AcSB's longstanding practice in this regard is associated with its volunteer membership. Confidentiality is intended to protect members from undue outside influence by allowing them to debate freely as individuals and vote without concern for the personal consequences in their relationships with clients, employers or business associates.</p> <p>Decisions to commence a new project, issue proposals for comment or issue a final standard require the affirmative vote of six of the nine AcSB members. Members are required to vote according to their own beliefs rather than the views of their firms or organisations.</p> <p>PSAB also follows a rigorous consultative procedure in the development and issuance of accounting standards and Statements of Recommended Practices.</p>

## 8.4.6 Canada – funding model options

- CPAB derives its revenue from Canadian reporting issuers. Each year, CPAB invoices the firms registered with it a fee, which they may, in turn, bill to their reporting issuer clients. The fee is designed to cover CPAB's annual operating costs and to provide a reasonable reserve for contingencies.
- In 2011 CPAB's base fee rate was 2.0 per cent of the audit fees both Canadian and foreign participating firms charged their reporting issuer clients, with a minimum fee of \$1,000. In 2011, 90 firms paid the minimum fee. The only exception to this rule is for firms in certain foreign jurisdictions that have audit regulatory oversight bodies in place. These reporting issuers are charged only 0.2 per cent of the firm's audit fees.
- CPAB had revenues of \$15.9 million in 2011 compared to revenues of \$16.4 million in 2010.
- CICA operates and funds the Standard Setting Body. Approximately \$136 per member is allocated to support for standard setting activities. The CICA has approximately 82,000 members.



## 8.5.1 Australia - registration

- Once an entity is required to prepare an annual financial report under the Corporations Act 2001 then the audit must be conducted by either a registered company auditor or an authorised audit company. Under Australian law a financial report and a directors' report must be prepared for each financial year by: (a) all disclosing entities; (b) all public companies; (c) all large proprietary companies; and (d) all registered schemes. Small companies only need to prepare these documents under shareholder direction or ASIC direction.
- The equivalent definition of a 'public listed company' in Australia is as follows: a company, managed investment scheme or other body is listed if it is included in the official list of a prescribed financial market operated in this jurisdiction. In February 2013 there were 2,181 listed entities on the Australian Securities Exchange.
- A 'public interest entity' is defined as a listed entity (see above) or any entity (a) defined by regulation or legislation as a public interest entity; or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator. The following will generally satisfy the conditions as having a large number and wide range of stakeholders and thus are likely to be classified as PIEs. In each instance, firms shall consider the nature of the business, its size and the number of its employees:
  - Authorised deposit-taking institutions (ADIs) and authorised non-operating holding companies (NOHCs) regulated by the Australian Prudential Regulatory Authority (APRA) under the Banking Act 1959;
  - Authorised insurers and authorised NOHCs regulated by APRA under Section 122 of the Insurance Act 1973;
  - Life insurance companies and registered NOHCs regulated by APRA under the Life Insurance Act 1995;
  - Disclosing entities as defined in Section 111AC of the Corporations Act 2001;
  - Registrable superannuation entity (RSE) licencees, and RSEs under their trusteeship that have five or more members, regulated by APRA under the Superannuation Industry (Supervision) Act 1993; and
  - Other issuers of debt and equity instruments to the public.
- The registration of Registered Company Auditors (RCA) and Authorised Audit Companies (AAC) is the responsibility of the ASIC. An audit of a listed company, disclosing entity, registered scheme or Australian Financial Services licencee may only be done by an RCA or AAC.
  - *In practice all of the large firms in Australia are still in the partnership model and therefore, partners register as RCAs. If a person is going to be a director of an AAC, their competency requirements are substantially the same.*
- Note: under the mutual recognition agreement with New Zealand, New Zealand-registered auditors can conduct registered company audits in Australia without registering with ASIC.

## 8.5.1 Australia – registration (cont'd)

- As the Registration Body, ASIC receives funding from the Australian Government. The amount of funding is not static and changes according to Government policy priorities and budgetary constraints. The Government most recently announced that ASIC would receive \$101.9 million over four years for its operational funding including registration activity.
- Per the most recent annual report, ASIC had 271 FTE staff in its registry and licensing services team – there is no information on how many of them are dedicated to auditor registrations.
- Any individual conducting an audit required by the Corporations Act 2001 must be registered with ASIC. The ASIC register of auditors records the name of the individual, and the firm that the partner practises with. The registration generally occurs at the time of promotion to partner.
- Appeal from decisions of the CALDB can be made to the Administrative Appeals Tribunal or the Federal (Magistrates) Court on questions of law. Note that these bodies were not specifically set up to hear appeals about decisions impacting auditors – their remits are broad.

## 8.5.2 Australia - inspection

- The Corporations Act 2001 mandates that all audits or reviews of financial reports (whether at full year or half year) must be conducted in accordance with auditing standards. The Australian Securities and Investments Commission (ASIC) is responsible for monitoring compliance with the Corporations Act 2001, and accordingly conducts inspections of audits of Public Interest Entities in Australia. ASIC does not delegate the performance of its inspection activity to others although it can conduct joint inspections with the Public Company Accounting Oversight Board (PCAOB) and Canadian Public Accountability Board (CPAB).
- The ASIC inspection activity runs on an 18 month cycle. The most recent one covered 20 firms, being the four large national firms (which are inspected every 18 months), six other national and network firms and 10 smaller firms. The inspection activity is directed at firms rather than individuals.
- The professional bodies, under the IFAC membership obligations, also have requirements to conduct quality reviews of their members. In that respect, they rely on the work of ASIC for the large accounting firms. In addition to this, the ICAA issues a report of the results of its quality reviews in some 400 practices; it did a survey of the larger firms in November 2011 and recently published the results.
- The ASIC inspection activity is funded by the Federal Government. They most recently announced that ASIC would receive \$101.9 million over four years for its operational funding. However, no allocation of this overall funding is given to inspection activity. ASIC has 15 FTEs dedicated to its audit inspection activity.
- Inspections cover both the review of an auditor's system of quality control and working papers of Corporations Act audit engagements. ASIC reviews the systems and process in place at each firm to comply with the Australian equivalent to ISQC1 which contains some additional requirements to ISQC1. There are no published guidelines on the inspection approach.
- Each inspection team is structured in a similar way to an audit team.
- Inspections typically take six weeks for a site visit. The issuance and finalisation of comment letters and the inspection report can take a much longer period. Reports include overall observations; changes since the last inspection; thematic and specific file findings; ASIC suggested remedial action; the firm's response to those actions.
- ASIC issues a consolidated public report every 18 months.



