Update on Independent Audit Oversight Report
The global picture

International Forum of Independent Audit Regulators (IFIAR) members:
- Abu Dhabi
- Albania
- **Australia**
  - Austria
  - Belgium
  - Botswana
  - Brazil
  - Bulgaria
- **Canada**
  - Cayman Islands
  - Chinese Taipei
  - Croatia
  - Czech Republic
  - Denmark
  - Dubai International Financial Centre (DIFC)
- Egypt
- Finland
- France
- Germany
- Gibraltar
- Greece
- Hungary
- Indonesia
- Ireland
- Italy
- Japan
- Jersey
- Korea
- Liechtenstein
- Lithuania
- Luxembourg
- Malaysia
- Mauritius
- Netherlands
- New Zealand
- Norway
- Poland
- Portugal
- Russian Federation
- **Singapore**
- Slovak Republic
- Slovenia
- South Africa
- Spain
- Sri Lanka
- Sweden
- Switzerland
- Thailand
- Turkey
- **UK**
- **USA**

European Union (EU) Member States:
- Austria
- Belgium
- Bulgaria
- Croatia
- Cyprus
- Czech Republic
- Denmark
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Latvia
- Lithuania
- Luxembourg
- Malta
- Netherlands
- Poland
- Portugal
- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- **UK**

Third countries with European Commission (EC) equivalence*

**status:**
- Abu Dhabi
- **Australia**
- Brazil
- **Canada**
- China
- Dubai International Financial Centre (DIFC)
- Guernsey
- Indonesia
- Isle of Man
- Japan
- Jersey
- Malaysia
- **Singapore**
- South Africa
- South Korea
- Switzerland
- Taiwan
- Thailand
- **USA**

* Equivalence of third countries’ regulatory systems is determined by the EC, the executive body of the EU. Auditors of an entity incorporated outside the European Economic Area (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)
Dear Dr Poon,

Independent consultancy services for the Financial Reporting Council (FRC): update on independent audit oversight report

We are delighted to present our study of independent audit oversight drawing on information available to June 2016. This follows on from our September 2013 study, prepared with a view to Hong Kong achieving International Forum of Independent Audit Regulators (IFIAR) membership and/or European Commission (EC) equivalence. Since 2013, the IFIAR Principles have not changed but the 2014 European Union (EU) audit reform legislation, applicable from 17 June 2016, does impact some of the criteria for European Commission (EC) equivalence. Indeed, a major new requirement is that the audit regulator is fully governed (in Hong Kong this would relate to the FRC Council) by non-practitioners.

As we previously set out in our 2013 study, audit regulators are required to have ultimate independent oversight responsibility for registration, inspection, investigation, enforcement, standard setting and continuing professional education (CPE). Delegation to other authorities or bodies (designated or otherwise authorised by law to carry out such tasks) is permitted and adopted in some jurisdictions, provided that the independent regulator retains ultimate oversight. It is clear from this updated study that independent statutory regulators in major jurisdictions continue to have regulatory oversight of registration, inspection, investigation, enforcement, standard setting and CPE.

Since we undertook our 2013 study, the Hong Kong Government has consulted and concluded on reform of the local audit market. The proposals would put in place much of the framework and, if implemented as proposed, are likely to meet the IFIAR and EC requirements and indeed international best practice. The FRC will however still need to put in place further regulations / policies / procedures to meet the detail of those requirements.

Finally, and by way of background, the data for the jurisdictions covered by the original study in addition to the EU (the UK, US, Canada, Australia and Singapore) was originally gathered using a question set provided to Deloitte by the FRC in 2013. This updated study reflects the relevant changes in those jurisdictions, provided to us by local Deloitte experts and - in addition to the new information regarding the Government’s proposed reforms - also features various analyses, possible approaches and comparisons relating to independent audit oversight, as well as detail on each of the jurisdictions and an updated overview of global regulatory reform activity.

Yours sincerely,

David Barnes
Deloitte LLP
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1. Executive Summary
1.1 Executive Summary – IFIAR / EC

Introduction

This report follows on from our 2013 study which looked at the requirements to achieve IFIAR membership and/or EC equivalence. Since 2013, the IFIAR Principles have not changed. However, the 2014 EU audit reform legislation, applicable since 17 June 2016 and comprising revisions to the existing Statutory Audit Directive (SAD) and a new Audit Regulation (AR), impacts some of the criteria for EC equivalence.

The scope of the two regimes against which we benchmark Hong Kong are as follows:

- IFIAR is concerned with the audit of public interest entities (PIEs). Neither its Charter nor Core Principles define PIEs, but it is understood to align with the definition used by the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA). This includes listed entities (on any exchange) together with any entities designated by local law or regulation as a PIE or for which law or regulation requires compliance with the same independence framework as a listed entity.

- EC equivalence is relevant to the role of a third country auditor\(^1\); if a third country auditor is subject to an equivalent regime then it is exempt from direct inspection by the relevant EU audit regulator.

Overview of IFIAR and EC requirements

Audit regulators are required to have ultimate independent oversight responsibility for registration, inspection, investigation, enforcement, standard setting and continuing professional education (CPE). Delegation to other authorities or bodies (designated or otherwise authorised by law to carry out such tasks) is permitted, provided that the independent regulator retains ultimate oversight. Key requirements of the oversight system are set out in the following table; many are common to both IFIAR and EC:

<table>
<thead>
<tr>
<th>Area of audit oversight</th>
<th>IFIAR</th>
<th>EC equivalence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall system</td>
<td>Mainly governed by non-practitioners(^2)</td>
<td>Fully governed by non-practitioners</td>
</tr>
<tr>
<td>Registration</td>
<td>Adequate powers and authority to address compliance with the requirements for authorisation / registration</td>
<td>Ultimate responsibility for the oversight of approval and registration</td>
</tr>
<tr>
<td>Inspection</td>
<td>Responsibility for the inspection of auditors of PIEs, including at least listed entities. Operationally independent; adequately resourced; risk-based, proportionate approach covering the firm’s system of internal quality control and testing of individual audits. Plus: Three year cooling-off period for quality assurance reviewers</td>
<td>Reviews at least every six years</td>
</tr>
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1. Third-country audit entity / auditor mean, respectively, an entity regardless of its legal form / a natural person that carries out audits of the annual or consolidated financial statements of a company incorporated in a third country (non-EU country), other than an entity / person registered as an audit firm / statutory auditor in any EU Member State.

2. EC Directive 2014/56/EC defines non-practitioner as: any natural person who, during his or her involvement in the governance of the public oversight system and during the period of three years immediately preceding that involvement, has not carried out statutory audits, has not held voting rights in an audit firm, has not been a member of the administrative, management or supervisory body of an audit firm and has not been employed by, or otherwise associated with, an audit firm.
1.1 Executive Summary – IFIAR / EC (cont’d)

<table>
<thead>
<tr>
<th>Area of audit oversight</th>
<th>IFIAR</th>
<th>EC equivalence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigation</td>
<td>Appropriate, effective system of investigations and penalties / sanctions in relation to inadequate or noncompliant execution of an audit Plus: Authority and ability to enforce inspection findings and recommendations</td>
<td>Right to investigate and conduct investigations and take appropriate action</td>
</tr>
<tr>
<td>Enforcement</td>
<td>Comprehensive enforcement powers including the ability to impose a range of sanctions</td>
<td>Effective, proportionate and dissuasive sanctions in respect of statutory auditors and audit firms The right to remove registration</td>
</tr>
<tr>
<td>Standard setting</td>
<td>Adequate powers and authority to address compliance with applicable auditing, professional and independence standards</td>
<td>Ultimate responsibility for adoption of standards on professional ethics, internal quality control and auditing</td>
</tr>
<tr>
<td>CPE</td>
<td>Not specified</td>
<td>Ultimate responsibility for oversight</td>
</tr>
<tr>
<td>Funding</td>
<td>Stable, sufficient, secure source of funding; free from any undue influence from the profession</td>
<td></td>
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**Proposed future framework**

In June 2014, the Hong Kong Government (Financial Services and the Treasury Bureau) conducted a public consultation to solicit views on proposals to introduce an independent oversight regime for the regulation of listed entity auditors (LEAs). The regulatory regime would cover auditors of PIEs, with PIEs defined in Hong Kong to mean, at least for the immediate future, listed entities.

The respondents’ views on the proposals, the specific issues raised and the Government’s responses to those were summarised in the consultation conclusions, available online (http://www.fstb.gov.hk/fsb/ppr/consult/doc/conclu_rpirrlea_e.pdf), which also set out in detail the major refinements and elaborations of the relevant proposals in light of the respondents’ comments. We understand that the Government’s target is to introduce the amendment bill into the Legislative Council in the 2016-17 legislative session.

The reform proposals will result in a division of responsibilities between the FRC and the Hong Kong Institute of Certified Public Accountants (HKICPA), with the FRC becoming the independent audit oversight body vested with direct inspection, investigation and disciplinary powers with regard to the audits of listed companies by LEAs – the cohort that this study focuses on - as set out below. The HKICPA’s existing oversight of non-LEAs and of the audits of non-listed entities audited by LEAs will be unchanged.

<table>
<thead>
<tr>
<th>Area of audit oversight</th>
<th>LEAs as proposed</th>
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</thead>
<tbody>
<tr>
<td>Registration</td>
<td>HKICPA to manage; FRC to have oversight</td>
</tr>
<tr>
<td>Inspection</td>
<td>FRC to conduct (LEAs’ listed entity engagements)</td>
</tr>
<tr>
<td>Investigation / enforcement</td>
<td>FRC to conduct re. listed entities / make decisions re. LEAs</td>
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</table>
1.1 Executive Summary – IFIAR / EC (cont’d)

<table>
<thead>
<tr>
<th>Area of audit oversight</th>
<th>LEAs as proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard setting</strong> (professional ethics / auditing and assurance – these standards are converged with the standards issued by the IESBA and the IAASB)</td>
<td>HKICPA to issue / specify professional ethics / auditing and assurance standards; FRC to have oversight</td>
</tr>
<tr>
<td><strong>CPE</strong></td>
<td>HKICPA to manage; FRC to have oversight</td>
</tr>
</tbody>
</table>

**The impact of the proposed changes**

The proposed way forward is likely to a) close the gaps originally identified in our 2013 study and that remain currently and b) meet the EC and IFIAR requirements. The overall system of governance is an exception to this, see below, and there are also certain other areas where the FRC will need to put in place further regulations / policies / procedures to ensure that all aspects of the detailed requirements for IFIAR membership and EC equivalence are met. The principal areas, drawing on the key gaps originally identified, are set out below:

**Overall system of governance**

- Meets IFIAR requirements
- EC requirements are not yet fully met as, from 17 June 2016, no practitioners are permitted to be involved in the governance structure – i.e. the Council of the FRC. Whilst it is likely that the Council members will all be independent by the first year to which equivalence could apply, there is no proposed mechanism that would prevent (an)other practitioner(s) from being appointed to the Council

**Cooling-off period for quality assurance reviewers**

- Not relevant for IFIAR
- In principle meets the EC requirements, but in finalising all aspects of its new responsibilities, the FRC will need to ensure that former audit practitioners acting as quality assurance reviewers have a three year cooling off period

**Source of funding**

- Meets IFIAR and EC requirements
- To note: the requirement for LEAs to pay a levy would not render the FRC subject to undue influence by the audit profession as the law will clearly stipulate that it is a statutory obligation for LEAs to pay the levy

**Composition of the inspection team**

- Meets IFIAR and EC requirements, but:
  - The FRC will still need to ensure that the inspection division and its operation and governance are suitably independent from the reviewed firms and auditors, are not controlled by a professional body and that conflicts of interest are avoided
1.1 Executive Summary – IFIAR / EC (cont’d)

Disciplinary mechanism

• Meets IFIAR and EC requirements, but:
  – The FRC will still need to ensure that: experts it engages for specific assignments are not conflicted; there is a mechanism for ensuring findings are addressed within a reasonable period; there are adequate complaints procedures / whistleblowing arrangements in place

System of public oversight

• Not relevant for IFIAR
• Likely to meet EC requirements but:
  – The FRC needs to be able to reclaim competencies on a case-by-case basis from the HKICPA. The FRC considers that the fact that it is able to issue a direction to the HKICPA, with which it must comply, will achieve the same effect. We agree that it will do so, but it is possible that the EC may take a different view
1.2 Executive Summary – other considerations

It can be observed that the proposed changes would bring Hong Kong closer to a number of other jurisdictions, for example the proposed future disciplinary mechanism will be similar to the new disciplinary system in the UK (effective – in line with the EU audit reforms – from 17 June 2016). The following are also worthy of consideration:

- **Registration**
  - The consensus approach amongst the jurisdictions reviewed is to distinguish between public interest companies (entities – i.e. 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. This allows a balance of resource and focus, recognising the need to demonstrate benefits in support of the cost of independent regulation. It is noted that the revised EU audit legislation has broadened the definition of PIEs in Europe. It also introduces stricter requirements relating to PIE audits / auditors.

- **Inspection**
  - The importance of independent challenge to the audit firms is evident from each of the jurisdictions. While the mechanics vary, there is an increasing trend towards transparency (note the new voluntary Canadian Protocol regarding communication of inspection findings to audit committees) 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’s audit committee is of particular note. The US, in contrast, publishes individual firm inspection reports as well as summarised reports (under Public Company Accounting Oversight Board (PCAOB) Rule 4010). These practices demonstrate different approaches to striking a balance between fostering improvement and transparency of findings.
  - Furthermore, national regulators are increasingly working and cooperating together and conducting joint inspections. For example, the PCAOB has signed Memoranda of Understanding (MOUs) with multiple jurisdictions in recent years and the European Audit Inspection Group (EAIG) – expected to become a subgroup of the Committee of European Audit Oversight Bodies (CEAOB)\(^3\) - is developing a Common Audit Inspection Methodology to be used by all inspectors in carrying out their work and has an inspection findings database where Member State regulators share findings.

- **Investigation and Enforcement**
  - The need for a 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 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 (the UK and Canada) and one jurisdiction (Australia) 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.

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\(^3\) In finalising the EU audit reform legislation, the EU decided to create a new body, the CEAOB, which will play a role in establishing colleges of Member State regulators to inspect members of accounting networks. The European Securities and Markets Authority (ESMA) is a non-voting member of the CEAOB and the European Banking Authority and European Insurance and Occupational Pensions Authority attend as observers. These changes will not directly affect EC equivalence but the CEAOB will contribute to the technical assessment of third countries’ public oversight systems carried out by the EC.
1.2. Executive Summary – other considerations (cont’d)

- **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 appears to be declining, with the UK withdrawing it and Australia likely moving towards a user pays model (with the amount of government funding reduced).

**Possible further considerations for the system of audit oversight in Hong Kong**

- The Hong Kong Government has already acknowledged that it may broaden the definition of PIEs in future, which may result in the FRC having a broader scope of independent audit oversight. However, it will do so in a step-by-step approach and only once the new regime has bedded in. Also, the definition will be set out in legislation such that any change in future could only be made by way of an amendment bill.

- While IFIAR can be inferred to refer to covering only PIEs in an established minimum cycle, in the spirit – and with the objective - of ever-improved audit oversight and audit quality and robust capital markets, it could be a consideration to ensure that all auditors are covered at least regularly and in a minimum cycle.

- The FRC could also conduct the inspections of auditors of those companies listed in the EEA and/or of systemically important financial institutions in which IFIAR is also interested.

- While six years is the baseline inspection frequency requirement for EC equivalence, other major jurisdictions typically cover key audit firms much more frequently (as is indeed currently the case in Hong Kong, notably for the Big Four firms).

- Transparency of findings – there is a trend noted towards increasing transparency (beyond annual inspection / work plan reporting) e.g. communicating with Audit Committees on inspection findings.

- While not a gap per se, another feature of the current system is that the FRC is unable to enter into MOUs with IFIAR members. This is because the FRC does not have inspection and enforcement powers – although this is likely to be addressed by the proposed reforms.
2. IFIAR-EC overview and impact of the proposed changes
2.1 IFIAR-EC overview

IFIAR Core Principles for Independent Audit Regulators

IFIAR is the organisation for independent audit regulators. Membership of IFIAR requires subscription to the IFIAR Charter (most recently revised in July 2013 and again in September 2015, with changes resulting from the latter coming into effect from April 2017, other than the transposition provision, in force as set out in section 5.4 of the updated Charter). This requires that members must be independent of the audit profession and engaged in audit regulatory functions in the public interest. The 2015 Charter changes mostly relate to IFIAR’s own governance and notably provide for the creation of a board; IFIAR’s current Advisory Council will be dissolved. Membership requirements have not changed since 2013 (between 2012 and 2013, the wording of the membership requirements was slightly adjusted). Membership of IFIAR does not require implementation of all the IFIAR Core Principles (unchanged since our original study on audit oversight was conducted in 2013), but members are encouraged to work towards their implementation where appropriate in their own jurisdictions, taking account of the risk profile, size and complexity of audit firms in their market. IFIAR considers that the Principles will also assist audit regulators who are not members of IFIAR to develop effective independent audit oversight arrangements. It is recognised that legislative change or other measures by national authorities not in control of the audit regulator may be required to achieve adherence to the Principles.