## 8.5.2 Australia – inspection (cont'd)

- No individual inspection reports are published, however a recent change in law will allow ASIC to issue deficiency reports if auditors are not deemed to have taken appropriate action to remedy previous inspection findings (in respect of deficiencies noted after 27 June 2012). As the ability to do so is new, there has not been any experience of ASIC exercising this power to date.
- To publish such a report, the specified failures must have been identified during the exercise of ASIC's statutory audit functions and ASIC must reasonably believe that they indicate a significant weakness in either the auditor's quality control system or the conduct of the audit, and could be detrimental to the overall quality of the audit.
- A specified failure is a failure by the auditor to comply with:
  - the auditing standards
  - the auditor independence requirements in the Corporations Act 2001
  - any applicable code of professional conduct, or
  - the provisions of the Corporations Act 2001 dealing with the conduct of audits.
- In relation to an identified failure and its deficiency report, ASIC:
  - must notify the auditor of the deficiency and set out any remedial action that it thinks necessary
  - must invite the auditor to make written submissions on the deficiency within six months about any remedial action that the auditor proposes to undertake
  - must take into account any submissions received from the auditor and whether or not the auditor has taken any remedial action to remedy the deficiency
  - may, if it considers it appropriate to do so, publish the report on the ASIC website
  - must give a copy of the audit deficiency report to the auditor before publishing the report on its website and invite the auditor to give ASIC comments on the report within 21 days
  - must publish any comments received from the auditor in its report
  - must not identify the audit client in the report
- A decision by ASIC to publish an audit deficiency report on its website is not reviewable by the Administrative Appeals Tribunal (AAT).
- There is no formal appeals process currently, however there is much interaction regarding comment letters before the reports are finalised. New from June 2012 onwards – if and when a deficiency report is issued, it will feature the relevant firm's comments in reply.

## 8.5.3 Australia - investigation

- The Australian Securities and Investments Commission (ASIC) is responsible for administering the Corporations Act 2001 (the Corporations Act), which includes requirements relating to auditor independence and audit quality. ASIC will commence an investigation if it has reason to suspect one of the provisions it administers has been contravened. ASIC's powers of investigation are set out in the Australian Securities and Investments Commission Act (ASIC Act), as well as the Corporations Act.
- Whilst there are no publicly available statistics on the types of investigations undertaken, recent investigation outcomes relevant to auditors have covered the following:
  - Action against directors, auditors and financial advisers following company collapse and investor losses
  - Financial report reviews (triggered by complaint or market intelligence) and subsequent suggestion of areas of focus for directors and auditors
  - Action against auditors whose conduct showed a lack of understanding of the importance of their independence
  - Breaches of auditor rotation requirements
  - Where significant fraud has been identified or concern has been raised as to the financial viability of the entity
- ASIC receives funding from the Federal Government to fulfil its duties as an Investigation Body. The amount which ASIC receives in funding is not static and changes according to Government policy priorities and budgetary constraints. The Government can also provide additional funding to ASIC for it to undertake specific projects.
- There are approximately 1,800 staff at ASIC with about 350 undertaking investigative work. The number of staff allocated to audit investigation is unknown. Very generally, staff have the following profiles:
  - Those who assess complaints from the public - legal background
  - In the stakeholder teams (liaison and compliance) - legal, accounting, economics or industry background
  - In the enforcement area (who carry out the formal investigations) - law enforcement (e.g. police), public investigatory or legal backgrounds
- ASIC commences investigations based on information from members of the public (complaints, which ASIC calls “reports of misconduct”), internal monitoring or surveillance work, referrals from other regulators or agencies and also from information contained in statutory reports (reports made to ASIC as required by law, such as from auditors or external administrators). ASIC accepts anonymous complaints and treats these as it treats complaints from named persons.
- ASIC has very broad powers to inspect books and records and to require people to be examined under oath or affirmation. ASIC has the power to give an Australian auditor a written notice requiring the auditor to give specified information or to produce specified books to ASIC. An auditor must comply with this notice even if to do so would breach confidentiality obligations. Penalties for non-compliance with notices or provision of misleading information include fines and /or imprisonment.
- ASIC may seek Enforceable Undertakings at this stage, rather than triggering enforcement proceedings – see section 8.5.4.
- Outcomes of investigations include: no further action (e.g. because insufficient evidence); referral to disciplinary tribunals, a negotiated enforceable undertaking requiring the subject to do certain things (e.g. cease practising for a certain period, paying compensation or review by external consultants), instituting civil proceedings or referral to authorities for criminal prosecution.

## 8.5.4 Australia - enforcement

### **The Companies Auditors and Liquidators Disciplinary Board (CALDB or “the Board”)**

- The CALDB is responsible for the discipline of auditors. The disciplinary boards of the professional accounting bodies may also be informed of the disciplinary action taken by the CALDB.
  - *In our experience the professional bodies are likely to require an auditor who has been before the CALDB to appear before the professional conduct tribunal. However, if ASIC has imposed penalties, additional penalties may be limited.*
- CALDB’s functions and powers are exercised by a panel of members which conducts hearings to determine whether a registered auditor (or liquidator) has failed to carry out their duties and functions adequately and properly; is not a fit and proper person to remain registered; is subject to disqualification or is otherwise ineligible to remain registered.
- Matters are referred to the CALDB by ASIC or the Australian Prudential Regulation Authority (APRA) for consideration. The panel has the power to make the following orders: cancel or suspend the subject’s registration; admonish or reprimand the subject; or require the subject to give an undertaking in relation to future conduct. The panel also has the power to make costs orders and to publicise its decision and reasons for that decision and to disclose sanctions and directions.
- CALDB is an independent tribunal that is allocated funding by the Federal Government through ASIC’s budget. All appointments to the Board are made by the Deputy Prime Minister and Treasurer. The Board consists of 14 paid members, eight of which must be non-accountants. The Chair and Deputy Chair are members of the legal profession.
- The disciplinary panel conducting a hearing is not bound by the rules of evidence and the proceedings should take place with as little formality and technicality as required. However, the panel must observe the rules of natural justice at and in connection with a hearing.
- Hearings of CALDB must take place in private unless a person (other than ASIC or APRA) who is entitled to be heard (the respondent auditor) requests that the hearing be in public, in which case it must be in public. The Panel can decide to hold some parts of the hearing in public and some in private and to suppress publication of certain evidence.
- The CALDB can disclose publicly the sanctions imposed and the directions made against any party on a named basis.
- Appeal from decisions of the CALDB can be made by either party to the Administrative Appeals Tribunal (under s1317B Corporations Act) on the merits (facts) of the decision. The AAT will stand in the shoes of the decision maker and look at the case afresh.
- Applications for review can also be made by either party to the Federal Magistrates Court (FMC) or the Federal Court (FC) under the Administrative Decisions (Judicial Review) Act 1977 on questions of law/ the legality of the decision (as specified in s6 of that Act, such as for breaching the rules of natural justice).

## 8.5.4 Australia – enforcement (cont'd)

### **The Companies Auditors and Liquidators Disciplinary Board (CALDB or “the Board”) (cont'd)**

- It is important to note that the AAT, the FMC and the FC were not specifically or purposefully set up to hear appeals about decisions impacting auditors. The jurisdiction of that Tribunal and those two Courts, the types of matters that they hear and determine, is much broader. Indeed matters concerning the CALDB or auditors more generally form an insignificant part of their caseload. For instance, there were only two cases concerning the CALDB’s decisions about auditors in the AAT in the last 10 years and none in either the FMC or FC.
- Once an auditor related matter goes into the AAT, FMC or FC it is basically entering the more general court system of Australia and cannot be seen as being a distinct system of appeal specifically set up for auditor related matters. The Australian court system is very similar to that in the UK.

### **ASIC’s Enforceable Undertakings (EUs)**

- It should be noted that whilst the CALDB is the recognised “disciplinary body” for Australian auditors, enforcement activity against auditors has more recently been led by ASIC (usually in connection with its investigation of large failures by companies and financial service providers). Indeed the last published CALDB decision relating to an auditor dates from November 2009.
- As noted in the investigations sections, as well as being able to take an auditor to the CALDB, ASIC can undertake other types of enforcement action against auditors for breaches of relevant provisions in the Corporations Act.
- There is an emerging trend of ASIC entering into enforceable undertakings (EU) with auditors, often at the investigation stage (i.e. before matters progress to enforcement), or at enforcement before the matter is taken to the CALDB. The enforceable undertaking is one of a number of remedies available to ASIC for contraventions of the legislation that it administers.
- Section 93AA of the ASIC Act gives ASIC the power to accept a written EU from a person in connection with any matter over which ASIC has jurisdiction. Section 93A of that Act contains the same power with respect to EU’s offered by responsible managers of registered schemes.
- ASIC does not have any power to compel a person to offer or enter into an EU. An EU is meant to be a consensual agreement to be used by ASIC instead of commencing civil or administrative proceedings or referring a matter to a specialist body such as the Companies Auditors and Liquidators Disciplinary Board.
- The usual process is that there are discussions between the parties, an EU is negotiated and then “offered” to ASIC by the subject.
- ASIC has used EUs to produce outcomes that might not have been available via other enforcement mechanisms (e.g. civil action or referral to CALDB).
- ASIC indicates that it will only use the EU mechanism if there is reason to believe that there has been a contravention of the law, ASIC has commenced an investigation into the conduct and the EU is the most effective regulatory outcome.

## 8.5.4 Australia – enforcement (cont'd)

### ASIC's Enforceable Undertakings (EUs) (cont'd)

- The EU cannot be used where the relevant breach has criminal consequences (e.g. fraud) as per a principle in Australian law you cannot contract out of criminal liability.
- The person who has been the subject of ASIC's concerns/ investigation and offers the EU (e.g. a delinquent auditor) is known as the "promisor" (as they agree to, they promise to, do a number of things in the EU).
- If ASIC believes that an EU has been breached, it may make an application to the Court under s93AA or 93A. The Court can then make a number of orders in relation to the EU if ASIC has proven the breach, e.g. The Court might:
  - order the promisor to comply with the EU, which then converts from a private agreement to a court undertaking (a breach of which may amount to contempt of court)
  - impose a civil penalty order on the promisor
  - order that the promisor compensates any other person who has suffered loss or damage as a result of the breach
- ASIC maintains a register of all its enforceable undertakings which are publicly available and free. Some investigation reports have been made available. Depending on the outcome and circumstances of the investigation, ASIC may make a media release.

## 8.5.5 Australia – standard setting

	Ethical standards	Auditing and Assurance Standards	Accounting Standards	Financial Reporting Framework
<b>Responsible body</b>	Australian Professional and Ethical Standards Board (APESB)	Australian Auditing and Assurance Standard Board (AUASB)	Australian Accounting Standards Board (AASB)	Financial Reporting Council (FRC)
<b>Function, powers and jurisdiction</b>	Established as an initiative of CPA Australia and the Institute of Chartered Accountants in Australia. The third professional body in Australia, the Institute of Public Accountants is also a member of the APESB.	An independent statutory agency of the Australian Government responsible for developing, issuing and maintaining high quality auditing standards in the public interest	Australian Government agency formed under ASIC Act 2001. The mission of the AASB is to: a) develop and maintain high-quality financial reporting standards for all sectors of the Australian economy; and b) contribute to the development of global financial reporting standards	Statutory body responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes and providing strategic advice in relation to the quality of audits conducted by Australian auditors
<b>Operated and funded by</b>	Funded by CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Public Accountants.	Operated by the Australian Government and primarily funded by the Australian Government. The FRC, whilst not a standard setting body, has oversight.	Operated by the Australian Government and primarily funded by the Australian Government. The FRC, whilst not a standard setting body, has oversight.	The Australian Government funds the operation of the FRC and expenditure is included in the Treasury's annual financial statements
<b>Level of funding</b>	Funding from the accounting bodies was A\$1.3m in the last two financial years	Funding varies from year to year. In 2010/2011 funding was A\$1.5m, in 2011/2012 funding was A\$2.1m	Funding varies from year to year. In 2011/12 funding from the Federal Government was A\$3.8m, A\$0.5m from State and Territory Governments and A\$100k from the Australian Securities Exchange (ASX).	Expenditure in connection with the FRC is not disclosed in the Treasury financial statements at a sufficiently detailed level to identify
<b>Structure and staffing</b>	The APESB is supported by a secretariat of three staff who oversee the drafting and development of relevant up-to-date professional and ethical standards for members of the profession. They are drawn from the accountancy profession.	The Chairman is appointed by the Minister, while other Board members are appointed by the FRC. Appointments may be made for a period of up to five years and retiring members are eligible for reappointment.	The chairman is appointed by the Minister whilst other members are appointed by the FRC. To be eligible for appointment, a person must have knowledge of, or experience in, business, accounting, law or government. Appointments may be made for a period of up to five years and retiring members are eligible for reappointment.	The FRC's Secretariat is provided by staff of the Treasury's Markets Group. The FRC has two board committees who advise it.