EC Equivalence Requirements

The EU Statutory Audit Directive 2006/43/EC (‘SAD’), last amended in 2014, applies from 17 June 2016 throughout the EU (and in the additional EEA countries, namely Norway, Liechtenstein and Iceland, as from a later date when formally adopted). The 2014 reforms are intended to strengthen the quality of statutory audit, reinforce the independence of statutory auditors and improve supervision; stricter requirements will apply to the statutory audit of PIEs. A statutory audit is defined as an audit of annual financial statements or consolidated financial statements in so far as: (a) required by EU law; (b) required by national law as regards small undertakings; (c) voluntarily carried out at the request of small undertakings which meets national legal requirements that are equivalent to those. 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 of the SAD). However, if the system of public oversight, quality assurance, investigations and sanctions are deemed to be equivalent by the EC, these requirements may be disapplied. The analyses below include the provisions of the amended SAD (applicable from 17 June 2016) against which the third country regime must be assessed in order to achieve equivalence under Article 46 of the SAD. Note that while the definition of PIE is broader than listed companies in the EU (see section 4.1), third country equivalence relates only to the audits of listed companies (i.e. unchanged since 2013).

References:

4 http://www.ifiar.org/IFIAR/media/Documents/General/Final-Core-Principles.pdf
8 See details here: http://ec.europa.eu/finance/auditing/reform/
2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions

The scope of the two regimes which we compare with the proposed Hong Kong regime is as follows:

- **IFIAR** is concerned with the audit of PIEs. Neither its Charter nor Core Principles define PIEs, but it is understood to align with the definition used by the IAASB and IESBA. This includes listed entities (on any exchange) together with any entities designated by local law or regulation as a PIE or for which law or regulation requires compliance with the same independence framework as a listed entity.

- **EC equivalence** is relevant to the role of a third country auditor; if a third country auditor is subject to an equivalent regime then it is exempt from direct inspection by the relevant EU audit regulator. As the role of third country auditor is only applicable to the audit of a non-EEA company with securities admitted to trading on an EEA regulated market (or, in the case of global depositary receipts (GDRs), the entity whose securities are represented by GDRs admitted to trading on an EEA regulated market), the EC equivalence criteria in effect only apply to such companies and need not, strictly, be applied to other types of PIEs or entities only listed outside the EEA.

<table>
<thead>
<tr>
<th>EC equivalence requirements</th>
<th>IFIAR</th>
<th>Features of proposed Hong Kong audit oversight system for LEAs</th>
<th>Compliance status *</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Quality assurance systems (Article 29 of SAD)</td>
<td>IFIAR Charter: [Members] must be independent of the audit profession, and engaged in audit regulatory functions in the public interest. 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 PIEs.</td>
<td>FRC: It is proposed that the FRC, as Hong Kong’s independent audit oversight body under the proposed new regulatory regime, should be: • responsible for independent oversight of the registration of LEAs • vested with the statutory powers to receive and make decisions on applications for recognising overseas auditors of specific overseas entities which have been approved for listing in Hong Kong • responsible, as now, for conducting independent investigations into relevant irregularities by LEAs • vested with direct disciplinary powers under the new regime To enable the FRC to effectively discharge its inspection functions, the Government proposes providing the FRC with a number of powers, similar to the statutory powers (conferred by s32B and s32D of the Professional Accountants Ordinance (PAO)) with which the HKICPA is equipped under its practice review programme. It proposes that the statutory functions to conduct recurring inspections of LEAs in respect of their listed entity audit engagements should be transferred from the HKICPA to the FRC. The FRC’s inspection programme should follow the relevant statutory procedures with reference to the existing arrangements for HKICPA’s practice review programme (under s32C of the PAO).</td>
<td>EC – yes IFIAR – yes</td>
</tr>
</tbody>
</table>

* Areas where the FRC will still need to put in place regulations / policies / procedures to ensure full compliance with the IFIAR/EC requirements are included in ‘to note’ for each relevant line item.
### 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

<table>
<thead>
<tr>
<th>EC equivalence requirements</th>
<th>IFIAR</th>
<th>Features of proposed Hong Kong audit oversight system for LEAs</th>
<th>Compliance status</th>
</tr>
</thead>
</table>
| 1.2 Quality assurance systems (Article 29 of SAD) | IFIAR Charter: Funding of the regulator is free of undue influence by the audit profession. **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. | **FRC:** it is proposed that the future FRC be funded by way of introducing new levies on (a) listed entities; (b) securities transactions; and (c) LEAs (one-third each).  
- The FRC should be able to sustain its operation without subsidy from general taxpayers  
- The international standard that the funding of independent audit oversight bodies should be free from undue influence by the audit profession does not mean that LEAs cannot be one of the parties to fund the future operation of the FRC under the proposed regime.  
- The Government considers that it would seem appropriate to maintain the flat fee per audit engagement approach for determining the levy on individual LEAs (rather than making it proportionate to their audit fees).  
- To ensure the impartiality of the disciplinary process, it is proposed that any pecuniary penalty paid to or recovered by FRC would be paid by the FRC into the Government general revenue. The Government should not however be a recurrent funding source for the FRC’s operation. | **EC:** yes  
**IFIAR:** yes  
**To note:** the requirement for LEAs to pay a levy would not render the FRC subject to undue influence by the audit profession as the law will clearly stipulate that it is a statutory obligation for LEAs to pay the levy. |
| 1.3 (b) the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms; | **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. | **FRC:** to facilitate the effective performance of the inspection functions by the FRC and with reference to the existing arrangements under the PAO for HKICPA to perform such functions through delegation to its committees, it is proposed that the FRC may delegate such functions and relevant powers to committees formed under its auspices. The FRC will focus on the inspection of LEAs and be unable to delegate this (their listed entity audit engagements). | **EC:** yes  
**IFIAR:** yes  
**To note:**  
- The FRC should ensure that the resourcing and competence of the future FRC inspection division meets the EC and IFIAR requirements around adequate quantity and expertise  
- Its policies and procedures will also need to meet the IFIAR requirement for adequate arrangements for consultation and discussion amongst inspectors |
## 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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<tr>
<th></th>
<th>EC equivalence requirements</th>
<th>IFIAR</th>
<th>Features of proposed Hong Kong audit oversight system for LEAs</th>
<th>Compliance status</th>
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<tbody>
<tr>
<td>1</td>
<td>Quality assurance systems (Article 29 of SAD)</td>
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| 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; | **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. 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. | **FRC**: will have the power to assign quality assurance reviewers to conduct inspections, who would be full-time reviewers with appropriate accounting qualifications and an audit background. | **EC**: yes  
**IFIAR**: yes  
**To note**: The FRC’s policies / procedures will need to ensure that the experience and training of the future FRC inspection division (including the supervision of new inspectors and arrangements for consultation between inspectors) meet the EC and IFIAR requirements. |
| 1.5 | (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;  
(At least the following criteria shall apply to the selection of reviewers:  
(a) reviewers shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;  
(b) a person shall not be allowed to act as a reviewer in a quality assurance review of a statutory auditor or an audit firm until at least three years have elapsed since that person ceased to be a partner or an employee of, or otherwise associated with, that statutory auditor or audit firm;  
(c) reviewers shall declare that there are no conflicts of interest between them and the statutory auditor and the audit firm to be reviewed.) | **IFIAR Principle 6 explanatory material**: Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff.  
**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. | **FRC**: should have the power to set its policies / procedures regarding inspectors which will include relevant training / conflict of interest prohibitions / checks and balances. | **EC**: yes  
**IFIAR**: yes  
**To note**: The FRC’s policies / procedures regarding inspections will need to ensure the appropriate:  
- Independence (incl. cooling off period – three years is required for EC equivalence)  
- Experience and training (as per 1.4 above)  
- Internal FRC quality control and other relevant procedures to ensure quality, consistency and objectivity and avoid any conflicts of interest |
## 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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| 1.6 (f)                   |       | **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. | **FRC:** the Government considers that the scope of FRC inspections will cover the quality control system of LEAs (in respect of their listed entity audit engagements) and those listed entity engagements themselves. In practice, firms have one common system of internal control for all audits – listed entities and others. In conducting inspections to ensure LEAs follow applicable professional standards in performing listed entity audit engagements, the FRC will follow SMO No 1, and may also make reference to other standards followed by IFIAR members where appropriate. To enable the FRC to effectively discharge its inspection functions, the Government proposes to provide it with powers including specifying the particular professional standards in relation to which inspections are to be carried out and issuing directions to require an examination or a review, to determine whether the specified professional standards have been observed, maintained or applied by the LEAs (as per other such powers and similar to the statutory powers set out in the PAO). | **EC:** yes  
**IFIAR:** yes |
| 1.7 (g)                   |       | **IFIAR Principle 11:** 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. | **FRC:** with reference to S32C of the PAO, it is proposed that before making a report to the FRC, a quality assurance reviewer should send the draft report to the LEA concerned and any individual named in the draft, who are entitled to make submissions or representations in writing to the quality assurance reviewer. The FRC may, having regard to the inspection report and any submissions or representations made in respect of the matters raised in the report, then take any one or more of the following actions:  
(a) conclude the inspection with no follow-up action required;  
(b) make recommendations and specific requests to an LEA concerned regarding the application by it of professional standards;  
(c) instruct that another inspection is required; and  
(d) initiate its investigation / disciplinary processes if a suspected auditing / reporting irregularity is identified. | **EC:** yes  
**IFIAR:** yes |

**To note:**  
- The future FRC’s policies and procedures will need to meet the EC and IFIAR requirements relating to review scope and process  
- The focus on LEAs’ quality control systems and relevant professional standards followed appears appropriate  
- For IFIAR, inspections would need to be risk-based and this approach reflected in firm-wide and file inspection procedures  
- For EC, inspectors should also consider the use of the audit firm’s resources and its fees
### 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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<td>Quality assurance systems (Article 29 of SAD)</td>
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| 1.8 (h) quality assurance reviews shall take place on the basis of an analysis of the risk and, in the case of statutory auditors and audit firms carrying out statutory audits as defined in point (a) of point 1 of Article 2 (i.e. an audit of annual financial statements or consolidated financial statements in so far as required by EU law), at least every six years; | 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. No direct equivalent in IFIAR principles regarding mandated frequency. | FRC: should have the power to set its policies / procedures regarding frequency of reviews and the inspection programme. | EC: yes IFIAR: yes

**To note:**
- The future FRC’s policies and procedures will need to ensure that LEAs are reviewed at least every six years (EC) / in an established minimum cycle (IFIAR)
- The inspections programme must be risk-based

| 1.9 (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. | FRC: the Government will make it a statutory requirement on the FRC to publish reports in its own name periodically to inform the public of the performance of its oversight functions (instead of requiring it to publish the periodic reports received from HKICPA as suggested during the 2014 consultation). This will not however cover the FRC’s inspection function, just its oversight functions. Note that the existing FRCO (section 20 (1) (a) states that: As soon as practicable after the end of each financial year of the Council, the Council shall submit to the Secretary a report on the activities of the Council for that financial year. | EC: yes IFIAR: yes

**To note:**
- The future FRC’s policies and procedures will need to ensure that the annual work plans and activity reports / overall inspection results are published annually
## 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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| Quality assurance systems (Article 29 of SAD) | 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. **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 PIEs. 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. **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. | FRC: as set out above, the FRC may, having regard to the inspection report and any submissions or representations made by LEAs in respect of the matters raised in the report, then take any one or more of the following actions:  
(a) conclude the inspection with no follow-up action required;  
(b) make recommendations and specific requests to a LEA concerned regarding the application by it of professional standards;  
(c) instruct that another inspection is required; and  
(d) initiate its investigation / disciplinary processes if a suspected auditing / reporting irregularity is identified.  
Regarding (d), it is proposed that the FRC should be empowered to exercise any one or more of the following disciplinary powers on a person subject to disciplinary action:  
(a) to reprimand him publicly or privately;  
(b) to direct him to carry out remedial actions as specified by FRC;  
(c) to order that his name be removed from the register of LEAs, either permanently or for a period of time as specified by FRC;  
(d) to prohibit him from applying to be registered / approved as a regulated person for such period or until the occurrence of such event as FRC may specify;  
(e) to impose conditions on his registration / approval as a regulated person;  
(f) to order him to pay to FRC the costs and expenses in relation or incidental to the investigation reasonably incurred by FRC; and  
(g) to order him to pay a pecuniary penalty not exceeding the amount which is the greater of $10,000,000; or three times the amount of the profit gained or loss avoided by the LEA as a result of the irregularity. | EC: yes  
IFIAR: yes  
To note: the future FRC’s policies and procedures will need to put in place a mechanism for ensuring that inspection findings are addressed (IFIAR) and within a reasonable period (EC) |
2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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| 1.11 | Quality assurance systems (Article 29 of SAD) | IFIAR Principle 9 explanatory material: 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. | FRC: should have the power to set its policies / procedures regarding the risk assessment process and scope of inspection. | EC: yes
IFIAR: yes
To note: the future FRC’s policies and procedures will need to ensure that inspections undertaken are proportionate to the scale and complexity of the LEAs; also that (for IFIAR) they take into account a risk assessment process. |

| 2 | Systems of investigations and sanctions (Article 30 of SAD) | IFIAR Principle 4 explanatory material: 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. | FRC: the present arrangement as provided in the FRCO for the FRC to be responsible for conducting independent investigations into relevant irregularities by LEAs will be continued under the new regime. However, the FRC may initiate a disciplinary process if a suspected irregularity is identified during the inspection or in handling complaints or referrals from other regulators. See also 1.7 and 1.10 for details of disciplinary powers including pecuniary penalties. The FRC is a body independent of the auditing profession and the HKICPA that currently 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. 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. | EC: yes
IFIAR: yes
To note: although they do not directly apply to EC equivalence, the FRC may wish to have regard to Article 30 a) to f) of the SAD regarding sanctions (relating to sanctioning powers; effective application of sanctions; publication of sanctions and measures; right of appeal; reporting of breaches and exchange of information). |
## 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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<td>2</td>
<td>Systems of investigations and sanctions (Article 30 of SAD)</td>
<td>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 &quot;requirement&quot;. Typically, auditors are required to produce the audit working papers in relation to a listed entity if that audit is being investigated. For enquiries, the FRC exercises powers under section 43 of the FRCO. Upon completion of an enquiry or an investigation, a report is prepared and adopted by the Council of the FRC. The FRC is able to exercise disciplinary powers as set out in 1.10 in respect of auditing or reporting irregularities identified. Any noncompliance 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 noncompliance identified or revise its financial statements to correct such compliance; however it is not empowered to discipline or prosecute listed entities or their directors. The Council of the FRC may decide to publish the entire report or a part of it. A report will not be published if it may adversely affect any criminal proceedings before a court or magistrate; any proceedings before the Market Misconduct Tribunal; or any proceedings under Part V of the PAO. However, upon the completion of these 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.</td>
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<td>2 Systems of investigations and sanctions (Article 30 of SAD)</td>
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<td>2.2</td>
<td>Without prejudice to Member States’ civil liability regimes, Member States shall provide for effective, proportionate and dissuasive sanctions 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 and, where applicable, Regulation (EU) No 537/2014. Member States may decide not to lay down rules for administrative sanctions for infringements which are already subject to national criminal law. In that event, they shall communicate to the Commission the relevant criminal law provisions.</td>
<td>No direct equivalent in IFIAR principles.</td>
<td>FRC: see 1.7 and 1.10 above for details of proposed disciplinary powers including pecuniary penalties.</td>
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<tr>
<td>2.3</td>
<td>Member States shall provide that measures taken and sanctions imposed on statutory auditors and audit firms are to be appropriately disclosed to the public. Sanctions shall include the possibility of the withdrawal of approval. Member States may decide that such disclosure shall not contain personal data within the meaning of point (a) of Article 2 of Directive 95/46/EC.</td>
<td>IFIAR Principle 6 explanatory material: Audit regulators should ensure that appropriate arrangements are in place to protect confidential information from public dissemination.</td>
<td>FRC: the amendment bill will make it clear that a disciplinary decision would be made public only after the expiry of the period allowed for making an application for appeal to the independent appeals tribunal (i.e. 21 days), or if an appeal has been made, be made public only after the appeal has been determined by the independent appeals tribunal. The tribunal will be empowered to obtain evidence, including ordering a person to attend before it to give evidence, and to prohibit the disclosure of evidence it receives at any sitting which is held in private.</td>
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### 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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<td><strong>3</strong> Principles of public oversight (Article 32 of SAD)</td>
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<tr>
<td><strong>3.1 / 3.2</strong> 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, and shall designate a competent authority responsible for such oversight.</td>
<td>IFIAR Principle 1: The responsibilities and powers of audit regulators should serve the public interest and be clearly and objectively stated in legislation. 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.</td>
<td>FRC: a draft amendment bill based on the consultation conclusions will be drawn up, with the aim of introducing the bill to the Legislative Council (the law-making body of the Hong Kong Special Administrative Region) in the 2016-17 legislative session. This will presumably set out the FRC’s new powers and its responsibility for the inspection, investigation and enforcement of LEAs (their listed audit engagements) and oversight responsibility for registration, continuing professional development (CPD) and standard-setting with respect to LEAs (done by HKICPA). At present, the FRC is the statutory authority for investigating into suspected relevant irregularities by LEAs. The nature of such irregularities is clearly defined in the FRCO.</td>
<td><strong>EC</strong>: yes  <strong>IFIAR</strong>: yes  <strong>To note:</strong> The Government’s Amendment Bill will have to clearly set out the FRC’s extended powers and relevant amendments to the PAO, to ensure that the FRC’s powers are clearly and objectively stated in legislation, meet the competent authority requirements (EC) and serve the public interest (IFIAR).</td>
</tr>
<tr>
<td>3.3 2. All statutory auditors and audit firms shall be subject to public oversight.</td>
<td>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.</td>
<td>FRC: see 3.5 below for details of the FRC’s new powers (direct and regarding oversight).</td>
<td><strong>EC</strong>: yes  <strong>IFIAR</strong>: yes  <strong>To note:</strong> - The FRC will have direct responsibility / oversight regarding LEAs so that IFIAR requirement is met - The FRC’s public interest and audit quality mandate/objective should be/remain clear</td>
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### 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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| 3.4 3. The competent authority shall be governed by non-practitioners who are knowledgeable in the areas relevant to statutory audit. They shall be selected in accordance with an independent and transparent nomination procedure. The competent authority may engage practitioners to carry out specific tasks and may also be assisted by experts when this is essential for the proper fulfilment of its tasks. In such instances, both the practitioners and the experts shall not be involved in any decision-making of the competent authority. | IFIAR Charter: [Members] must be independent of the audit 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. | FRC: Governance – proposal for the FRC states that it should comprise not less than seven members appointed by the Chief Executive of the Hong Kong Special Administrative Region (CE), together with the CEO (ex officio member), of which at least two possess knowledge of and experience in the auditing of Hong Kong listed entities. In appointing the remaining members, the CE will continue to consider candidates who either because of their experience in accounting, finance, banking, law, administration or management, or because of their professional or occupational experience, are suitable for such appointment. There is a proposal to change the present requirement of a majority of ‘lay persons’ to a majority of ‘non-practitioners’ (to be defined as a person who is not, and has not during the previous three years been, a CPA (practising) or a partner, director, agent or employee of a practice unit). The Government proposes maintaining the present requirement for the FRC to have a Chairman and a majority of members who are independent of the audit profession. The amendment bill will also provide for the appointment of executive directors by the CE to be members of FRC, and correspondingly make it a statutory requirement that the number of executives in the Council must not exceed the number of non-executive Council members to ensure proper corporate governance. Funding – see 1.2 above; will be split between a) listed entities, b) securities transactions, c) LEAs. | Governance  
EC: no  
IFIAR: yes  

To note:  
- The proposed definition of non-practitioner meets the EC’s three year cooling-off period requirement  
- The revised EC SAD no longer allows a minority of practitioners to be involved in the governance of the public oversight system. This may impact when the FRC seeks equivalence. The passage of time and checking the ‘cooling off’ of former auditors proposed for Council membership mean that the Council is likely to meet this test by the time equivalence could first take effect. However, as the proposed legislation includes no restrictions on future membership, there can be no guarantee that the Council would continue to meet the criteria. In order to satisfy the EC that the Council will always be suitably independent of the profession, we recommend that some mechanism be established to ensure independence  
- For IFIAR this is however fine as, per its Charter, only a majority of the relevant governing body must be non-practitioners (with an appropriate cooling off period for former auditors)  
- The FRC’s policies / procedures regarding inspections will need to ensure the appropriate independence of inspectors. The FRCO already sets out matters relating to the ‘avoidance of conflicts of interest’  

**Funding**  
EC: n/a  
IFIAR: yes (stable source of proposed funding) |
### 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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| **3.5** 4. The competent authority shall have the ultimate responsibility for the oversight of: | a) Registration: | a) HKICPA to manage; FRC to have oversight | **EC**: yes  
**IFIAR**: yes |
| | b) Standard setting (professional ethics/auditing and assurance): | b) HKICPA to issue / specify professional ethics / auditing and assurance standards (these standards are converged with the standards issued by the IESBA and the IAASB); FRC to have oversight | To note:  
- IFIAR Charter requirement is met as the FRC will conduct the inspections of auditors of PIEs (as defined locally i.e. listed companies)  
- EC equivalence requirements are met given the FRC's new oversight of the HKICPA for certain activities and own broadened powers re. others, relating to LEAs (i.e. PIEs as defined locally)  
- Note that the FRC should however be able to reclaim those competencies from the HKICPA re. LEAs (see also below 3.5B) for EC equivalence |
| | c) CPD: | c) HKICPA to manage; FRC to have oversight | |
| | d) Inspection: | d) FRC to conduct (LEAs’ listed entity engagements) | |
| | e) Investigation / enforcement: | e) FRC to conduct re. listed entities / make decisions re. LEAs | |
| | a) the approval and registration of statutory auditors and audit firms; | | |
| | b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing; except where those standards are adopted or approved by other Member State authorities; | | |
| | c) continuing education; | | |
| | d) quality assurance systems; and | | |
| | e) investigative and disciplinary systems. | | |
| | No direct equivalent in IFIAR principles, but note IFIAR Charter, which states that regulators must exercise their responsibility for the system of recurring inspection of audit firms undertaking audits of PIEs either directly or through independent oversight. | | |
## 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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| 3.5A Principles of public oversight (Article 32 of SAD) | **IFIAR Principle 6:** Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements. **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. | See 3.5 above re. planned FRC / HKICPA duties. **FRC:** the FRCO already has sections relating to confidentiality and conflicts of interest. | **EC:** yes  
**IFIAR:** yes  
**To note:**  
- Re. EC equivalence, the FRC will have actual or oversight responsibility for all relevant areas, i.e. will effectively act as the key competent authority re. LEAs  
- See also 3.5B below re. reclaiming delegated responsibilities  
- The FRCO already sets out matters relating to the ‘avoidance of conflicts of interest’ (EC and IFIAR) and the ‘preservation of secrecy’ (IFIAR) |
2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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<td>3.5B</td>
<td>4(b) Member States may delegate or allow the competent authority to delegate any of its tasks to other authorities or bodies designated or otherwise authorised by law to carry out such tasks. The delegation shall specify the delegated tasks and the conditions under which they are to be carried out. The authorities or bodies shall be organised in such a manner that conflicts of interest are avoided. Where the competent authority delegates tasks to other authorities or bodies, it shall be able to reclaim the delegated competences on a case-by-case basis.</td>
<td>No direct equivalent in IFIAR principles but note IFIAR Charter, which states that regulators must exercise their responsibility for the system of recurring inspection of audit firms undertaking audits of PIEs either directly or through independent oversight. See above re. planned FRC / HKICPA duties and delegation.</td>
<td><strong>EC:</strong> yes  <strong>IFIAR:</strong> yes  <strong>To note:</strong>  - For EC equivalence, the FRC should be able to reclaim relevant competencies from the HKICPA re. LEAs (i.e. as regards registration, CPD and standard-setting)  - IFIAR appears fine given the FRC’s new role with regard to inspection of LEAs</td>
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<td><strong>3.6</strong></td>
<td>5. The competent authority shall have the right, where necessary, to initiate and conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action. Where a competent authority engages experts to carry out specific assignments, it shall ensure that there are no conflicts of interest between those experts and the statutory auditor or the audit firm in question. Such experts shall comply with the same requirements as those provided for in point (a) of Article 29(2). The competent authority shall be given the powers necessary to enable it to carry out its tasks and responsibilities under this Directive. <strong>IFIAR Principle 4 explanatory material:</strong> 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.</td>
<td>FRC: may initiate a disciplinary process if a suspected irregularity is identified during the inspection or in handling complaints or referrals from other regulators. The FRC will continue to be responsible for conducting independent investigations into relevant irregularities by LEAs. Disciplinary action may be imposed on a LEA, a person approved to be its audit engagement authorised person and/or a person approved to be its engagement quality control reviewer, if the LEA and/or the person concerned (as the case may be) is proved to have committed an irregularity in relation to an audit engagement. In addition to other actions, the FRC may, having regard to the inspection report and any submissions or representations made in respect of the matters raised in the report, initiate its investigation/disciplinary processes with regard to LEAs and their listed entity engagements if a suspected auditing/reporting irregularity is identified. The FRC would also be required to put in place appropriate arrangements to ensure that its investigative staff would not be involved in the disciplinary process and the determination of disciplinary sanctions.</td>
<td><strong>EC:</strong> yes  <strong>IFIAR:</strong> yes  <strong>To note:</strong>  - The FRC will be able to both initiate and conduct investigations re. LEAs, meeting the EC requirements  - Any experts it engages for specific assignments cannot be conflicted, which should be covered by the existing FRCO section on ‘Avoidance of conflicts of interest’  - For IFIAR, the FRC’s proposed investigative / enforcement powers appear appropriate. Its existing arrangements for managing complaints from third parties should also be appropriate; IFIAR requires that regulators have adequate and appropriate such mechanisms</td>
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</table>
2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

<table>
<thead>
<tr>
<th>EC equivalence requirements</th>
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<th>Features of proposed Hong Kong audit oversight system for LEAs</th>
<th>Compliance status</th>
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</thead>
</table>
| 3.7 6. Principles of public oversight (Article 32 of SAD) | IFIAR Principle 3: Audit regulators should be transparent and accountable. 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. | FRC: It will be a statutory requirement that the FRC publishes reports in its own name periodically to inform the public of the performance of its oversight functions re. registration, CPD and standard-setting (rather than requiring it to publish the periodic reports received from HKICPA). This will not however cover the FRC’s inspection function, just its oversight functions. Note that the existing FRCO section 20 (1) (a) states that: As soon as practicable after the end of each financial year of the Council, the Council shall submit to the Secretary a report on the activities of the Council for that financial year. Appeal to a tribunal • A new independent appeals tribunal will be established for hearing appeals (instead of referring such appeals directly to the court system). This would help reduce the time and cost to be incurred by both the appellant and FRC/the HKICPA Registrar. • Any person who disagrees with a registration decision made by the HKICPA Registrar in respect of him - e.g. a decision to reject a registration application/renewal application or to remove his name from the register or who is aggrieved by a disciplinary decision made in respect of him by FRC - may apply to the proposed new independent appeals tribunal for a review of the decision within 21 days after a notice of the relevant decision has been served upon him. • The independent appeals tribunal shall comprise a chairman, who should be a person qualified for appointment as a judge of the High Court and two members who are not public officers. All of them are to be appointed by the Chief Executive. • In terms of the review proceedings, it is proposed that the independent appeals tribunal: - may confirm, vary, reverse, set aside the relevant decisions or remit the matter to FRC/the HKICPA Registrar with any directions that it may consider appropriate; - will determine any relevant question or issue on the basis of standard of proof applicable to civil proceedings in a court of law; - will give both the applicant and FRC/the HKICPA Registrar an opportunity of being heard in reviewing a decision; and - will be empowered to obtain evidence, including ordering a person to attend before it to give evidence, and to prohibit the disclosure of evidence it receives at any sitting which is held in private. | EC: yes IFIAR: yes  
To note: - The future FRC’s policies and procedures will need to ensure that the annual work plans and activity reports / overall inspection results are published annually. |
### 2.2 Hong Kong - IFIAR-EC gap analysis per the Government’s consultation and related conclusions (cont’d)

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<tr>
<td>3.8 Principles of public oversight (Article 32 of SAD)</td>
<td>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.</td>
<td>See above (1.2 and 3.4)</td>
<td>EC: yes  IFIAR: yes</td>
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<td>3.9 No direct equivalent in SAD</td>
<td>IFIAR Principle 7: Audit regulators should make appropriate arrangements for cooperation with other audit regulators and other third parties.</td>
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<td>Note that the 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. The new Regulation (EU) 537/201</td>
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<td>Note: The EC equivalence requirements</td>
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<td>3.8</td>
<td>7. The system of public oversight shall be adequately funded and shall have adequate resources to initiate and conduct investigations, as referred to in paragraph 5. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms.</td>
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<td>See above (1.2 and 3.4)</td>
<td>EC: yes  IFIAR: yes</td>
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<td>To note:</td>
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<td>An applicant for recognition as an overseas auditor of a specific overseas entity listed in Hong Kong shall apply to FRC for recognition in respect of such engagements. The FRC will take into account the regulatory regime of overseas regulators before entering into an agreement with them.</td>
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<td>The FRC will be vested with the statutory powers to receive and make decisions on applications for recognising overseas auditors of specific overseas entities which have been approved for listing in Hong Kong, noting that it will be best placed to make such decisions in an independent and unbiased manner. Overseas auditors who wish to enter into audit engagements with specific overseas entities approved for listing in Hong Kong shall apply to FRC for recognition in respect of such engagements. The FRC will take into account the regulatory regime of overseas regulators before entering into an agreement with them.</td>
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<td></td>
<td>An applicant for recognition as an overseas auditor of a specific overseas entity listed in Hong Kong must meet the following criteria:</td>
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<td>(a) the auditor is a member of a body of accountants recognised by FRC;</td>
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<td>(b) there is in force an agreement of mutual or reciprocal cooperation arrangement between the overseas regulator of the auditor and FRC; and</td>
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<td></td>
<td>(c) they must demonstrate to the satisfaction of FRC that they have adequate resources and possesses the capability to perform the audit of the relevant overseas entity listed in Hong Kong.</td>
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<td>The FRC will issue guidance notes on what would be taken into account in considering an application for recognition from overseas auditor.</td>
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**To note:**
- The future FRC’s policies / procedures should set out detail on how the FRC will cooperate and share information with other audit regulators (and third parties) going forward (IFIAR).
- There are a number of cooperative MOUs in place with domestic and overseas regulatory authorities. While the FRC cannot currently enter into MOUs with IFIAR members because it does not have inspection and enforcement powers, this is likely to be addressed by the proposed reforms (as they relate to LEAs).
3. Current Hong Kong - IFIAR-EC gap analyses
3.1 Current Hong Kong – IFIAR-EC gap analysis: key gaps

This section 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 updated EU SAD.

Key gaps identified

- In our 2013 study, we concluded that Hong Kong did not meet the requirements for (a) membership of IFIAR or (b) obtaining EC equivalence. There have not been significant changes to Hong Kong’s system of audit oversight since 2013 and we maintain this view.

- Based on the status quo and the detailed analysis set out later in this section, one gap has widened and there is a new gap since 2013 (both in relation to the updated EC equivalence requirements):

  1. **Wider gap: the governance structure of the Hong Kong Institute of Certified Public Accountants (HKICPA)** (item 3.4) - membership of the Council of the HKICPA currently consists of approximately one third (8 out of 22 total non-executives) practising Certified Public Accountants (CPAs). The remaining members are not current practitioners, but a change in the membership of the Council may result in it ceasing to comprise a majority of non-practitioners (as the constitution of the HKICPA Council does not require that the non-practising Council members have not, within the previous three years, carried out statutory audits, held voting rights in an audit firm, been a member of the administrative or management or supervisory body of an audit firm or been employed by, or otherwise associated with, an audit firm). This presents a gap as:

     (a) The EU requirements now stipulate that the competent authority is governed by non-practitioners. Previously, a minority of practitioners were able to be involved in the governance of the public oversight system but this provision has been removed from the updated SAD. The existing EC equivalence gap has therefore widened; and

     (b) IFIAR requires 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. (Note, however, that IFIAR does not prevent the involvement of a minority of practitioners in the governance structure.)

  2. **New gap: the cooling-off period for quality assurance reviewers** (item 1.5) - EC equivalence requires a cooling-off period of three years (from the time the reviewer ceased to be a partner or an employee of, or otherwise associated with, the statutory auditor or audit firm(s) in question). The cooling-off period for HKICPA reviewers is generally two years.

- The other key gaps identified in 2013 are unchanged. These are focused around the following:

  **The 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. While other jurisdictions do impose a levy on professional bodies (for example the UK), the setting of that levy is done by the independent oversight body which has no practicing auditors on its governing board, and therefore is not influenced by the profession.
3.1 Current Hong Kong – IFIAR-EC gap analysis: key gaps (cont’d)

3. The composition of the Practice Review Committee (PRC) (items 3.4 and 3.5A) – the Quality Assurance Department (reviewers are full-time employees of the HKICPA) carries out practice reviews following the PRC’s instructions and in turn reports to the PRC. As the PRC mainly comprises practising members, this creates a gap (EC and IFIAR) in relation to the (perceived) objectivity and independence of the quality assurance programme.

4. The disciplinary mechanism (items 1.10 and 3.6)
   - Other than complaints recommended by the PRC and Investigation Committee, all other complaints 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 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 as a result of its investigations.
   - The appointment of members of Disciplinary Panel B (comprising CPAs) by the HKICPA Council creates a gap as only the HKICPA Council can refer matters to the Disciplinary Panels. This gap is particularly relevant given the EC and IFIAR requirements that the competent authority itself must have the right to initiate and conduct investigations and enforce sanctions (and the sanction of removal of registration has to be within the ultimate responsibility of the independent oversight body).

5. The system of public oversight / competent authority (item 3.5) – EC equivalence requires that the competent authority shall have the ultimate responsibility for the oversight of statutory auditors or audit firms with regard to registration, standard setting (except where adopted or approved by other Member State authorities), continuing education, quality assurance systems 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 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 – and per the 2014 revisions to the SAD, the competent authority also needs to be able to reclaim the delegated competences on a case-by-case basis.