## 8.5.5 Australia – standard setting (cont'd)

	Ethical standards	Auditing and Assurance Standards	Accounting Standards	Financial Reporting Framework
<b>Overview of standard setting process</b>	APESB or an external party initiates development of a new standard. The Board considers the proposal, has a taskforce draft a proposal; this is sent out for consultation before the Board considers a revised draft and determines whether a final pronouncement is made	When an issue is identified, it is added to the Board's agenda and researched; stakeholders are consulted before a new standard is issued.	When an issue is identified, it is added to the Board's agenda and researched; stakeholders are consulted before a new standard is issued.	
<b>Comment on level of convergence with international standards</b>	<p>The ethical professional standard issued by the APESB (APES 110) is the same as the IESBA Code of Ethics, except for one difference (the emergency exception to the prohibition on bookkeeping services for public interest entities that are audit clients) and a few local additional requirements.</p> <p>Most of the independence provisions in the law mirror the requirements in the IESBA Code of Ethics, however there are some additional and stricter prohibitions e.g. audit partner rotation. There are no scope of service prohibitions in law so IESBA Code prevails.</p> <p>The APESB has issued standards for professional services for which there are no international pronouncements e.g. valuation services.</p>	<p>The AUASB followed FRC directive (see right) on using international standards as a base point.</p> <p>Directed to make amendments or incorporate additional requirements to ISAs as necessary to ensure that Australian Auditing Standards conform to the Australian regulatory environment and statutory requirements and are legally enforceable.</p> <p>The process of developing Australian Auditing Standards should include monitoring and reviewing auditing and assurance standards issued by other standard-setting bodies in other national jurisdictions</p>	<p>In carrying out its functions the AASB must have regard to the interests of Australian corporations which raise or propose to raise capital in major international financial centres.</p> <p>In July 2004, the Board issued the initial Australian equivalents to International Financial Reporting Standards (IFRSs) that applied from 2005.</p> <p>Some of the existing domestic AASB and AAS Accounting Standards in 2005 were retained where there was no IASB equivalent. These pre-2005 AASB and AAS Standards have now all been revised or superseded.</p>	<p>In 2002 the Financial Reporting Council provided a strategic direction to the AASB to work towards adopting Standards that are the same as those issued by the International Accounting Standards Board (IASB), for application on 1 January 2005.</p> <p>FRC issued strategic directive that AUASB should use, as appropriate, International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as a base from which to develop Australian Auditing Standards.</p>

## 8.5.6 Australia – funding model options

### **Inspection**

- The ASIC inspection activity is funded by the Federal Government. They most recently announced that ASIC would receive \$101.9m over four years for its operational funding. However, no allocation of this overall funding is given to inspection activity.

### **Investigation**

- ASIC receives funding from the Federal Government to fulfil its duties as an Investigation Body. The amount which ASIC receives in funding is not static and changes according to Government policy priorities and budgetary constraints. The Government can also provide additional funding to ASIC for it to undertake specific projects.

### **Enforcement**

- The CALDB is an independent tribunal that is allocated funding by the Federal Government through ASIC's budget. All appointments to the Board are made by the Deputy Prime Minister and Treasurer. The Board consists of 14 paid members, eight of which must be non-accountants. The Chair and Deputy Chair are members of the legal profession.

### **Ethical standards**

- The APESB is funded by CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Public Accountants. Funding from these accounting bodies was A\$1.3m in each of the last two financial years.

### **Auditing and assurance standards**

- The AUASB is primarily funded by the Australian Government. Funding varies from year to year. In 2010/2011 funding was A\$1.5m, in 2011/2012 funding was A\$2.1m.

### **Accounting standards**

- The AASB is primarily funded by the Australian Government. Funding varies from year to year. In 2011/12 funding from the Federal Government was A\$3.8m, A\$0.5m from State and Territory Governments and A\$100k from the ASX.

### **Financial reporting framework overseen by FRC**

- The Australian Government funds the operation of the FRC and expenditure is included in the Treasury's annual financial statements. Expenditure in connection with the FRC is not disclosed in the Treasury financial statements at a sufficiently detailed level to identify.





## 8.6.1 Singapore - registration

- There are both differences and similarities between private and public companies, and PIEs, in Singapore with regard to audit requirements.
- Listed companies subject to Singapore statutory legal requirements are those incorporated, and admitted to the official list of a securities exchange, in Singapore.
- ACRA has clarified that PIEs include companies listed on the Singapore Exchange or which are in the process of issuing its debt or equity instruments for trading on Singapore Exchange; entities in regulated financial industries; and other entities which raise funds from the public (such as charities, IPCs and religious organisations).
- ACRA (Accounting and Corporate Regulatory Authority) is the independent regulatory body responsible for registration of auditors for Singapore publicly listed companies and public interest entities, and the national regulator of business entities and public accountants in Singapore. ACRA is a statutory board under the Ministry of Finance.
- An ACRA registered issuer must appoint a suitable ACRA registered (or otherwise acceptable to the Exchange) auditing firm to meet its audit obligations. All Singapore incorporated companies which are broadly categorised as private companies limited by shares and public companies are registered with ACRA.
- Any person who wants to be registered as a public accountant must register with ACRA; both the individual and the firm need to be registered.
- We are not aware of a separate register for overseas firms/individuals.
- The Institute of Certified Public Accountants of Singapore (ICPAS) is the national accountancy body that develops, supports and enhances the integrity, status and interests of the profession. ACRA will not register any person as a public accountant unless he is a member of ICPAS.
- Any public accountant or firm aggrieved with any decision made by the ACRA may appeal to the High Court within a period of 30 days. The decision of the High Court on an appeal shall be final.
- With effect from 1 January 2019, a chartered accountant under the Singapore Accountancy Commission (SAC) would meet the qualifications and membership requirements for registration as a public accountant. However, the applicant would also be required to attend ACRA's Public Practice Programme, achieve minimum hours of Continuing Professional Education and achieve minimum length of relevant practical experience to be registered as a public accountant.
- The SAC was established in April 2013. Its introduction will not change ACRA's current responsibilities with regards to the regulation of companies, businesses, public accountants and auditing practice.