- Finally, and while not a gap per se, another feature of the current system is that both the FRC and HKICPA are currently unable to enter into Memoranda of Understanding (MOU) with IFIAR members. This is because the FRC does not have inspection and enforcement powers and the HKICPA is not independent of the profession. This may be something that Hong Kong wishes to address.
3.2 Current Hong Kong – IFIAR-EC gap analysis: detail

Detailed analysis of Hong Kong’s existing audit oversight system versus the requirements for gaining both regulatory equivalence of the EC and membership of IFIAR

(Where noted * it can be interpreted that if the HKICPA were sufficiently independent - in terms of its overall, and the practice review, governance; the disciplinary mechanism; the funding model - it would be compliant with the requirements.)

<table>
<thead>
<tr>
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<tr>
<td>Quality assurance systems (Article 29 of SAD)</td>
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<tr>
<td>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:</td>
<td>IFIAR Charter: [Members] must be independent of the audit profession, and engaged in audit regulatory functions in the public interest.</td>
<td>The Hong Kong Institute of Certified Public Accountants (HKICPA) is incorporated by the 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. 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. 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 PIES of a higher profile, predominantly listed entities.</td>
<td>Neither EC nor IFIAR. The practice reviews are conducted by the full-time employees of the Quality Assurance Department of the HKICPA following the instructions of the PRC and in turn report the results of practice reviews to the Committee. However, 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 3.5A for details).</td>
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</table>

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 is subject to public oversight. | 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. | |

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## 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

<table>
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<tr>
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<tr>
<td>Quality assurance systems (Article 29 of SAD)</td>
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<td>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 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. 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. For details of the practice review process, refer to 1.5 below.</td>
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<td>1.1</td>
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<td>(b) the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms; IFIAR Charter: Funding of the regulator is free of undue influence by the audit profession. 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.</td>
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<td>1.2</td>
<td>IFIAR</td>
<td>The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and CPD fees.</td>
<td>Neither EC nor IFIAR 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.</td>
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### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td>1. Quality assurance systems (Article 29 of SAD)</td>
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<tr>
<td>1.3 (c) the quality assurance system shall have adequate resources;</td>
<td>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.</td>
<td>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 unit 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.</td>
<td>Yes * The HKICPA has a team of full-time reviewers who conduct the practice reviews.</td>
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<td>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;</td>
<td>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. 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.</td>
<td>All the reviewers of the QAD are qualified accountants with experience in auditing and are required to undergo regular technical training and updates to keep them up to date with professional standards and to enhance their skills in dealing with practices in a fair and sensitive manner. When reviewers newly join the QAD, they will receive specific one-to-one training before commencement of their first practice review and also on the job training by a more senior reviewer.</td>
<td>Yes * All reviewers are qualified CPAs with a background in auditing and regular professional training and updates are required.</td>
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<tr>
<td>1.5 (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; (At least the following criteria shall apply to the selection of reviewers: (a) reviewers shall have appropriate professional education and relevant experience in statutory audit and financial reporting combined with specific training on quality assurance reviews;</td>
<td>IFIAR Principle 6 explanatory material: Audit regulators should have in place prohibitions against conflicts of interest by its governing body and staff. 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.</td>
<td>All the reviewers of the QAD are qualified accountants with experience in auditing. From time to time, reviewers of QAD are provided with regular training, case sharing and updates to ensure they have up-to-date professional knowledge. In general, the reviewers of QAD have a two-year cooling off period whereby they will not perform a review of the audit firm where they were employed by before joining the HKICPA. A longer cooling off period may be applied if considered necessary. Every reviewer of QAD is required to provide a declaration annually to declare that there are no conflicts of interest between them and the audit firms to be reviewed. 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. The practice reviews include the following major processes:</td>
<td>No - EC The cooling off period of the reviewers required by EC is at least three years whilst the cooling off period for the HKICPA practice reviewers is two years in general.</td>
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### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td>1.5</td>
<td>(b) A person shall not be allowed to act as a reviewer in a quality assurance review of a statutory auditor or an audit firm until at least three years have elapsed since that person ceased to be a partner or an employee of, or otherwise associated with, that statutory auditor or audit firm; reviewers shall declare that there are no conflicts of interest between them and the statutory auditor and the audit firm to be reviewed.</td>
<td>The inspection process should be subject to appropriate internal quality control within the audit regulator to ensure high quality and consistency.</td>
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<td>(c)</td>
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<td>(i) Selection of practice for practice review visit 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: a) A firm of (practising) certified public accountants, practising accountancy pursuant to the PAO; b) A (practising) certified public accountant, practising accountancy on its own account pursuant to the PAO; or c) A corporate practice pursuant under the PAO. 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 and other relevant information. Practices with regulated or significant PIE 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 1.8 below.</td>
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<td>(ii) Notification to audit firms 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.</td>
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<td>(iii) Preliminary assessment of submitted key documents 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.</td>
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11 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 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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</table>
| 1.5 Quality assurance systems (Article 29 of SAD) |       | (iv) Scope of review  
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 (HKSOQC 1); and  
(c) assessing compliance with professional standards in the operation of quality control procedures and the conduct of audit work.  
The details 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:  
(a) interviewing different levels of personnel to assess the practice’s culture and commitment to quality;  
(b) reviewing the documented quality control procedures and checking how they are applied in practice;  
(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;  
(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;  
(e) communication of findings from the practice review to the practice; and  
(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.  
Opening and exit meetings will be held among the practice review reviewers and the representatives of the practice. |
3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<tr>
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<tr>
<td>Quality assurance systems (Article 29 of SAD)</td>
<td>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.</td>
<td>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. 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. 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. 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 PIEs 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.</td>
<td>Yes * 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 performed. The practice reviews are conducted on a risk-based approach.</td>
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### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| Quality assurance systems (Article 29 of SAD) | **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. | 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:  
(a) conclude a practice review with no follow-up action required;  
(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;  
(c) instruct that another visit is required; or  
(d) make a complaint to initiate a disciplinary action.  
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. | Yes *  
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. |

1. Quality assurance systems (Article 29 of SAD)

(g) the quality assurance review shall be the subject of a report which shall contain the main conclusions of the quality assurance review;
### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<tr>
<td>1.8</td>
<td>(h)</td>
<td>quality assurance reviews shall take place on the basis of an analysis of the risk and, in the case of statutory auditors and audit firms carrying out statutory audits as defined in point (a) of point 1 of Article 2 (i.e. an audit of annual financial statements or consolidated financial statements in so far as required by EU law), at least every six years;</td>
<td>No direct equivalent in IFIAR principles regarding mandated frequency. If the IFIAR scope only relates to PIEs, which can be inferred, there is not in fact a gap.</td>
</tr>
</tbody>
</table>

#### 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. No direct equivalent in IFIAR principles regarding mandated frequency.

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.

The frequency of review varies from different practices:

1. **Big Four firms** – subject to practice review annually. It recognises the predominance of listed and other PIEs in Big Four client portfolios.
2. **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.
3. **Other practices with listed clients** – subject to review at least once every three years.
4. **Other practices** – the frequency of review is based on risk profiles and random selection.

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.

The details and extent of review work to be carried out varies from practice to practice depending on the size and complexity of the practice units and their client base.
### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td><strong>1</strong> Quality assurance systems (Article 29 of SAD)</td>
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<tr>
<td><strong>1.9</strong> (i) the overall results of the quality assurance system shall be published annually; and</td>
<td>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.</td>
<td>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. The common issues found under the practice review programme are also communicated through the following channels: - Forums hosted by the QAD which go through the quality assurance annual report and discuss common issues identified from the practice review. - Key findings identified from reviews of practices with listed clients are reported in the HKICPA Financial and Auditing Alert. - 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. In addition, the HKICPA’s activities are made public in HKICPA’s monthly newsletter, technical update, monthly magazine and annual report.</td>
<td>Yes * The activities and outcomes of the HKICPA practice reviews are published annually on its website and common issues are communicated via other public channels.</td>
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<td><strong>1.10</strong> (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.</td>
<td>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.</td>
<td>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. 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: (a) conclude a practice review with no follow-up action required; (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; (c) instruct that another visit is required; or (d) make a complaint to initiate a disciplinary action.</td>
<td>Neither EC nor IFIAR 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. 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).</td>
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### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| Quality assurance systems (Article 29 of SAD) | 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. **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. | 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. Section 33 of the PAO requires the setup of two Disciplinary Panels:  
- **Disciplinary Panel A** 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.  
- **Disciplinary Panel 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.  
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:  
- one person appointed by the Disciplinary Committee Convenor from Disciplinary Panel A to be the chairman of the Disciplinary Committee;  
- two persons appointed by the Disciplinary Committee Convenor from Disciplinary Panel A; and  
- two persons from Disciplinary Panel B of whom one is the holder of a practising certificate.  
The Disciplinary Committee Convenor shall not be appointed as a member of a Disciplinary Committee.  
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. | The EC/IFIAR requirements state that the disciplinary mechanism must have independent oversight. Article 32(5) of the amended EC Directive 2006/43/EC requires that the competent authority shall have the right, where necessary, to initiate and 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.  
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 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. |
3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| 1                           | Quality assurance systems (Article 29 of SAD) | 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. 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:  
  • 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;  
  • an order that the certified public accountant be reprimanded;  
  • an order that the certified public accountant pay a penalty not exceeding HK$500,000 to the HKICPA;  
  • an order that the certified public accountant pay the costs and expenses of proceedings;  
  • an order that the practising certificate issued to the certified public accountant be cancelled; and  
  • 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.  

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. | 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). It is a matter of judgement as to whether these sanctions 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. |
### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td><strong>Quality assurance systems (Article 29 of SAD)</strong></td>
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<td>1.11 (k) quality assurance reviews shall be appropriate and proportionate in view of the scale and complexity of the activity of the reviewed statutory auditor or audit firm. (Member States shall require competent authorities, when undertaking quality assurance reviews of the statutory audits of annual or consolidated financial statements of medium-sized and small undertakings, to take account of the fact that the auditing standards adopted in accordance with Article 26 are designed to be applied in a manner that is proportionate to the scale and complexity of the business of the audited entity.)</td>
<td><strong>IFIAR Principle 9 explanatory material:</strong> 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.</td>
<td>See 1.8.</td>
<td>See 1.8.</td>
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| **Systems of investigations and sanctions (Article 30 of SAD)** |       |                                                     |                                                               |
| 2.1 1. Member States shall ensure that there are effective systems of investigations and sanctions to detect, correct and prevent inadequate execution of the statutory audit. | **IFIAR Principle 4 explanatory material:** 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. | **Investigations and enquiries by the FRC**<br>**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.**<br>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. | Yes *<br>The FRC and HKICPA have established effective systems of investigations of audit practices.<br>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. |

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12 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 listed entity auditors was seen as an important step in addressing the problem.
3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<tr>
<td>2 Systems of investigations and sanctions (Article 30 of SAD)</td>
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<td>Investigation of potential &quot;relevant irregularities&quot; may be initiated if the FRC believes that there are &quot;circumstances suggesting&quot; or &quot;reasonable cause to believe&quot; 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. The FRRC is responsible for looking into non-compliance with accounting requirements by listed entities only. According to Sections 25 to 28 of the FRCO, the AIB may compel any party it considers has relevant information to cooperate with its investigations by issuing a &quot;requirement&quot;. Typically, auditors are required to produce the audit working papers in relation to a listed entity if that audit is being investigated. Upon completion of an enquiry or an investigation, a report is prepared and adopted by the Council of the FRC. 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 noncompliance identified or revise its financial statements to correct such compliance; however it is not empowered to discipline or prosecute. The Council of the FRC may decide to publish the entire report or a part of it. A report will not be published if it may adversely affect any criminal proceedings before a court or magistrate; any proceedings before the Market Miscondunt Tribunal; or any proceedings under Part V of the PAO. However, upon the completion of these 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. 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 enquiry of possible non-compliance with accounting requirements outside this scope continues to be undertaken by the HKICPA under the PAO. 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.</td>
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<td>Investigations into misconduct of members or member practices by the HKICPA</td>
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<td>2.1</td>
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<td>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:</td>
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<td>• Investigation Panel A 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;</td>
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<td>• Investigation Panel B 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.</td>
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<td>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.</td>
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<td>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.</td>
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<td>The investigation process is as follows:</td>
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<td>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 practicing certificate) from Investigation Panel B, which comprises no fewer than 12 members of the Institute appointed by the Council.</td>
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<td>2. The Investigation Committee conducts its investigation and reports to the Council.</td>
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13 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.
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<td>2 Systems of investigations and sanctions (Article 30 of SAD)</td>
<td>2.1</td>
<td>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. For power and types of disciplinary actions imposed on HKICPA members or member practices, please refer to 1.10 above.</td>
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<tr>
<td>2.2 Without prejudice to Member States’ civil liability regimes, Member States shall provide for effective, proportionate and dissuasive sanctions 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 and, where applicable, Regulation (EU) No 537/2014. Member States may decide not to lay down rules for administrative sanctions for infringements which are already subject to national criminal law. In that event, they shall communicate to the Commission the relevant criminal law provisions.</td>
<td>No direct equivalent in IFIAR principles</td>
<td>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. 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 1.10 above.</td>
<td>Yes * 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 1.10 for details. The form of penalties taken will be assessed dependent on the gravity of violations or deficiencies.</td>
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### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| 2                           | Systems of investigations and sanctions (Article 30 of SAD) | Disciplinary actions against the audit firms and individual practising CPAs are publicised in HKICPA journal – “APLUS” which is also available on the HKICPA website; press release and also HKSAR Gazette (removal order only). The disclosure is limited to the name and membership number of relevant practice unit/individual CPA as well as the key disciplinary matters and actions taken by the HKICPA. Disciplinary hearings are also open to the public. The HKICPA has the privacy policy to meet the requirements of Personal Data (Privacy) Ordinance, Cap 486 in Hong Kong in respect of collection, retention, storage and sharing of personal data. As defined in the Ordinance, “personal data” used throughout HKICPA’s policy is any data that:
(a) relating directly or indirectly to a living individual;
(b) from which it is practicable for the identity of the individual to be directly or indirectly ascertained; and
(c) in a form in which access to or processing of the data is practicable. The HKICPA is not allowed to transfer or disclose personal information to any third party unless prior consent is obtained from relevant individuals, or as required by law, or in the circumstances described in part VIII of the Ordinance in which the concerned personal data are exempt from the provisions of data protection principle 3 of the Ordinance. The range of disciplinary actions is set out in Section 35 of the PAO. Please refer to 1.10 above for details. | Yes * Disciplinary actions imposed on the practices and the practising CPAs are disclosed to the public. There are appropriate arrangements in place to protect confidential information from public dissemination. |
## 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| 3.1 | 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. | 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. The HKICPA's duties on public oversight of auditors are as follows:  
  - registering accountants and issuing practising certificates to professional accountants who have satisfied the professional qualification requirements under the PAO;  
  - setting codes of ethics and standards of accounting and auditing;  
  - regulating the quality of entry to the profession through its qualification programme and related courses;  
  - providing continuing education and other services to members;  
  - conducting audit quality reviews (or practice reviews);  
  - oversight of remedial action taken by audit firms for deficiencies identified during audit quality reviews;  
  - conducting investigation and remedial/ disciplinary actions for complaints against or misconduct of its members; and  
  - promoting the accountancy profession both in Hong Kong and overseas.  

Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA. | Yes *  
The responsibilities and powers of the HKICPA are clearly set out in the PAO. |
| 3.2 | 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, and shall designate a competent authority responsible for such oversight. | **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. | The PAO provides the statutory power to the HKICPA to exercise its authorities and duties for audit oversight. Specifically,  
  - Sections 7 and 8 of the PAO sets out the objects and the powers of the HKICPA.  
  - 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.  
  - Sections 32A to 321 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. | Neither EC nor IFIAR, in terms of the funding model and the governance structure of the HKICPA. See 3.4 and 3.8. |
### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<tr>
<td>3.2 Principles of public oversight (Article 32 of SAD)</td>
<td>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.</td>
<td>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.</td>
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3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td>3 Principles of public oversight (Article 32 of SAD)</td>
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<td>- Eight – all inspection by professional bodies under independent oversight body supervision. However, under the EU Statutory Audit Regulation, competent authorities may no longer delegate quality assurance/inspections of auditors of PIEs to other bodies (Article 24.1) so by 17 June 2016, at least for PIEs, all Member States should be in the first category mentioned above i.e. ‘inspection by independent oversight body’.</td>
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3.3 The competent authority shall be governed by non-practitioners who are knowledgeable in the areas relevant to statutory audit. They shall be selected in accordance with an independent and transparent nomination procedure.

The competent authority may engage practitioners to carry out specific tasks and may also be assisted by experts when this is essential for the proper fulfilment of its tasks. In such instances, both the practitioners and the experts shall not be involved in any decision-making of the competent authority.

**IFIAR Charter:** [Members] must be independent of the audit 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.

**Governing structure of the HKICPA**

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.

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:

- 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.
- Two certified public accountants co-opted by the Council to round out skills.
- Two ex-officio member from HKSAR Government.
- Four lay members who are prominent business leaders appointed by the HKSAR Government to provide independent views and advice.

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.

**Funding source**

The funding of HKICPA is sourced from the subscription fees from members and students, registration fees and income from examination and CPD fees. Regarding the funding source of the FRC, please refer to 3.8 below.

Neither EC nor IFIAR.

**Governing structure of the HKICPA:** EC Directive 2014/56/EC defines ‘non-practitioner’ as follows: “any natural person who, during his or her involvement in the governance of the public oversight system and during the period of three years immediately preceding that involvement, 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 or supervisory body of an audit firm and has not been employed by, or otherwise associated with, an audit firm.”

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).
## 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td><strong>3.4</strong> Principles of public oversight (Article 32 of SAD)</td>
<td><strong>IFIAR Principle 5</strong>: 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.</td>
<td>Inspection staff member: 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. Practice Review Committee (PRC): 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. The HKICPA may set up specific task force or working groups and invite practitioners to provide professional views. For instance, the HKICPA’s quality assurance programme is supported by the Professional Standards Monitoring Expert Panel (“Expert Panel”). It is an advisory panel that gives advice to the QAD on the appropriate course of actions on significant, complex or controversial issues, including views on the appropriateness of the application of professional standards by the listed companies, formulation of enquiry letters and determination of appropriate follow-up actions and conclusions. Members of the Expert Panel are drawn from the Big Four and medium-sized practising firms, a representative from Hong Kong Exchanges and Clearing Limited and two non-practising members. All decision making of the task force/working groups rest with the HKICPA.</td>
<td>Further, whilst 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 also upset the requirement. 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 members must be independent of the profession. This gap is particularly relevant given: (a) the EC requirement that the system of public oversight shall be 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 exercise of its functions and powers, including not being controlled in its governance by audit practitioners.</td>
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### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| 3.4 Principles of public oversight (Article 32 of SAD) |       | **Composition of the Practice Review Committee:** 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.  
**Source of funding of HKICPA:** 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. |
3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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| 3.5 Principles of public oversight (Article 32 of SAD) | 4. The competent authority shall have the ultimate responsibility for the oversight of: | See 3.1 above for duties of the HKICPA. See 2.1 above for FRC’s investigation responsibilities. | No – EC  
The relevant responsibilities of the HKICPA are set out in the PAO and the FRC’s investigation power is set out in the FRCO. 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.  
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. |
# 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td>3.5A 4(a) Member States shall designate one or more competent authorities to carry out the tasks provided for in this Directive.</td>
<td><strong>IFIAR Principle 6:</strong> Audit regulators should be objective, free from conflicts of interest, and maintain appropriate confidentiality arrangements. <strong>IFIAR Principle 6 explanatory material:</strong> 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.</td>
<td>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. 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. 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.</td>
<td>Neither EC nor IFIAR 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.</td>
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<td><strong>3.5B</strong> Principles of public oversight (Article 32 of SAD)</td>
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<td>4(b) Member States may delegate or allow the competent authority to delegate any of its tasks to other authorities or bodies designated or otherwise authorised by law to carry out such tasks. The delegation shall specify the delegated tasks and the conditions under which they are to be carried out. The authorities or bodies shall be organised in such a manner that conflicts of interest are avoided. Where the competent authority delegates tasks to other authorities or bodies, it shall be able to reclaim the delegated competences on a case-by-case basis.</td>
<td>No direct equivalent in IFIAR principles but note IFIAR Charter, which states that regulators must exercise their responsibility for the system of recurring inspection of audit firms undertaking audits of PIEs either directly or through independent oversight.</td>
<td>The HKICPA is the only statutory licensing body of accountants in Hong Kong responsible for registration, professional development and regulation of the accountancy profession including in respect of quality assurance reviews, investigations and disciplinary matters of the HKICPA members and member practices.</td>
<td>No - EC Gap is identified in respect of the audit oversight system in Hong Kong. See 3.4 and 3.8.</td>
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<td><strong>3.6</strong></td>
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<td>5. The competent authority shall have the right, where necessary, to initiate and conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action. Where a competent authority engages experts to carry out specific assignments, it shall ensure that there are no conflicts of interest between those experts and the statutory auditor or the audit firm in question. Such experts shall comply with the same requirements as those provided for in point (a) of Article 29(2). The competent authority shall be given the powers necessary to enable it to carry out its tasks and responsibilities under this Directive.</td>
<td>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.</td>
<td>The HKICPA is empowered under the PAD 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. 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 enquires power of the FRC are set out in the FRCO. For details, refer to 2.1 above.</td>
<td>Neither EC nor IFIAR The investigation responsibilities are taken up by both the HKICPA and the FRC. The mechanism of complaints and system of investigations and penalties are established. However the PCC is mainly composed of practising CPAs and it 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. The PCC’s role presents 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.</td>
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<td>3.6 Principles of public oversight (Article 32 of SAD)</td>
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<td>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 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. The complaints against HKICPA members, member practices and registered students are dealt with by the HKICPA’s PCC, supported by the HKICPA’s compliance department. The PCC comprises both certified public accountants and lay members. 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 as explained above. The HKICPA’s investigation process of complaints is as follows: 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. 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: 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; b. issue formal letters of disapproval (Disapproval Letters) to adjudicate minor complaints; or c. Refer more serious complaints to the HKICPA Council for its consideration of whether to refer the matter to the Disciplinary Panels. 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. 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.</td>
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<td>3.6 Principles of public oversight (Article 32 of SAD)</td>
<td>IFIAR Principle 3: Audit regulators should be transparent and accountable. <strong>IFIAR Principle 3 explanatory material:</strong> 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.</td>
<td>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. 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 1.10 above.</td>
<td>Yes * The activities and outcome of the HKICPA practice reviews are annually published on its website and common issues are communicated via other public channels.</td>
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<td>3.7 The system of public oversight shall be adequately funded and shall have adequate resources to initiate and conduct investigations, as referred to in paragraph 5. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms. <strong>IFIAR Principle 2 explanatory material:</strong> 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.</td>
<td>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. The common issues found under the practice review programme were also communicated through various channels. For details, please refer to 1.10 above. 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.</td>
<td>Neither EC nor IFIAR 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.</td>
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| 3.8 The system of public oversight shall be adequately funded and shall have adequate resources to initiate and conduct investigations, as referred to in paragraph 5. The funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms. **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. | The funding of HKICPA is sourced from the subscription fees from members and students, registration fees, and income from examination and CPD fees. 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 an MOU under which they have agreed to contribute as follows:  - HK$5 million each (a one-off total of HK$20 million) to establish a Reserve Fund;  - HK$4 million each (a total of HK$16 million) for recurring expenses of the PRC in 2010;  - Contributions for the recurring expenses will be adjusted for inflation from 2011 to 2014. | Yes * The activities and outcome of the HKICPA practice reviews are annually published on its website and common issues are communicated via other public channels.
### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

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<td><strong>3.9 No direct equivalent in SAD</strong></td>
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<td>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. The new Regulation (EU) 537/2013 on specific requirements regarding statutory audit of public-interest entities organizes cooperation between EEA competent authorities through the CEAOB. The tasks of the CEAOB include contributing to the technical assessment of public oversight systems of third countries and to the international cooperation between Member States and third countries in that area, as referred to in Articles 46(2) and 47(3) of SAD. 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 prerequisite for equivalence.</td>
<td>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. 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.</td>
<td>Cooperation with domestic regulatory authorities There is an 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. 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. 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. 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 the 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. 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. 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. 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. 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. Yes * The relevant EC equivalence requirement does not apply to Hong Kong as a non-EEA regulator/third country auditor. There are a number of cooperative MOUs in place with domestic and overseas regulatory authorities. However, the FRC cannot enter into MOUs with IFIAR members because it does not have inspection and enforcement powers and HKICPA cannot sign MOUs with IFIAR members because it is not independent of the profession.</td>
<td></td>
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</tbody>
</table>
### 3.2 Current Hong Kong – IFIAR-EC gap analysis: detail (cont’d)

<table>
<thead>
<tr>
<th>EC equivalence requirements</th>
<th>IFIAR</th>
<th>Features of existing Hong Kong audit oversight system</th>
<th>Is the existing HK system compliant with the EC/IFIAR requirements?</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 Principles of public oversight (Article 32 of SAD)</td>
<td></td>
<td>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. 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.</td>
<td></td>
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</tbody>
</table>
4. Possible approaches to audit oversight
4. Possible approaches to audit oversight

Analysis of possible approaches

This section includes several key decisions relevant to the system of audit oversight. In each case, each of the options presented would at least meet the relevant IFIAR Core 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 and the AR. 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 below.
### 4.1 Possible approaches to audit oversight - spotlight on PIE definitions

<table>
<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
</tr>
</thead>
</table>
| **Is there a definition of PIE?** | Yes, *All statutory audits (whether of listed or unlisted companies) are subject to independent oversight (Article 32(2) of SAD).* | Yes. However, all audits are subject to independent oversight, whether of PIEs or not. | No. However, auditor oversight legislation (Sarbanes-Oxley Act (SOX), Dodd-Frank Act) requires that the PCAOB oversees the audits of issuers and nonissuer brokers and dealers registered with the SEC (broker-dealers). | Yes. PIEs are defined as (i) a Listed Entity; and (ii) an entity (a) defined by regulation or legislation as a PIE 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. | Yes. The 2015 revised ACRA Code defines PIEs as:  
  a) All listed entities;  
  b) Entity incorporated in Singapore with securities listed on an overseas exchange;  
  c) Entity in the process of issuing its debt or equity on Singapore exchange;  
  d) Financial Institutions; and  
  e) Large charities and large Institutions of Public Character (IPC) (Charities with gross annual receipts in each financial year of not less than $10 million in the two financial years immediately preceding the current financial year of the charity). |
| Updated 2014 SAD definition of PIE (Article 2 (13) of SAD): (a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC; (b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council, other than those referred to in Article 2 of that Directive; (c) insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC; or (d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees. | PIEs include 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. See 8.2.1. | Notable changes as of 17 June 2016 include the addition of all insurance providers and unlisted banks also become PIEs. Source: Statutory Auditors (Transparency) Instrument 2008 issued by the Professional Oversight Board of the UK FRC and the forthcoming Statutory Auditors and Third Country Auditors Regulations 2016 (under powers conferred by the Companies Act 2006). | Source: International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants para 290.25. Reaffirmed in CPA Canada (Chartered Professional Accountants Canada) Exposure Draft on Independence. | Source: ACRA Revised Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities | | | | | | | |
## 4.1 Possible approaches to audit oversight (cont'd)

### 4.1 Focus area: scope of regulation

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public interest listed companies only:</strong> The HK FRC's stated remit is in respect of those companies listed in Hong Kong that meet certain public interest criteria. <em>NB: EC equivalence only requires regulation of auditors of companies with securities (debt and equity) admitted to trading on an EEA regulated market – it does not matter whether auditors of domestically listed companies or other companies are regulated.</em></td>
<td>EC equivalence</td>
<td>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.</td>
<td>Does not cover entities with listed debt, unlisted financial institutions 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 and have a potential systemic impact on the economy.</td>
</tr>
<tr>
<td><strong>All listed companies, all public interest companies:</strong> The UK goes even further, applying UK FRC regulation to large private companies, charities and pension funds. In the US, the PCAOB also oversees the auditors of broker-dealers.</td>
<td>EU, UK, US, SG, AU, CA</td>
<td>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 could 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.</td>
<td>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 PIEs.</td>
</tr>
<tr>
<td>‘Public interest’ companies only: 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.</td>
<td>IFIAR (doesn’t define)</td>
<td>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.</td>
<td>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.</td>
</tr>
</tbody>
</table>
4.2 Possible approaches to audit 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.

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Regulation of firm only:</strong> 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.</td>
<td>IFIAR</td>
<td>Simplicity.</td>
<td>Inability to directly discipline individuals and/or prevent individuals who caused sanction of one firm from moving to another firm.</td>
</tr>
<tr>
<td><strong>Regulation focusing on firms with limited regulation of individuals:</strong> Registration as a third country auditor with the EC requires information about some or all partners within the firm.</td>
<td>EC equivalence, US</td>
<td>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 (in the US, the State Boards of Accountancy) remain responsible for assessing qualification.</td>
<td>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.</td>
</tr>
<tr>
<td><strong>Regulation of firms and individuals:</strong> 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). Australian registration focuses on individuals.</td>
<td>EU, UK, CA, AU, SG</td>
<td>Ability to regulate at a granular level. Direct ability to sanction individuals.</td>
<td>Cost and complexity.</td>
</tr>
</tbody>
</table>
4.3 Possible approaches to audit 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)

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14 Per the revised SAD, Article 2 re. definitions, a ‘third-country audit entity’ means an entity, regardless of its legal form, which carries out audits of the annual or consolidated financial statements of a company incorporated in a third country, other than an entity which is registered as an audit firm in any Member State as a consequence of approval in accordance with Article 3; and a ‘third-country auditor’ means a natural person who carries out audits of the annual or consolidated financial statements of a company incorporated in a third country, other than a person who is registered as a statutory auditor in any Member State as a consequence of approval in accordance with Articles 3 and 44.
### 4.3 Possible approaches to audit oversight (cont'd)

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

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation of overseas auditors in all cases</td>
<td>US</td>
<td>Greatest ability to supervise overseas auditors of public interest listed companies. Note however that the PCAOB does have a cooperative framework that allows it to rely, to a degree deemed appropriate by the Board and on a sliding scale, on work performed by home-country regulators (the more independent and rigorous a home-country system of oversight, the more the Board may rely upon it).</td>
<td>Cost and complexity of regulating all overseas auditors.</td>
</tr>
<tr>
<td>Regulation of overseas auditors unless there is an equivalent audit regime: 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.</td>
<td>EC equivalence, EU, UK, CA</td>
<td>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.</td>
<td>Reliance on an overseas regulator who may have different standards for disciplinary action and sanctions.</td>
</tr>
<tr>
<td>No regulation of overseas auditors: IFIAR only deals with regulation of audits that are in scope; it does not mandate scope. (Note change to AU’s mutual recognition agreement with New Zealand, whereby New Zealand-registered auditors can only conduct registered company audits in Australia after registering with ASIC.)</td>
<td>IFIAR, AU, SG</td>
<td>Simplicity.</td>
<td>Lack of protection of the public interest where there are significant inbound listings of entities incorporated in other jurisdictions.</td>
</tr>
</tbody>
</table>

EC equivalence is about the audit of entities listed in the EEA – it does not matter whether the HK FRC regulates non-HK auditors of HK listed entities.

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

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation of all component auditors</td>
<td>N/A</td>
<td>Greatest ability to inspect and discipline.</td>
<td>Cost and complexity. Overly complex when ISA 600 requires group auditor to take sole responsibility for audit.</td>
</tr>
<tr>
<td>Regulation of component auditors unless parent auditor can enforce co-operation</td>
<td>EU (partly), US</td>
<td>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.</td>
<td>Cost and complexity. Overly complex when ISA 600 requires group auditor to take sole responsibility for audit.</td>
</tr>
<tr>
<td>No regulation of component auditors</td>
<td>IFIAR, EC equivalence, UK, CA, AU, SG</td>
<td>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.</td>
<td>Legal bars to co-operation (e.g. inability to obtain access to component auditors’ working papers due to professional secrecy laws) may reduce effectiveness.</td>
</tr>
</tbody>
</table>
4.4 Possible approaches to audit 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.

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
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</thead>
<tbody>
<tr>
<td><strong>Regime as a whole:</strong> This is the minimum requirement for both EU auditors and EC equivalence as well as IFIAR membership.</td>
<td>IFIAR, EU, EC equivalence, SG</td>
<td>Stakeholders have an overview of the quality of the audit regime in the jurisdiction.</td>
<td>Audit committees and shareholders have no insight into the quality of individual audit firms.</td>
</tr>
<tr>
<td><strong>Firm-by-firm reporting:</strong> UK publishes a report on each of the larger firms, plus a combined report on smaller firms that carry out the audits of PIES. The 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 ASIC can issue deficiency reports if auditors are not deemed to have taken appropriate action to remedy previous inspection findings (not yet done).</td>
<td>UK, US, CA (in part), AU (provision exists)</td>
<td>Audit committees and shareholders have insight into the quality of individual audit firms. Publication of weaknesses (either at end of inspection – UK; if unresolved – US (in relation to Part II quality control deficiencies) / Canada) acts as a deterrent.</td>
<td>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.</td>
</tr>
<tr>
<td><strong>Audit by audit reporting:</strong> UK provides private reports on individual audits to audit committees and audit committees are encouraged to discuss in annual reports. In Canada, a new CPAB Protocol (introduced in 2014) requires participating audit firms, who voluntarily opt in, to share a copy of CPAB’s public reports on inspections with their clients’ audit committees as well as any file-specific significant inspection findings.</td>
<td>UK, CA (optional – opt-in approach)</td>
<td>Audit committees and investors have insight into the performance of individual audits to help inform their own assessment. Public discussion of weaknesses acts as a deterrent.</td>
<td>Cost and complexity. Inappropriate conclusions (positive or negative) can be drawn from one-off issues. Infrequent reviews of individual audits means past history may not reflect current performance.</td>
</tr>
</tbody>
</table>
4.5 Possible approaches to audit 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 UK 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 (but this will no longer be feasible for PIEs as of June 2016). The degree to which inspection can be delegated will affect resourcing and the time taken to implement any reforms.