## 8.6.2 Singapore - inspection

- The inspection of auditors is administered under the oversight of the Public Accountants Oversight Committee (PAOC), a board committee under the ACRA. The PAOC, established by ACRA per the Accountants Act, and under its direct oversight, performs the work. ACRA is responsible for registration and for the control and regulation of the practice of the profession; and generally for the administration of the Accountants Act.
- All public accountants registered in accordance with the Accountants Act are required to comply with the Act and are subject to the Practice Monitoring Programme (PMP) administered by the PAOC. The PMP reviewers select the public accountants for review using a risk-based approach, comprising engagement reviews of public accountants and firm reviews (the latter only apply to accounting firms that audit PIE entities). ACRA issues the public accountant/accounting firm with a report which includes a discussion on the findings raised, a reference to the relevant prescribed standards, as well as recommendations of areas for improvements. The public accountant/accounting firm is given time to respond to the findings raised.
- The Monetary Authority of Singapore (MAS) formerly stipulated that banks incorporated in Singapore should not appoint the same public accounting firm for more than five years. Note however that the audit firm rotation requirement for banks has been suspended since 2008 due to the global economic crisis. The banks are required to submit annually the name of the auditor they propose to appoint or reappoint for each financial year, for MAS' approval.
- Auditors are able to provide non-independence impairing non-assurance services to audit clients, under the ambit of the Accountants Act, which is based on IFAC.
- Inspection takes place on both a firm and individual basis. Inspections of firms that audit non-PIEs are carried out with the assistance of ICPAS, under the direct oversight of ACRA. The scope of inspection on these firms focuses only on individual engagement inspections.
- ACRA also publishes an annual Practice Monitoring Programme Public Report.
- For public accounting firms operating in the PIE segment, ACRA assesses a public accounting firm's system of quality controls (firm-level inspections) against the requirements of the Singapore Standards on Quality Control 1. ACRA also inspects a public accountant's audit engagements to assess compliance with the Singapore Standards on Auditing.
- In facilitating the assessment of a firm's system of quality controls, the firm's practices in each of the Singapore Standard on Quality Control 1 quality control elements will be benchmarked and peer-rated against those in their peer groups for comparison. ACRA uses the assessment of a firm's system of quality controls to determine the number of engagements selected and the intensity of inspection of individual audit engagements and the frequency and intensity of ACRA's future inspections of the firm.

## 8.6.2 Singapore – inspection (cont'd)

- At the conclusion of each inspection, ACRA advises the firms and public accountants of areas of non-compliance with standards as well as areas that require improvement in line with best practice. ACRA requires a response from firms on their remediation plans to address areas of deficiencies. Status updates on the remediation efforts are also obtained every six months to monitor the firms' progress. The PAOC is the deciding authority on the outcome of these inspections.
- Following each firm-level inspection, ACRA discusses the areas of deficiencies in its reports and directs firms toward appropriate improvements. Where the public accountant fails the Practice Review, the Oversight Committee has recourse to a number of actions – see section 8.6.4.
- In the future:
  - ACRA intends to apply conditions of approval to accounting entities that conduct PIE engagements. Presently, an accounting entity's approval is permanent and unconditional whilst a public accountant's licence is to be renewed annually. ACRA plans to require accounting entities that conduct PIE engagements to accede to requests for information for purposes of demonstrating that the entity meets the conditions for conducting PIE engagements and will need to comply with subsequent requests for information to ensure that the entity continuously fulfils such conditions and to assist ACRA with its monitoring.
  - Presently, there is no statutory obligation on a firm to follow up with ACRA's recommendations. In conjunction with the proposed remediation that would be required of accounting entities, ACRA plans to provide for a more robust and fair process for the finalisation of the report's contents and conclusions and the firm would be given an opportunity to comment on the draft. Where a firm does not achieve progress on areas identified in previous inspections, ACRA may, if it considers it necessary, take further action such as the publication of findings or placing restrictions on accounting firms (for example so that the firm is unable to undertake PIE engagements). Where significant deficiencies are identified and a firm fails to address the deficiencies, the firm's practice may be restricted or made conditional on undertaking specific steps or achieving a satisfactory result in a firm level inspection within a certain time period.
  - With regards to publishing all or portions of a firm's report, ACRA wants the right to provide all or portions of a firm's report to relevant local regulators such as the MAS and the Singapore Exchange and, if an audit firm fails to make sufficient progress under a remediation plan, make non-publication of certain matters conditional on the firm making improvements within certain time periods.

## 8.6.3 Singapore - investigation

- ACRA is responsible for investigating auditing irregularities, under the Accountants Act.
- Two bodies may initiate an investigation – the Complaints and Disciplinary Panel established under the PAOC, and the ICPAS Investigation Committee. PAOC may refer any complaint or information received for an inquiry or a formal hearing.
- Any public accountant, accounting corporation, an accounting firm or an accounting limited liability partnership (LLP) registered under the Accountants Act, and any member registered with ICPAS, may be subject to an investigation.
- The chairman of the Complaints Committee records its proceedings in writing and in sufficient detail to enable the Oversight Committee to follow the course of the proceedings. The PAOC receives the report. No information is publicly available on the content of the report.
- PAOC will notify the public accountant, accounting corporation, accounting firm or accounting LLP concerned and the person who made the complaint of its decision.
- PAOC has the power to inquire into any complaint against any public accountant, accounting corporation, accounting firm or accounting LLP; or any information relating to any professional misconduct on the part of any public accountant, accounting corporation, accounting firm or accounting LLP, and, if necessary, institute disciplinary proceedings in accordance with the Accountants Act.
- Upon receiving the report and recommendation of the Disciplinary Committee, the Oversight Committee has a number of options at its disposal – see section 8.6.4.
- Note: the oversight system is somewhat unusual as the same body oversees both companies and accountants, and can pursue both company directors and accountants in cases of fraud or a qualified audit report for example.
- Note also: at present, there is no process for special investigations on public interest cases where, for example, it relates to non-compliance with audit requirements for financial statements of listed companies that might have harmed investors or damaged confidence, although they can carry out a ‘special practice review’ – i.e. an additional inspection of that particular audit file and audit partner. *We understand that ACRA intends to introduce a special investigation process to improve its ability to deal with public interest cases of potential non-compliance with audit and review standards and related requirements.*