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<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>No delegation of inspection</strong> (or delegation only to overseas inspectors who do not in turn delegate)</td>
<td>US, AU, EU (for PIEs, competent authorities can contract experts for carrying out specific inspections / be assisted by experts where essential - but such experts shall not be involved in the governance of, or employed or otherwise contracted by, professional associations and bodies)</td>
<td>Highest perception of independence and rigour. Lowest likelihood of conflicts of interest.</td>
<td>Resourcing can be a challenge, particularly where there are peaks and troughs in the inspection cycle.</td>
</tr>
<tr>
<td><strong>Delegation by type of audit:</strong> e.g. UK and Singapore delegate inspections of non-PIE audits to professional bodies, but without the participation of firms. IFIAR Principles suggest no delegation of public interest audit inspection.</td>
<td>IFIAR, UK, CA, SG</td>
<td>Independence as well as rigour, but quicker to implement than no delegation.</td>
<td>Perceived lower quality and/or independence of delegated inspections.</td>
</tr>
<tr>
<td><strong>Delegation of some portions of inspections</strong></td>
<td>EC equivalence</td>
<td>Cost-effective. Ability to manage changes in demand over the annual inspection cycle.</td>
<td>Perceived lack of rigour and independence. Increased risk of conflicts of interest.</td>
</tr>
</tbody>
</table>
### 4.6 Possible approaches to audit oversight

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

<table>
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<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Separate panel or tribunal</td>
<td>UK (currently UK FRC but separate Conduct Committee and Disciplinary Tribunal; see also below), SG (Public Accountants Oversight Committee (PAOC) appoints a Complaints and Disciplinary panel, but is ultimately under ACRA).</td>
<td>Less susceptible to judicial review / appeal.</td>
<td>Can take longer to resolve.</td>
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<td></td>
<td>Independence is both inherent and perceived.</td>
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<td></td>
<td>Concept of ‘natural justice’ – the regulator is not both the prosecutor and the jury.</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulator itself</td>
<td>CA (CPAB), US (PCAOB).</td>
<td>Simple to administer and possibly lower cost.</td>
<td>Although it may well actually be equally independent, there is not the same level of perceived independence.</td>
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<tr>
<td></td>
<td></td>
<td>Potentially speedier.</td>
<td>Greater possibility of appeal / judicial review.</td>
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</tr>
<tr>
<td>Combination</td>
<td>UK (forthcoming; note ongoing UK FRC consultation)</td>
<td>As for separate panel/tribunal but allows for early resolution of agreed cases without convening a tribunal.</td>
<td>Complexity of rules.</td>
</tr>
<tr>
<td></td>
<td>AU (ASIC either pursues an enforceable undertaking or refers the matter to the CALDB. CALDB is the recognised disciplinary body, but much enforcement activity against auditors has recently been led by ASIC itself).</td>
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</tbody>
</table>

**EC equivalence**: the competent authority shall have the right, where necessary, to initiate and conduct investigations in relation to statutory auditors and audit firms (as defined in Article 45 ‘Third Country Auditors or Audit Firms’⁴⁵ - 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 (2014 revision)**: Member States may delegate or allow the competent authority to delegate any of its tasks to other authorities or bodies designated or otherwise authorised by law to carry out such tasks. The delegation shall specify the delegated tasks and the conditions under which they are to be carried out. The authorities or bodies shall be organised in such a manner that conflicts of interest are avoided. Where the competent authority delegates tasks to other authorities or bodies, it shall be able to reclaim the delegated competences on a case-by-case basis.

**EU AR regarding PIEs**: the delegation of tasks related to sanctions and enforcement measures may be delegated to other authorities or bodies if this is set out in law and the majority of persons involved in governance of this authority or body are independent of the audit profession.

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### 4.6 Possible approaches to audit oversight (cont’d)

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

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fines, censure and registration suspended/removed</td>
<td>All</td>
<td>Simple and easily understood by all concerned and the market at large.</td>
<td>While dissuasive, these can have unintended and adverse consequences, notably disruption to the audit market and especially at firm level. Potential lack of granularity to the penalty; it could be perceived and act as a ‘catch all’ mechanism.</td>
</tr>
<tr>
<td>In addition, the ability to impose tailored restrictions e.g. need to undergo training or independent monitoring</td>
<td>All to greater or lesser extent. UK and US appear to have most stated options regarding tailored solutions; SG - accounting firm and individual public accountant and AU - individual required to give specific undertaking; CA – firm may be required to engage an external monitor to review audit work prior to the release of an audit opinion.</td>
<td>Granular, tailored approach. Less risk of market disruption.</td>
<td>Adds some complexity. Requires more follow-up inspection / monitoring.</td>
</tr>
</tbody>
</table>

Note: EU / EC equivalence not specified, just that sanctions must be ‘effective, proportionate and dissuasive’ in respect of statutory auditors and audit firms.
4.7 Possible approaches to audit 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.

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Use of international standards:</strong></td>
<td>IFIAR, EU, EC equivalence, UK (accounting) CA (accounting)</td>
<td>Global acceptance. Ease of application across group audits.</td>
<td>Lack of tailoring to respond to local needs.</td>
</tr>
<tr>
<td><strong>Use of international standards with supplementation</strong></td>
<td>UK (auditing and ethics), CA (auditing), US (private company audits), AU (accounting and auditing), SG</td>
<td>Global acceptance. Ease of application across group audits.</td>
<td>Need to communicate additional requirements to other group auditors.</td>
</tr>
<tr>
<td><strong>Development of own standards</strong></td>
<td>US public company audits. EU (auditing) – EC has the power to set, adopt or endorse auditing standards.</td>
<td>Ability to tailor to respond to local needs e.g. US standards relating to the audit of internal control under 404 SOX.</td>
<td>Complexity of group audits when referring work to component auditors in other jurisdictions.</td>
</tr>
</tbody>
</table>
4.8 Possible approaches to audit 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, secure and independent of the firms being regulated.

Note, since 2013, a move away from Government funding (removal – UK; reduction – AU per current proposals).

(Continued on the following page)
## 4.8 Possible approaches to audit oversight (cont'd)

### 4.8 Focus area: Funding models (cont’d)

<table>
<thead>
<tr>
<th>Possible approach</th>
<th>Where applied</th>
<th>Potential advantages</th>
<th>Potential disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Levy on companies whose audits are regulated or a subset thereof</td>
<td>US (in part), UK (in part)</td>
<td>Easy to collect where there are other levies charged to such companies (e.g. a securities regulator levy or charge for accounting standard-setting). Independent of auditors who have little or no interest in the quantum of such fees. Ability to levy on parts of the population e.g. listed companies and PIEs.</td>
<td>If there is no pre-existing collection mechanism, it may be costly to develop one. Larger population of payees (more audited entities than auditors) may increase collection costs.</td>
</tr>
<tr>
<td>Levy on professional bodies</td>
<td>UK (in part)</td>
<td>Professional bodies tend to already have a mechanism to charge fees to member firms and individual practitioners, so no new collection mechanism is necessary.</td>
<td>Perceived influence of professional bodies on scale and scope of regulation.</td>
</tr>
<tr>
<td>Levy on individual firms or practitioners</td>
<td>US (in part), CA, SG (firms are billed following inspections), AU (proposal to move in this direction)</td>
<td>Ease of collection – non-payment results in immediate forfeiture of audit registration.</td>
<td>If there is no pre-existing collection mechanism, it may be costly to develop one. Larger population of payees may increase collection costs. Perceived influence of firms or members on scale and scope of regulation.</td>
</tr>
<tr>
<td>Government subsidy</td>
<td>UK (small element and to be abolished from 2016/17), AU (but note move towards levies, see 8.5.6)</td>
<td>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. Fully independent of influence by audited entities and auditors.</td>
<td>Costs borne by the wider public purse rather than (directly or indirectly) those entities benefiting from audits.</td>
</tr>
</tbody>
</table>
4.9 Possible approaches to audit oversight

4.9 Focus area: CPE

The requirements for audit partners and professional staff to undertake CPE are broadly similar across each of the jurisdictions but the approaches to its oversight and monitoring differ:

- In Singapore, the oversight body directly oversees CPE for practising accountants (those able to sign off accounts) whereas the professional body (the Institute of Singapore Chartered Accountants (ISCA)) does this for non-practising accountants. ISCA monitors both via random audits;
- 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, the professional body monitors CPE compliance; and
- In Canada and the US, regional bodies (US - State Boards of Accountancy, Canada - Provincial Institutes) play this role.
5. Comparisons per jurisdiction, per function
## Spotlight on the role of oversight bodies and delegated functions

<table>
<thead>
<tr>
<th>Oversight Body</th>
<th>EU requirements per SAD and AR</th>
<th>IFIAR</th>
<th>UK (UK FRC)</th>
<th>US (PCAOB)</th>
<th>Canada (CPAB)</th>
<th>Australia (ASIC)</th>
<th>Singapore (ACRA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registration</td>
<td>Delegation allowed (with conditions and oversight)</td>
<td>Delegation allowed (with oversight)</td>
<td>Deligated to Recognised Supervisory Bodies (RSB) with oversight</td>
<td>Oversight body</td>
<td>Oversight body</td>
<td>Oversight body</td>
<td>Oversight body</td>
</tr>
</tbody>
</table>
| Inspection     | • PIEs – cannot be delegated  
• Non-PIEs – can be delegated | • PIEs – cannot be delegated  
• Non-PIEs – can be delegated | • PIEs – oversight body  
• Non-PIEs – delegated to RSBs with oversight | Oversight body | Reporting issuers - oversight body  
Non-publicly listed – delegated to CPA Canada with oversight | Oversight body | • PIEs – oversight body  
• Non-PIEs – oversight body with ISCA |
| Investigation  | • PIEs – cannot be delegated  
• Non-PIEs – can be delegated | • PIEs – cannot be delegated  
• Non-PIEs – can be delegated | • PIEs – oversight body  
• Non-PIEs - delegated to RSBs with oversight | Oversight body plus SEC | Oversight body | Oversight body | Oversight body |
| Enforcement    | • PIEs – can be delegated (if authority delegated to is majority independent)  
• Non-PIEs – can be delegated | • PIEs – cannot be delegated  
• Non-PIEs – can be delegated | • PIEs – oversight body  
• Non-PIEs - delegated to RSBs with oversight | Oversight body plus SEC | Oversight body | Oversight body and independent board | Oversight body |
| Standard setting| Delegation allowed (with conditions and oversight) | N/A | Oversight body |  
• Auditing & Assurance – oversight body (public companies) / AICPA (non-public)  
• Financial reporting – Financial Accounting Standards Board (FASB) / SEC  
• Ethics – oversight body / AICPA | 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 & Accounting – Government; Ethical – independent board established by the professional bodies) | • Accounting - separate independent body  
• Audit – delegated to professional body with oversight  
• Ethics - oversight body |
| CPE            | Delegation allowed (with conditions and oversight) | N/A | Delegated to RSBs with oversight | State Boards of Accountancy | Provincial Institutes | Professional bodies | Practising accountants (oversight body); non-practising accountants (professional body) |
## 5.1 Registration

<table>
<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td><strong>Audit requirement scope</strong></td>
<td>All public-interest entities (EU companies listed on EU regulated markets, credit institutions and insurance undertakings and any other additional entity defined as a PIE under their Member State’s legislation) regardless of size and all limited companies other than small companies and certain subsidiaries guaranteed by an EU incorporated parent.</td>
<td>Audit requirements extend to a wide range of companies defined in the local law, broadly categorised as private and public companies. Exemption rules apply to small and dormant companies and certain subsidiaries guaranteed by an EU incorporated parent.</td>
<td>Registration with the PCAOB is required for the auditors of issuers and broker-dealers.</td>
<td>For public companies there is an annual audit requirement as part of ongoing filing requirements as reporting issuers.</td>
<td>Audit requirements extend to a wide range of companies defined in the local law, broadly categorised as private and public companies. Exemption rules apply to small companies in certain circumstances.</td>
</tr>
<tr>
<td></td>
<td>Note: Third country equivalence is only relevant to audits of listed companies.</td>
<td></td>
<td>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.</td>
<td>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.</td>
<td>ACRA is responsible for the registration of auditors for Singapore publicly listed companies and PIEs (the definition changed in July 2015). A new small company concept has been introduced for exemption from statutory audit. A company qualifies as a small company if it (a) is a private company in the financial year in question; and (b) meets at least two of the following criteria for the preceding two financial years: (i) total annual revenue ≤ $10m; (ii) total assets ≤ $10m; (iii) no. of employees ≤ 50</td>
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</table>
5.1 Registration (cont’d)

<table>
<thead>
<tr>
<th>EU (requirement)</th>
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<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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<tbody>
<tr>
<td><strong>Registration requirements</strong></td>
<td>All statutory auditors and audit firms shall be subject to public oversight. The competent authority shall have the ultimate responsibility for the oversight of: the approval and registration of statutory auditors and audit firms.</td>
<td>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.</td>
<td>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. In respect of non-issuer broker-dealers, financial statements filed with the SEC must be certified by a registered firm. 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. Non-US firms that audit or play a substantial role in preparing an audit report for any US issuers or broker-dealers are also subject to PCAOB registration requirements.</td>
<td>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, (b) in compliance with any remedial actions imposed by the CPAB as provided in National Instrument 52-108, and (c) in compliance with the notice requirements as provided in National Instrument 52-108.</td>
<td>The registration of Registered Company Auditors (RCA) and Authorised Audit Companies (AAC) is the responsibility of the ASIC. An audit required by the Corporations Act 2001 (the Corporations Act) and some other regulatory audits, such as for the Australian Prudential Regulatory Authority, may only be performed by an RCA or AAC. For individuals, registration generally occurs at the time of promotion to partner.</td>
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</table>

| Is the registration body also the oversight body? | Not necessarily. | No. | Yes. | Yes. | Yes. | Yes. |
## 5.2 Inspection

<table>
<thead>
<tr>
<th>Review frequency</th>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td>For auditors of PIEs, as specified in the 2014 AR, inspections must take place at least every three years. Other statutory auditors (those that do not carry out audits of PIEs) are reviewed every six years.</td>
<td>Largest four audit firms are subject to inspection on an annual basis. The other major firms that audit PIEs are reviewed on an extended cycle of up to three years. Auditors that do not audit PIEs are reviewed at least every six years, depending on size. Note that in line with a Competition and Markets Authority (CMA) recommendation, the UK FRC’s Audit Quality Review Team (AQRT) aims to review all FTSE 350 audits every five years.</td>
<td>PCAOB annual inspection for firms that audit more than 100 issuers. For others, at least once every three years.</td>
<td>Firms with 100 or more reporting issuer clients are subject to annual inspections. Those with between 50 and 99 reporting issuer clients are subject to inspection every two years. Other firms are subject to inspection every three years.</td>
<td>The four large national firms are inspected every 18 months and on a continuous basis (one audit engagement file is inspected per firm per month). Mid-tier firms’ audit files may be reviewed every quarter. Small firms that only audit one or two listed companies may be reviewed once every 12 years.</td>
<td>ACRA carries out offsite monitoring on a bi-annual basis and onsite review is on an annual basis. For auditors of PIEs, inspections are now on an annual basis for firms that audit over 10% share of market capitalisation of listed companies; and take place every three years for firms auditing less than 10% (unless significant control lapses require more frequent inspection).</td>
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</table>

| Inspection approach (risk focus) and grading | 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. | Risk-based. The model takes account of priority sectors determined annually. The majority of audits reviewed are drawn from those identified as higher risk. No overall grading of firms. Individual audits are however graded by the AQRT and the summarised results included in the public report. Individual ratings are given to audit committees of inspected clients on a confidential basis. | The PCAOB's individual audits and focus areas are most often selected on a risk-weighted basis. No overall grading. | CPAB uses a number of risk analysis processes to identify higher-risk reporting issuer audits and allocates its inspection resources accordingly. No overall grading. | ASIC file selection process is risk-based (as part of which ASIC may consider areas of IFIAR findings). No overall grading. | Risk-based approach, with engagement reviews of public accountants plus, for accounting firms that audit PIEs, firm-wide reviews too. Grading: ACRA informs each firm how it fared in the respective Singapore Standard on Quality Control (SSQC) area (against a three colour ‘traffic light’ system) but the grading is not made public. The colour result determines the frequency of ACRA’s review on that SSQC area. |
## 5.2 Inspection (cont'd)

<table>
<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td><strong>Annual report (or equivalent)</strong></td>
<td>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.</td>
<td>UK FRC publishes annual inspection reports including work programme and activity reporting.</td>
<td>The US PCAOB does not publish an annual inspection report (but may publish its findings as the Board deems appropriate).</td>
<td>CPAB publishes an annual inspection report on the Big Four firms as well as a publication on Big Four firms as highlights for audit committees. In addition, CPAB publishes an annual report on all firms inspected.</td>
<td>ASIC issues a consolidated public report every 18 months. The professional bodies are also required to conduct quality reviews of their members. They rely on the work of ASIC for the large accounting firms. In addition, the Chartered Accountants Australia and New Zealand (CAANZ) 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. There has been no separate evaluation of audit quality in the larger firms since that time.</td>
</tr>
</tbody>
</table>

| **Transparency of firm-specific reporting** | The competent authority shall be transparent. This shall include the publication of annual work programmes and activity reports. | 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). Copies of these letters are sent by the UK FRC directly to the chairman of the Audit Committee of the audited entities concerned. 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, CPAB can make the relevant portions of the final Inspection report (and the fact that they have not been addressed to the CPAB’s satisfaction) public on its website. | In Australia, the individual firm inspection report is private. However, a 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 Singapore, the individual firm inspection report is private. |
### 5.2 Inspection (cont'd)