## 8.6.4 Singapore - enforcement

- ACRA is the Disciplinary Body in Singapore, and its powers are governed by the Accountants Act. The Oversight Committee assists the Authority in the discharge of the Authority's functions, including inquiring into any complaint against any public accountant, accounting corporation, firm or LLP; or any information relating to any professional misconduct on the part of the aforementioned; and if necessary instituting disciplinary proceedings.
- The Public Accountants Oversight Committee appoints the Complaints and Disciplinary Panel. It may sanction any public accountant, accounting corporation, firm or LLP registered under the Accountants Act. The initiation of disciplinary process can come from the Complaints Committee or the Minister.
- Upon receiving the report and recommendation of the Disciplinary Committee, the PAOC may:
  - revoke the approval granted to the accounting corporation, accounting firm or accounting LLP;
  - suspend the accounting corporation, accounting firm or accounting LLP from providing public accountancy services for such period not exceeding two years as may be specified in the order;
  - impose such conditions as are necessary to restrict the provision of public accountancy services by the accounting corporation, accounting firm or accounting LLP in such manner for a period not exceeding two years;
  - impose on the accounting corporation, accounting firm or accounting LLP a penalty not exceeding \$100,000;
  - censure the accounting corporation, accounting firm or accounting LLP;
  - require the accounting corporation, accounting firm or accounting LLP to give such undertaking as the Disciplinary Committee thinks fit; or
  - make such other order as it thinks just and expedient in the circumstances of the case.
- The duration of the investigations would vary on a case-by-case basis as it depends on the complexity of the case, the amount and nature of the evidence, and other factors. It could take two to six months.
- PAOC has the authority to register or de-register an auditor. Public Accountants removed from the Register due to disciplinary actions or failure of practice review under the Accountants Act would be gazetted; including individuals whose licences are suspended, cancelled or not renewed.
- No information is publicly available on the report, however PAOC will notify the firm concerned - and the person who made the complaint – of its decision.
- Any public accountant who is aggrieved by a decision of the Oversight Committee may appeal to the High Court within a period of 30 days after the service of PAOC's decision on the public accountant.

## 8.6.5 Singapore – standard setting

- PAOC assists ACRA in determining, prescribing and reviewing the codes of professional conduct and ethics for public accountants. ACRA was established as a statutory board under the purview of the Ministry of Finance.
- The ASC is responsible only for the formulation and promulgation of accounting standards. It was also established under the purview of the Ministry of Finance.
- ICPAS's AASC, which is under the direct oversight of PAOC, develops Singapore's auditing and assurance standards.
- There is no public information available on the process of setting the professional standards. However, generally, ACRA will issue public consultation papers inviting members of the public to provide feedback and suggestions should there be any proposed amendments, and the consultation is opened for a period of time.
- The professional standards of Singapore converged with the standards issued by IESBA, IASB and IAASB, with such amendments as are necessary to serve the public interest in Singapore and to conform with Singapore's regulatory environment and statutory requirements.

## 8.6.6 Singapore – funding model options

- ACRA is a statutory board under the Ministry of Finance.
- The firms themselves are also billed following each inspection (based on a flat day rate per inspector, i.e. the total amount is presumably linked to firm size).
- PAOC is pro-bono; people on PAOC have full-time jobs elsewhere.



## 9. Global audit regulatory reform overview

# 9.1 Regulatory reform in the UK

## UK FRC

- In September 2012, the FRC updated the UK Corporate Governance Code, which includes provision for FTSE 350 companies to tender their external audit every 10 years on a 'comply or explain' basis.
- This is effective for periods commencing on or after 1 October 2012.
- Transitional provisions include:
  - all lead engagement partners are able to complete their five year partner rotation period before a tender is required; and
  - where a company has undertaken a tender process or has changed auditors in or since 2000, a further five year cycle would be permitted by another lead engagement partner from the same firm before a tender would be required.
- Reappointment of the incumbent auditor is permitted.

## Competition Commission (CC)

- The CC published provisional findings from its investigation of the statutory audit market of large companies and has outlined *potential* remedies that it will be investigating further.
- Its concerns are with the structure of the market rather than the behaviours of individual audit firms. It did not find any evidence of tacit collusion, bundling of services, targeting of mid-tier firms' clients with particularly low prices, or undue influence on regulators through extensive alumni networks.
- The CC did find that there is a lack of competition in the market that leads to higher prices, lower quality and less innovation for companies; auditors tend to focus on satisfying management rather than shareholders; concerns that companies lack bargaining power and barriers to switching hold back levels of competition.
- Seven possible remedies are being investigated:
  - Mandatory tendering (likely every five or seven years)
  - Mandatory rotation (likely every seven, 10 or 14 years)
  - Expanded remit and/or frequency of inspection (AQRT reviews)
  - Prohibition of "Big 4 only" clauses in loan documentation
  - Strengthened accountability of the external auditor to the audit committee
  - Enhanced shareholder-auditor engagement
  - Extended reporting requirements