<table>
<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td><strong>Operation and funding of the inspection process</strong></td>
<td>The quality assurance system shall be organised in such a manner that it is independent of the reviewed statutory auditors and audit firms and is subject to public oversight.</td>
<td>AQRT, part of the UK FRC – inspection of ‘major audits’ including listed companies, banks, large insurance companies (all from 17 June 2016) and, until 17 June 2016, large pension funds, large charities and the very largest private companies. Professional bodies (under UK FRC oversight) inspect other audits.</td>
<td>PCAOB, overseen by the SEC</td>
<td>CPAB</td>
<td>ASIC</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>PAOC under ACRA</td>
<td></td>
</tr>
<tr>
<td><strong>Appeal process for inspection findings</strong></td>
<td>Member States shall ensure that decisions taken by the competent authority in accordance with Directive and Regulation (EU) No. 537/2014 are subject to a right of appeal.</td>
<td>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.</td>
<td>Interim review by the SEC can be sought (and the report is then delayed until that review is complete).</td>
<td>The firm may petition for a review proceeding which can lead to arbitration.</td>
<td>No formal appeals process, however there is much interaction regarding comment letters before the reports are finalised. When a deficiency report is issued, it features the relevant firm’s comments in reply.</td>
</tr>
<tr>
<td></td>
<td>NB: Inspection reports of the major firms already published in full.</td>
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</tbody>
</table>
## 5.3 Investigations

<table>
<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Body and overview</td>
<td>Member States shall ensure that there are effective systems of investigations and sanctions to detect, correct and prevent inadequate execution of the statutory audit.</td>
<td>Professional bodies can refer cases to the UK FRC; and/or the UK FRC can decide to investigate a matter. The UK 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 UK FRC’s conduct division to investigate; if not it will refer the case on to the relevant professional body. Professional bodies will also launch their own disciplinary investigations and, if they believe they are of public interest, can refer them to the UK FRC Conduct Committee.</td>
<td>Both the PCAOB and the SEC have investigative responsibilities; as do the state boards of accountancy. 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.</td>
<td>CPAB may issue an order for an Investigation if it considers that a Violation Event may have occurred.</td>
<td>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. ASIC commences an investigation if it has reason to suspect one of the relevant provisions it administers has been contravened. 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. Both the Complaints and Disciplinary Panel established under the PAOC and the ISCA Investigation Committee may initiate an investigation. PAOC can institute disciplinary proceedings in accordance with the Accountants Act. Note the oversight system oversees both companies and accountants (also the case in Australia); and can pursue both company directors and accountants in cases of fraud or dishonesty or non-compliance in financial reporting for example.</td>
</tr>
</tbody>
</table>
## 5.4 Enforcement

<table>
<thead>
<tr>
<th>Range of penalties and sanctions available</th>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Member States shall provide for effective, proportionate and dissuasive sanctions in respect of statutory auditors and audit firms. Sanctions shall include the possibility of the withdrawal of approval.</td>
<td>Fines (from 17 June 2016 ‘financial penalties’) (potentially unlimited as specified by the Tribunal); 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). The firm may also be required to waive/repay client fees. From 17 June 2016, the UK FRC may also choose 'constructive engagement' with the auditor for more minor cases – see 8.2.3. It will also be able to make Interim Orders, restricting the firm’s activities pending final decision and declare that an audit report did not satisfy audit reporting requirements.</td>
<td>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. 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.</td>
<td>Disciplinary action starts with Requirements (a precursor to Restrictions and Sanctions). These include requiring the firm to engage an external monitor to review its audit work prior to the release of an audit opinion; prohibiting a partner from acting as an engagement partner on a reporting issuer audit and requiring partners and staff to undertake training. Sanctions include fines, censure, deregistration and directions on various remedial actions. The firm may ultimately lose the right to audit public companies.</td>
<td>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.</td>
<td>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.</td>
<td>PAOC can revoke the approval granted; suspend the public accountant or accounting corporate/firm/LLP from providing public accounctancy services; deregister the public accountant; impose a penalty; censure; require the public accountant or accounting corporate/firm/LLP to give certain undertakings. There is a stipulation of two years maximum for suspension / restriction of services.</td>
</tr>
</tbody>
</table>

| Disciplinary body | Disciplinary Tribunal is appointed by a convenor, comprising either: • A lawyer, an accountant (from 17 June 2016 – someone with audit experience) and a lay person; or • One or two lawyers, two accountants (from 17 June 2016 – someone with audit experience) and one or two lay persons. Tribunal members are independent of the UK FRC. In all cases the chair is legally qualified. | PCAOB – i.e. the regulator. The SEC may also sanction auditors (in addition to PCAOB sanctions). | CPAB – i.e. the regulator. | If ASIC does not pursue an enforceable undertaking itself, it refers the matter to the CALDB. The CALDB is the recognised disciplinary body and independent of ASIC. It is a civil, rather than criminal process, but the principle is the same as the criminal courts being independent of prosecuting authorities. | ACRA – i.e. the regulator. |
### 5.4 Enforcement (cont'd)

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<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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<tbody>
<tr>
<td><strong>Disclosure</strong></td>
<td>Member States shall provide that measures taken and sanctions imposed on statutory auditors and audit firms are appropriately disclosed to the public.</td>
<td>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).</td>
<td>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.</td>
<td>Upon inquiry to CPAB and on CPAB website. If CPAB were to impose a Restriction upon an audit firm, there is a requirement to notify relevant provincial Canadian securities regulators. A sanction is the most serious level of discipline and also requires notifying audit committees of the firm’s reporting issuer clients.</td>
<td>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.</td>
</tr>
</tbody>
</table>

| **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 licensees 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

<table>
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<th>EU (requirement)</th>
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<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td><strong>Operation of the standard-setting process</strong></td>
<td><strong>Stakeholders are consulted, albeit through different mechanisms, in all jurisdictions</strong></td>
<td><strong>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.</strong> EC has the option to adopt international auditing standards (in practice ISAs) but has not done so; until then, Member States set auditing standards.</td>
<td><strong>The PCAOB operates its own standards setting function. Similarly to the UK, the PCAOB’s functions also include registration, inspection and investigations / enforcement.</strong></td>
<td><strong>CPA Canada operates and funds standard setting. For ethical, financial reporting and auditing and assurance standards different regulatory bodies have different functions and powers (see 8.4.5).</strong></td>
<td><strong>The Australian Professional and Ethical Standards Board (APESB) was established as an initiative of CPA Australia and CAANZ. The third professional body in Australia, the Institute of Public Accountants is also a member of the APESB. The AASB and the Australian Auditing and Assurance Standard Board (AUASB) are operated by the Australian Government. The Financial Reporting Council (AU FRC), whilst not a standard setting body, has oversight for them.</strong></td>
</tr>
<tr>
<td><strong>Standard-setter(s) independent of the profession?</strong></td>
<td><strong>N/A</strong></td>
<td><strong>Yes</strong></td>
<td><strong>No (but subject to oversight as part of CPAB’s strategic plan).</strong></td>
<td><strong>No - ethics (but with independent oversight). Yes - auditing and accounting.</strong></td>
<td><strong>Yes = ethics and accounting. No = auditing, but with independent oversight.</strong></td>
</tr>
</tbody>
</table>
### 5.5 Standard setting (cont'd)

<table>
<thead>
<tr>
<th>EU (requirement)</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
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<tr>
<td><strong>Convergence</strong></td>
<td>Member States shall require statutory auditors and audit firms to carry out statutory audits in compliance with international auditing standards adopted by the EC.</td>
<td>Ethical standards are at least equivalent to IESBA’s standards. UK FRC Ethical Standards impose some additional restrictions, but use the IESBA Code as their starting point. From 17 June 2016, will include EU bans. Accounting standards are either IFRS as adopted by the EU (converged with the standards of the IASB) or based on the EC Accounting Directive. Auditing standards are converged with IAASB standards but contain additional requirements (&quot;pluses&quot;) where necessary to respond to EU and local laws and regulations. There are no &quot;minuses&quot;. All of these standards are developed by the UK FRC after consulting on the adoption of international standards.</td>
<td>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 IAASB Consulting Advisory Group (CAG) meetings. Currently professional standards applicable to auditing public companies are being developed by staff at the PCAOB. The auditing standards of the AICPA are converged with the ISAs. US Generally accepted accounting principles (GAAP) remains not fully converged to IFRS.</td>
<td>IAASB - international auditing standards adopted as Canadian Auditing Standards (CASs). International Accounting Standards Board (IASB) - Canadian reporting issuers are generally required to follow IFRS as issued by the IASB. Alignment with the IESBA: the PTC of CPA Canada 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 CPA profession, regarding any future changes to the Code of Ethics. While the principles of the Canadian Harmonized Rules of Professional Conduct (Rule 204) align with the IFAC Code of Ethics, there are some differences where the Canadian Rule 204 is more stringent.</td>
<td>The AU FRC issued strategic directive that AUASB should use, as appropriate, ISAs of the IAASB as a base from which to develop Australian Auditing Standards. There are Australian accounting standard equivalents to IFRS. The ethical professional standard issued by the APESB (APES 110) is essentially the same as the IESBA Code of Ethics.</td>
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## 5.6 Funding models

<table>
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<tr>
<th>EU (requirement)</th>
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<th>US</th>
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<th>Singapore</th>
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<tbody>
<tr>
<td><strong>Registration</strong></td>
<td>N/A</td>
<td>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.</td>
<td>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).</td>
<td>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.</td>
<td>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. However note upcoming reduction and proposed move towards a user pays model (see 8.5.6).</td>
</tr>
<tr>
<td><strong>Inspection</strong></td>
<td>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. The system of public oversight shall be adequately funded.</td>
<td>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 UK FRC’s core operating costs.</td>
<td>The PCAOB - see above</td>
<td>CPAB - see above</td>
<td>ASIC - see above</td>
</tr>
</tbody>
</table>

No specific allocation of ASIC’s overall funding is given to inspection activity; however the proposed industry funding model suggests that costs of $6m are to be recouped from auditors in 2016/17 - we understand that these are based on the cost of current inspection and enforcement activity.

ACRA - as above

Firms are also billed following each inspection PAOC is pro-bono.
## 5.6 Funding models (cont'd)

<table>
<thead>
<tr>
<th>EU (requirement)</th>
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<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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<tr>
<td>Investigation and enforcement</td>
<td>The system of public oversight shall be adequately funded and shall have adequate resources to initiate and conduct investigations (in relation to statutory auditors and audit firms and the right to take appropriate action).</td>
<td>The UK FRC's Conduct Committee is responsible for both investigation and enforcement activities. The UK 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 (none from June 2016) is provided by government.</td>
<td>The PCAOB - see 'registration'.</td>
<td>CPAB does not have a separate investigation body; funding is therefore ultimately from the revenue CPAB derives from Canadian reporting issuers (see previous page).</td>
<td>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. As set out above, note that the proposed industry funding model suggests that costs of $6m are to be recouped from auditors in 2016/17, based on the cost of current inspection and enforcement activity. 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.</td>
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### 5.6 Funding models (cont'd)

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<tr>
<th>EU (requirement)</th>
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<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td><strong>Standard setting</strong></td>
<td>No prescription as to funding of standard-setting.</td>
<td>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).</td>
<td>The PCAOB - see 'registration'.</td>
<td>CPA Canada operates and funds the standard setting body.</td>
<td>The APESB is funded by the CPA Australia, the CAANZ and the National Institute of Accountants. The AASB and the Australian AUASB are primarily funded by the Australian Government. The AU FRC is funded by the Australian Government.</td>
</tr>
</tbody>
</table>
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.

Section 3 of this report sets out gaps between the current Hong Kong regulatory system and that required for:

- IFIAR membership; and
- recognition as EC equivalent

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. However, 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

<table>
<thead>
<tr>
<th>Summary of additional changes needed to match the registration regime in each jurisdiction</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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<tbody>
<tr>
<td>Audit registration is also required for entities other than companies including charities, pension funds and limited liability partnerships.</td>
<td>Audit registration is also required for broker-dealers. Non-US firms that audit or play a substantial role in preparing an audit report for any US issuers or broker-dealers are also subject to PCAOB registration requirements.</td>
<td>No substantial additional requirements.</td>
<td>No substantial additional requirements.</td>
<td>No substantial additional requirements.</td>
<td></td>
</tr>
</tbody>
</table>
### 6.2 Hong Kong – five major jurisdictions gap analysis – Inspection

<table>
<thead>
<tr>
<th>Summary of additional changes needed to match the inspection regime in each jurisdiction</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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<tbody>
<tr>
<td>Auditors of PIEs (not just those with securities admitted to trading on an EEA regulated market) must be reviewed at least every three years. (Note that this is now also enshrined in the revised 2014 EU AR for all EU/EEA auditors of PIEs.)</td>
<td></td>
<td>Annual inspection for firms that audit more than 100 issuers. For others, at least once every three years.</td>
<td>Inspections to be carried out:  * Every year for a firm with 100+ listed clients.  * Every two years for firms with 50-99 listed clients.  * Every three years for all other auditors.</td>
<td>Inspections to be carried out:  * Every 18 months for the four large national firms.  * Annually for auditors of PIEs with over 10% share of market capitalisation of listed companies; and  * Every three years for firms auditing less than 10% (or more frequently if significant control lapses identified).</td>
<td></td>
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</tbody>
</table>
### 6.3 Hong Kong – five major jurisdictions gap analysis – Enforcement

<table>
<thead>
<tr>
<th>Summary of additional changes needed to match the enforcement regime in each jurisdiction</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td>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. From 17 June 2016, the UK FRC will also be able to: a) make Interim Orders, restricting the firm’s activities pending final decision; and b) declare that an audit report did not satisfy audit reporting requirements.</td>
<td>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. 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. Note: the SEC may impose additional penalties.</td>
<td>Additional penalties include the possibility of unlimited fines and CPAB may sanction an audit firm, meaning it could no longer audit reporting issuers in Canada. CPAB Requirements (precursors to Restrictions and Sanctions) also feature other forms of enforcement penalty (see 5.4)</td>
<td>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.</td>
<td>Additional penalties include fining the accounting corporation/firm/LLP up to SG$100k and the possibility of requiring undertakings such as the Disciplinary Committee sees fit.</td>
<td></td>
</tr>
</tbody>
</table>
## 6.4 Hong Kong – five major jurisdictions gap analysis – Standard setting

<table>
<thead>
<tr>
<th>Summary of additional changes needed to match the standard-setting regime in each jurisdiction</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
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</thead>
<tbody>
<tr>
<td>Combined oversight of standard-setting, inspection, investigation and enforcement. Funding from a wide range of bodies including auditors, preparers and the wider accounting profession.</td>
<td>Combined oversight of standard-setting, inspection and enforcement. Funding from issuers and auditors.</td>
<td>No substantial additional requirements.</td>
<td>Auditing and accounting standards set by government funded bodies.</td>
<td>Independent accounting standard setter.</td>
<td></td>
</tr>
</tbody>
</table>
6.5 Hong Kong – five major jurisdictions gap analysis – CPE

<table>
<thead>
<tr>
<th>Summary of additional changes needed to match the CPE regime in each jurisdiction</th>
<th>UK</th>
<th>US</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent oversight of the RSBs’ activities in relation to CPE.</td>
<td>No substantial additional requirements.</td>
<td>No substantial additional requirements.</td>
<td>No substantial additional requirements.</td>
<td>Independent oversight body to operate CPE system for practising accountants.</td>
<td></td>
</tr>
</tbody>
</table>

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. For example, the UK FRC approves the CPE regulations of each of the six professional bodies, and the small (1-2 people) UK FRC team which inspects the professional bodies considers monitoring as part of its annual checks on each of the bodies. 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.
7. Overview per jurisdiction
7.1 Snapshot – EU and UK

EU

The EU 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 2014 AR has increased the requirements of this framework which now include specific minimum powers for the competent authorities, including the right to impose sanctions. The AR has also formalised cooperation between the different Member States’ relevant authorities through the CEAOB and the EAIG.

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 AR and SAD amendments were negotiated, although this is less the case than previously as the common framework has been strengthened under the 2014 European legislation.

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 PIEs 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 that aimed to bring the various arms of the UK 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 2015-2019 included:

- its independence and experience;
- its knowledge of audit practices gained through more than ten years of inspection and enforcement experience;  
- direct and timely communication with individual audit firms related to such firms’ inspection results and remediation progress; and
- close working relationship with other regulators and standard-setters, including the SEC and other US and non-US regulators and standard setters.

Conversely, the key weaknesses identified included:

- the non-public nature of disciplinary processes (until any adverse findings are published) and restrictions on public reporting of certain inspection information (Part II, or portions thereof, is not public unless weaknesses remain unresolved 12 months after the original inspection);
- competition for talent; and
- outdated technology systems that may not fully address future risks or current.

**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 (note that CPAB CEO Brian Hunt is the incoming IFIAR Chair).

In the past, there was a perceived significant weakness relating to the transparency of the inspection reporting. This has since been addressed with the introduction of the 2014 Protocol, by CPAB, which requires participating audit firms, who voluntarily opt in, to share a copy of CPAB’s public reports on inspections with the audit committees of their clients (reporting issuers) as well as any file-specific significant inspection findings.
7.3 Snapshot – Australia and Singapore

**Australia**

The key strengths of the Australian regime include:

- ASIC regulates both the market and auditors; and
- proportionate regulation of firms by size and impact.

Area for potential improvement includes:

- 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
- private ‘traffic light’ grading of firms which gives them an imperative to improve in areas of weakness.