## 9.2 Regulatory reform in Europe

### EU: EC proposals

- In November 2011, the **EC** proposed measures to reform the statutory audit of public interest entities (PIEs) across Europe, including:
  - Mandatory rotation every six years (nine years for joint auditors)
  - Mandatory tendering every time a new auditor is appointed
  - Non-audit services (NAS) categorised as either prohibited services or services requiring prior approval, with financial audit-related services capped at 10% of the statutory audit fee
  - Audit-only firms (for firms meeting specific revenue criteria)
  - Prohibition of 'Big 4' only clauses in loan agreements
  - Extended auditor reporting
  - Strengthened requirements regarding the quality assurance system:
    - independent of all statutory auditors and audit firms, not just those being reviewed;
    - delegation of tasks by the oversight authority (e.g. to a professional body) limited to the approval and registration of statutory auditors and audit firms;
    - no audit practitioners will be allowed to participate in governance of the public oversight system (the current directive allows for a minority of practitioners on the oversight body) – this would mean that nobody who had been an auditor within the last three years could be on the oversight board; and
    - report of the main conclusions of the quality assurance review to be made available by the competent authority to all interested parties.
- The Commission proposed that these measures would apply to PIEs across Europe, defined as:
  - Banks, insurance undertakings and companies listed on regulated markets
  - Investment firms, payment institutions, undertakings for collective investment in transferable securities, electronic money institutions and alternative investment funds
- These proposals also need to be agreed by the **European Parliament** and the **Council of Ministers**. The three parliamentary committees have reviewed the proposals and defined their positions (see following page).

## 9.2 Regulatory reform in Europe (cont'd)

### EU: EC proposals (cont'd)

- JURI (key parliamentary committee) voted on its position on 25 April. The committee voted to:
  - Mandate rotation of firms every 14 years (maximum) or Member States may extend this period up to 25 years if one of the following criteria is met during the 14 years: there was a joint audit; the audit is tendered; or a comprehensive assessment of the auditor was conducted by the audit committee.
  - Mandate tendering when a change of auditor is proposed to shareholders.
  - Reject audit only firms; remove caps on non-audit services, though requiring a company policy on non-audit services to be approved by the board and shareholders; remove caps on financial related audit services; a 'black list' of prohibited services (close to the IESBA list) and a 'white list' of permitted audit-related services.
  - Apply the proposals only to listed companies, insurance companies and banks, with member states having a choice whether to extend 'public interest entities' to include other classes of entity.
  - Continue to permit Member States to allow a minority of practitioners to be involved in the governance of the public oversight system. Member States may also continue to allow the public oversight body to delegate approval and registration, CPE and standard setting, provided that this is under the oversight of the public oversight system. A process whereby the professional body can propose rule changes to the oversight body for approval, and operate the administrative arrangements for these functions, would seem to meet the requirement. The public oversight authority may delegate quality assurance reviews for non public interest entities to certain other bodies designated by law, such as a professional body.
- ECON's position includes: rejection of audit-only firms, mandatory firm rotation and caps on NAS; approval of mandatory audit tendering every seven years; a 'black list' of prohibited NAS; a minority of audit practitioners allowed to be involved in the governance of the public oversight system.
- ITRE's position includes: 12 years mandatory firm rotation (15 years for joint audits); tendering every six years; audit-only firms; 10% cap on audit-related and other assurance services; prior approval of NAS though some services are prohibited; making the quality assurance report available to interested parties to be a Member State option rather than a requirement; and a minority of audit practitioners allowed to be involved in the governance of the public oversight system. It allows "certain tasks" to be delegated by the public oversight body to other bodies (e.g. professional body), rather than limiting this to the approval and registration of auditors as included in the EC proposals.
- The next stage in the legislative process involves the relevant Council of Ministers. The Council will now aim to reach a consensus position on the reforms among the 27 Member States and then start a 'trilogue' process designed to agree a final position between the Council, Parliament and the Commission to enable a plenary vote of the Parliament and approval by the Council.
- If an agreed compromise text is available in time, there will be a plenary vote of the European Parliament in November 2013. If an agreed compromise text is not available by then, the vote may slip several months. If the agreed text is adopted by the Parliament, the Council would then formalise its agreement and the text would become law.
- It is theoretically possible for the Parliament to reject an agreed compromise text and adopt a different text. It would then be up to the Council to approve or reject the Parliament text. If the Council rejects the Parliament text, the process of negotiating a compromise would start all over again.

## 9.3 Regulatory reform worldwide

Some of the countries listed below are closely following the international regulatory developments (e.g. in the EU and the US).

### Americas

- **Brazil** – mandatory rotation for listed companies, excluding banks
- **Canada** – discussions on mandatory firm rotation and mandatory tendering have been held, though they are not considered as the preferred course of action preferring instead mandatory comprehensive review of the auditor's performance with a focus on audit quality. The audit regulator (CPAB) and Canadian Institute (CICA) have been jointly leading the Enhancing Audit Quality initiative, which has focused on three main areas: 'Auditor Independence', 'Auditor Reporting' and the 'Role of the Audit Committee'. For non-audit services, Canada continues to use a principles-based approach to evaluating threats to, and safeguards for, the provision of non-audit services, with appropriate rule-based prohibitions for services when threats cannot be overcome. Canada will also be aligning with the IAASB exposure draft that was issued in January 2013 proposing changes to the framework for audit quality, and the 2010 IESBA Code changes regarding exposure draft to the Independence rules
- **US** - in December 2011, the PCAOB launched a concept release on mandatory firm rotation, however this is no longer considered as a short-term priority. The PCAOB standard-setting projects for the first nine months of 2013 include: companies relations and transactions with 'Related Parties'; 'Reorganisation of PCAOB Auditing Standards'; 'Auditor's Reporting Model'; 'Auditors' Responsibilities with Respect to Other Accounting Firms, Individual Accountants, and Specialists'; and 'Audit Transparency: Identification of the Engagement Partner'. It is also discussing a project on audit quality indicators and may also consider projects on 'Audits of Brokers and Dealers' and 'Going Concern'

### EMEA

- **Italy** – mandatory rotation every nine years for all listed companies
- **Netherlands** - in December 2012, the Dutch Parliament approved new legislation, which includes mandatory firm rotation after eight years (effective 1 January 2016) and prohibition of all non-audit services for public interest entities (effective 1 January 2013)
- **Saudi Arabia** – mandatory rotation for listed companies, excluding banks
- **Turkey** – mandatory rotation every eight years for banks and every seven years for all other listed companies, although further discussions are ongoing
- **UAE** – currently there are no regulations on mandatory firm rotation in place, but government entities in Abu Dhabi (where government has 50% or more equity interest) have to tender the audit every four years

## 9.3 Regulatory reform worldwide (cont'd)

### Asia Pacific

- **Australia** – Treasury does not currently have further audit reform proposals on the table. Auditors are allowed to provide non-audit services to their clients subject to conformity with the IESBA code. In June 2012, the audit enhancement bill 2012 was passed, with the key changes including: firms being required to produce Audit Transparency Reports; ASIC can issue audit deficiency reports; ASIC can communicate directly with the audit committee on the results of its audit inspection activity; and directors can extend the time served by the partner on a listed entity to seven years if it maintains quality (with an explanation provided in the directors' report)
- **China** – mandatory rotation every five years for financial institutions and state-owned enterprises; mandatory tendering in place for certain types of companies, such as financial institutions and state-owned enterprises
- **India** – in the process of enacting a revised Companies Bill, which includes provisions for mandatory rotation every five years and a list of prohibited services
- **Indonesia** – current requirements include audit firm rotation every six years, with a cooling off period of one year. New legislation was enacted in May 2011, but the implementation guidance, which may alter the rotation requirements, is still being developed. Insurance companies are the only ones subject to mandatory tendering
- **Japan** – no proposals or legislations/regulations on mandatory firm rotation or mandatory tendering in place
- **Malaysia** - no legal requirement or proposals for mandatory rotation of audit firms or mandatory tendering
- **Singapore** - mandatory rotation every five years for banks was suspended during the financial crisis and has not yet been reinstated. There are no other planned reforms.
- **South Korea** – mandatory audit firm rotation for listed companies was introduced from 1 January 2006, however, the requirement was abolished from the year when the listed company adopted K-IFRSs as its accounting standards (which companies were required to satisfy by FY 2011)
- **Taiwan** – no proposals or legislations/regulations on mandatory firm rotation or mandatory tendering in place
- **Vietnam** – mandatory firm rotation after five years for public interest entities, credit institutions and foreign bank branches. There is also an unwritten rule that an audit firm is not supposed to audit a World Bank-funded project for more than six years.

# Appendix: Glossary

# Glossary

## EU

- European Commission (EC)
- European Economic Area (EEA)
- European Union (EU)
- Statutory Audit Directive (SAD)

## UK

- Auditing Practices Board (APB)
- Audit Quality Review Team (AQRT) [formerly Audit Inspection Unit (AIU)]
- Financial Reporting Council (FRC)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Recognised Qualifying Body (RQB)
- Recognised Supervisory Body (RSB)
- Responsible Individual (RI)

## US

- American Institute of CPAs (AICPA)
- Financial Accounting Standards Board (FASB)
- Public Company Accounting Oversight Board (PCAOB or 'the Board')
- Securities Exchange Commission (SEC or 'the Commission')
- The Sarbanes-Oxley Act of 2002 (SOX)



# Glossary (cont'd)

## Canada

- Auditing and Assurance Standards Board (AASB)
- Accounting Standards Board (AcSB)
- Accounting Standards Oversight Council (AcSOC)
- Auditing and Assurance Standards Oversight Council (AASOC)
- Canadian Auditing Standard (CAS)
- Canadian Institute of Chartered Accountants (CICA)
- Canadian Public Accountability Board (CPAB)
- Canadian Standard on Quality Control (CSQC)
- Certified General Accountants (CGAs)
- Chartered Accountants (CAs)
- Council of Senior Executives (CSE)
- Emerging Issues Committee (EIC)
- Ontario Securities Commission (OSC)
- Public Sector Accounting Board (PSAB)
- Public Trust Committee (PTC)
- Reporting Issuer (RI)

# Glossary (cont'd)

## Australia

- Administrative Appeals Tribunal (AAT)
- Australian Accounting Standards Board (AASB)
- Australian Auditing and Assurance Standard Board (AUASB)
- Australian Professional and Ethical Standards Board (APESB)
- Australian Prudential Regulation Authority (APRA)
- Australian Securities and Investments Commission (ASIC)
- Australian Securities Exchange (ASX)
- Authorised Audit Companies (AAC)
- Authorised Deposit-Taking Institution (ADI)
- Authorised Non-Operating Holding Company (NOHC)
- Companies Auditors and Liquidators Disciplinary Board (CALDB)
- Enforceable Undertaking (EU)
- Financial Reporting Council (FRC)
- Institute of Chartered Accountants in Australia (ICAA)
- Institute of Public Accountants (IPA)
- Registered Company Auditors (RCA)
- Registrable Superannuation Entity (RSE)

# Glossary (cont'd)

## Singapore

- Accounting and Corporate Regulatory Authority (ACRA)
- Accounting Standards Council (ASC)
- Auditing and Assurance Standards Committee (AASC)
- Institute of Certified Public Accountants of Singapore (ICPAS)
- Institutions of a Public Character (IPC)
- Monetary Authority of Singapore (MAS)
- Practice Monitoring Programme (PMP)
- Public Accountants Oversight Committee (PAOC)
- Singapore Accountancy Commission (SAC)

## Hong Kong / People's Republic of China

- Financial Reporting Council (FRC)
- Financial Reporting Council Ordinance (FRCO)
- Hong Kong Exchanges and Clearing Limited (HKEx)
- Hong Kong Institute of Certified Public Accountants (HKICPA)
- Ministry of Finance in the People's Republic of China (China MOF)
- Practice Review Committee (PRC)
- Professional Conduct Committee (PCC)
- Stock Exchange of Hong Kong (SEHK)

# Glossary (cont'd)

## Other

- Competition Commission (CC)
- Consulting Advisory Group (CAG)
- Continuing Professional Development (CPD)
- Continuing Professional Education (CPE)
- European Group of Auditor Oversight Bodies (EAOB)
- [International] Financial Reporting Standards ([I]FRS)
- Generally accepted accounting principles (GAAP)
- International Accounting Standards Board (IASB)
- International Auditing and Assurance Standards Board (IAASB)
- International Ethics Standards Board for Accountants (IESBA)
- International Federation of Accountants (IFAC)
- International Forum of Independent Audit Regulators (IFIAR)
- International Standards on Auditing (ISAs)
- Limited Liability Partnership (LLP)
- Non-audit services (NAS)
- Public Interest Entity (PIE)
- Supervision and Inspection Bureau (SIB)

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