An area for potential improvement remains:

- How ACRA might improve ongoing monitoring. We understand that ACRA may seek to obtain more regular updates from firms post-inspection.

A new development since 2013:

- To enable Audit Committees of listed companies to better evaluate and select the right auditor, ACRA has introduced an AQI Disclosure Framework which is available for voluntary adoption by audit committees of all listed entities in Singapore from 1 January 2016 onwards. We understand that some Audit Committees have requested the accounting firms to communicate the AQI data during reappointment, and in some cases, the AQI data is requested during proposal stage. The AQI Disclosure Framework requires disclosure of firm and engagement level information such as compliance with independence requirements, results of inspections, training hours, headcount in quality control function, partner/manager ratio etc.
8. Jurisdiction-specific, per function
8.1 EU
8.1.1 EU – registration

- European law in respect of auditing and financial reporting applies throughout the EU and in the additional EEA countries, (namely 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. EU regulations are 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 financial statements as:
  a) required by EU law;
  b) required by national law as regards small undertakings; and
  c) voluntarily carried out at the request of small undertakings which meets national legal requirements.

- Statutory audits can be carried out only by statutory auditors or audit firms which are approved by the Member State requiring the statutory audit (or by an audit firm approved in another Member State, providing that the key audit partner is approved in the Member State requiring the statutory audit).

- Each Member State designates the competent authority which shall be responsible for approving statutory auditors and audit firms. The competent authorities shall be governed by non-practitioners, who are knowledgeable in the areas relevant to statutory audit, and shall be selected in accordance with an independent and transparent nomination procedure. Competent authorities have the ultimate responsibility for the oversight of investigative and administrative disciplinary systems and shall be organised in such a manner as to avoid conflicts and be free from undue influence by the profession.

- In addition to the statutory audits of EEA incorporated entities, the Transparency Directive\(^\text{16}\) requires that the financial statements of non-EEA incorporated (third country) entities with securities admitted to trading on a regulated market in the EEA must be audited by a third-country auditor/audit entity, registered in accordance with Article 45 of the SAD. This may be a full registration, subject to full regulation by the relevant EEA competent authority, or from a country deemed equivalent under Article 46 in which case reliance may be placed on that country’s own system of regulation. Registered third-country auditors (including those carrying out the audit on behalf of a third-country audit entity) must:
  a) meet requirements equivalent to:
     - being of good repute;
     - having individuals who have educational qualifications at a level equivalent to a university degree, with both theoretical instruction and practical experience;

8.1.1 EU – registration (cont’d)

- having passed exams which cover accounting, legal requirements relating to financial statements, international accounting and auditing 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, employment law, information technology, economics, mathematics and statistics and financial management;
- having at least three years of practical experience; and

b) comply with equivalent ethical, independence and auditing standards (see section 8.1.5 of this report).

- Furthermore, third country audit entities must comply with another requirement in addition to the above; namely that a majority of the board must comprise auditors or equivalent (Article 45.5 (b) of SAD).

- The EC 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. A decision on their equivalence is expected before August 2016.

- The requirements for equivalence are covered in sections 2.2 and 3.2 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 competent authority must have ultimate responsibility for standard setting.

- In seeking to register and/or become equivalent (there is no derogation from this requirement for equivalence) statutory auditors of PIEs are required to publish an Audit Transparency Report. This was previously set out in the SAD but is now in the EU AR and the requirements of an Audit Transparency Report have been broadened (see Article 13).
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 adequately 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 PIEs, 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. A person shall not be allowed to act as a reviewer in a quality assurance review of a statutory auditor or an audit firm within three years of ceasing to be a partner or an employee of, or otherwise associated with, that statutory auditor or audit firm.

- 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 sanctions in the same way as enforcement.

- The AR introduces additional stricter requirements for inspections of statutory auditors or audit firms that carry out statutory audits of PIEs but these additional requirements are not relevant for third country auditors and therefore not for determining EC equivalence.
8.1.3/4 EU – investigation / enforcement

- Member States are required to ensure that there are effective systems of investigations and sanctions 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 sanctions 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 SAD and, where applicable, the AR.

- Member States must provide that measures taken and sanctions imposed on statutory auditors and audit firms are appropriately disclosed to the public. Sanctions 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:
  - The new EU AR, which entered into force in June 2014 and will apply to financial periods starting after 17 June 2016, sets specific requirements for the independence of statutory auditors or audit firms carrying out statutory audits of PIEs, in addition to the principles set out in the SAD.
  - Member States shall ensure that, when carrying out a statutory audit, a statutory auditor or an audit firm, and any natural person in a position to influence the outcome of the statutory audit, is independent of the audited entity. The SAD requires that a statutory auditor or an audit firm shall take all reasonable steps to ensure that, when carrying out a statutory audit, their independence is not affected by any existing or potential conflict of interest or business or other direct or indirect relationship involving the statutory auditor or audit firm or its network, managers, employees or certain other persons linked to the statutory auditor or audit firm. Further, the statutory auditor or the audit firm shall not carry out a statutory audit if there is any threat of self-review, self-interest, advocacy, familiarity or intimidation created by financial, personal, business, employment or other relationships between the statutory auditor, the audit firm, its network, and any natural person in a position to influence the outcome of the statutory audit, and the audited entity such that an objective, reasonable and informed third party, taking into account the safeguards applied, would conclude that the statutory auditor's or the audit firm's independence is compromised.
  - The AR will apply stringent restrictions to the provision of NAS that an auditor can provide to its PIE audit clients, including a 'black list' of prohibited services and a 70% cap on the fees allowable for permitted NAS (based on an average of the previous three years’ audit fees).
  - The AR will require that PIEs rotate their auditors at least every ten years, with a Member State option to extend to 20 years, providing there is a tender after ten years, or 24 years where there are joint auditors.

- 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 Accounting Directive\textsuperscript{17}.

- The EC has the power to set, adopt or endorse auditing standards, including auditor independence and internal quality control standards, subject to 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 the competent authority which shall be responsible for approving statutory auditors and audit firms. The competent authorities shall be governed by non-practitioners, who are knowledgeable in the areas relevant to statutory audit, and shall be selected in accordance with an independent and transparent nomination procedure.

- **Inspection**
  - Note Article 29 1 (b) of SAD: *the funding for the quality assurance system shall be secure and free from any possible undue influence by statutory auditors or audit firms*;
  - and Article 32 (7) of SAD: *the system of public oversight shall be adequately funded and shall have adequate resources to initiate and conduct investigations, as referred to in paragraph 5 [the competent authority shall have the right, where necessary, to initiate and conduct investigations in relation to statutory auditors and audit firms and the right to take appropriate action]. The funding of 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 EC - there is no specific funding for activities in this area.
8.2 United Kingdom
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 PIEs: 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 (from 17 June 2016 admitted to trading on any EEA regulated market).
  - All non-EEA incorporated companies with listed equity and/or debt audited by a UK Registered Auditor.
  - AIM or Plusquoted companies incorporated in the UK with a market capitalisation in excess of £100m (expected to continue after 17 June 2016, although could be delegated).
  - UK incorporated banks.
  - UK Building Societies.
  - Insurance companies (until 17 June 2016 limited to Mutual Life Offices whose "With-Profits" fund exceeds £1,000m and Friendly Societies with total net assets in excess of £1,000m).

Until 17 June 2016:
  - UK unquoted companies, groups of companies, limited liability partnerships or industrial and provident societies with Group turnover in excess of £500m.
  - Private sector pension schemes with either more than £1,000m of assets or more than 20,000 members.
  - Charities with incoming resources exceeding £100m.
  - UK Open-Ended Investment Companies and UK Unit Trusts managed by a fund manager with more than £1,000m of UK funds under management.

Thereafter these entities cease to be PIEs to free up UK FRC resource to take on direct inspection responsibility for the audits of all insurance companies, and increased responsibility for the inspection of ‘whole firm procedures’ for smaller audit firms that audit PIEs – previously delegated fully to the RSBs.
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 UK 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 UK FRC, for the UK 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 UK FRC. The UK FRC has a 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 UK FRC.
8.2.1 UK – registration (cont’d)

- The UK FRC also supervises Recognised Qualifying Bodies (RQBs) – 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 an RQB. RQBs must be approved by the Secretary of State (business minister) – his/her role has been legally delegated to the UK 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 SAD. Again, the UK 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 UK FRC’s AQRT is the UK’s independent audit inspector which monitors the quality of the audits of listed and other major PIEs and the policies and procedures supporting audit quality at the major audit firms in the UK.

Until 17 June 2016:

- 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 UK FRC is required to publish each year a list of those other PIEs, 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 UK FRC and the RSB and the UK 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 PIE. During these inspections the AQRT reviewed approximately 100 audits.

From 17 June 2016:

- The UK FRC will legally have the responsibility to inspect all audits and audit firms, but will be required by ministerial direction to delegate to the maximum extent practicable to the RSBs. Audits of entities with securities admitted to trading on an EEA regulated market, banks, building societies and insurance companies cannot be delegated. The UK FRC will carry out more of the work on whole firm procedures for firms with 10 or fewer PIE audits; previously these were delegated to the RSBs.

Ongoing:

- 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. In line with a CMA recommendation, they aim to review all FTSE 350 audits every five 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 UK FRC has commented publicly that its 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.
  - Copies of these letters are sent by the UK FRC directly to the chairman of the Audit Committee of the audited entities concerned.
  - Audit committees are encouraged to report in the entity’s annual report if their audit has been subject to AQRT inspection; they are also encouraged to discuss issues arising and the auditor’s response but are not permitted to publish the individual grade.
8.2.3 UK – investigation

- The UK FRC has investigation responsibility for PIEs; it delegates this for non-PIEs.
- The UK FRC can start a disciplinary investigation in one of two ways:
  - the professional bodies can refer cases to the UK FRC; and
  - the UK FRC may decide of its own accord to investigate a matter.

- The UK 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 UK FRC Board), an Executive Director (i.e. UK FRC staff), the rest of the non-executive members of the UK FRC Board (none of whom are auditors), the chairs of the monitoring and case management sub-committees, and other members appointed by the UK FRC. None of the members are practising auditors or officers of any professional body. Members cannot have been practising auditors for at least three years before joining any of the UK FRC’s committees.

Until 17 June 2016:

- 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.

Proposals from 17 June 2016:

- A UK FRC case officer considers if an issue merits action. This will have regard to factors like the public interest, financial impact, need for deterrence, whether an action is wilful or reckless, In more minor cases they may choose 'constructive engagement' with the auditor, which may include understanding actions the firm has already taken, training requirements or voluntary undertakings (e.g. to cease certain types of work or restrict the audit role of certain partners and staff).
- If it is, they will delegate to an RSB (in cases of less public interest) or pass it to the Conduct Committee (or its Investigation Committee), who will consider whether to appoint a Tribunal. Tribunals will broadly operate as before.
- Interim Orders are a new feature which can restrict the activities of a firm prior to a final decision being taken.
8.2.4 UK – enforcement

- The UK 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 UK 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.\(^\text{18}\)

- The Companies Act 2006 gives power to enforce. Until 17 June 2016, the UK FRC’s powers come from a requirement that RSBs require their members participate in a scheme (the Accountancy Scheme). From 17 June 2016, these powers will come directly from the Act.

- The Disciplinary Tribunal is able to impose the following sanctions on members and/or member firms:
  - A reprimand or severe reprimand (until 17 June 2016) or a statement confirming the person responsible and the nature of the breach.
  - Direction (until 17 June 2016) or condition (from 17 June 2016) - The Disciplinary 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 or condition 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 Disciplinary Tribunal (from 17 June 2016 this will be called a ‘financial penalty’ – it will continue to be potentially an unlimited amount).
  - Waiver/repayment of client fees (from 17 June 2016 this will be called ‘restitution’).
  - 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) (from 17 June 2016 a prohibition order of up to 5 year’s duration from carrying out statutory audits or signing audit reports and/or exercising functions in an audit firm or PIE).
  - Order that a member’s practising certificate/registration/authorisation/licence be withdrawn (for the practice of any activity requiring such a certificate, registration, authorisation or licence). The Disciplinary Tribunal may recommend that such a certificate, registration, authorisation or licence not be reinstated for a specific period of time.
  - From 17 June 2016 the UK FRC may also make a declaration that an audit report did not satisfy the audit reporting requirements.

\(^\text{18}\) In order to implement its mandatory responsibility for audit enforcement in relation to PIE and any specific non-PIE matters, the UK FRC developed a new Enforcement Procedure – effective from 17 June 2016 - to investigate allegations in relation to statutory audit matters not delegated to the RSBs. These ‘Retained Matters’ are defined in the FRC’s Delegation Agreements with the RSBs, but broadly include audits of PIES and of AIM companies with a market capitalisation in excess of €200m, plus investigations which the FRC may reclaim from the RSBs from time to time (‘Reclaimed Matters’). All other statutory audit enforcement matters not ‘retained’ by the FRC will usually be delegated to the RSBs who will continue to investigate those delegated matters in accordance with their own procedures.
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 Disciplinary 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 (from 17 June 2016 a person with audit experience) or (b) four other members – either one lay person, one lawyer and two accountants (from 17 June 2016 people with audit experience) or two lay people and two accountants (from 17 June 2016 people with audit experience). Neither the convener nor tribunal members can be office holders or staff of professional bodies (nor have held such a role within the last two years – or three years from 17 June 2016), individuals who have been previously subject to an adverse tribunal finding (or where there is an ongoing appeal), or members of the UK FRC board or other UK FRC committee.
8.2.5 UK – standard setting

- The UK FRC 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 UK FRC sets the operational standards for auditors (International Standards on Auditing (UK and Ireland)) and independence standards for auditors (Auditing Practices Board (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). From 17 June 2016 some of the matters previously in the Audit Regulations will become part of the Companies Act – i.e. the obligation to follow will be direct rather than indirect. In practice:
  - the scope for variation in auditing regulations is limited as they must be approved by the UK 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 UK 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 UK 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 Directive.

- UK GAAP has historically not been substantively different from IFRS but has not specifically converged in all areas. The UK FRC has released new accounting standards which will apply from 2015 and entirely replace old UK GAAP: FRS 101 is IFRS with reduced disclosures and may be adopted by subsidiaries; 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; FRS 103 supplements FRS 102 for insurance contracts; FRS 104 is the equivalent of IAS 34 for those adopting FRS 102; and FRS 105 is for micro-entities.

- Standard setting is funded by a levy on preparers and professional bodies (as representatives of users).
8.2.6 UK – funding model options

- The UK 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 UK FRC’s core operating costs.

- The UK 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 UK FRC).

- Very little funding is provided by government.

- The UK FRC's 2015/16 budget showed that it budgeted costs of £33.7m, of which £30.8m related to accounting, audit and corporate governance.
  - That £30.8m broke down as £18.4m core operating costs, £5.4m audit quality review and £7m disciplinary.
  - The £18.4m core operating costs were funded from the following: £0.2m from reserves, £12.1m from preparers, £5.2m from accountancy bodies, £0.3m from government and £0.6m from other sources (e.g. interest).
  - The £5.4m audit quality review costs were primarily met by the accountancy profession (the individual RSBs that the firms are registered with) and passed on to the firms; the remaining contribution (£1m) came from other sources (e.g. the Crown Dependencies).
  - The £7m disciplinary costs were fully funded by the accountancy professional bodies.
  - Thus of the relevant £30.8m, £0.3m came from government, £0.2m from UK FRC reserves, £1.6m from other sources, £12.1m from preparers and £16.6m 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 United States
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 oversees 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 rules include 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 done 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-US firms that audit or play a substantial role in preparing an audit report for any US issuers or broker-dealers are also subject to PCAOB registration requirements.

- 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

- 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 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 US companies, other issuers, brokers and dealers.
- The PCAOB annually inspects PCAOB registered firms that audit more than 100 public companies. Registered 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 Division of Registration and Inspections carries out the inspection function and is led by a Director, a Senior Deputy Director and four Deputy Directors. Per the 2014 PCAOB Annual Report, more than 60 percent of the 809 PCAOB staff work in registration and inspections.
- The AICPA regime for non-public entity audits relies on peer review (rather than using AICPA staff).
The PCAOB inspections are performed at the firm level (rather than the individual level) as its 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 inspections are 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 those firms registered with the PCAOB. 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 licensed 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 SOX;
    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 registered public accounting firms pursuant to PCAOB Rule 5200(a) – Grounds for Commencement of Disciplinary Proceedings. The SEC also has the ability to discipline auditors of issuers and broker dealers.

- 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 US$100,000 for a natural person or US$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 US$750,000 for a natural person or US$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 a Deputy Chief Auditor. 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, depending on the nature of the project, 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.
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 2016 the PCAOB budget suggests that it will assess US$253m in accounting support).

The PCAOB budget details are as follows:

<table>
<thead>
<tr>
<th></th>
<th>PCAOB’s Division of Registration and Inspections</th>
<th>PCAOB’s Office of The Chief Auditor</th>
<th>PCAOB’s Division of Enforcement and Investigations</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>US$126.3m</td>
<td>US$8.9m</td>
<td>US$20.2m</td>
</tr>
</tbody>
</table>
8.4 Canada
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 has ongoing filing requirements with one or more provincial securities commissions including interim financial statements and annual audited financial statements.

- There are no audit requirements for private companies unless required by a user (e.g. banks, etc.). For public companies there is an annual audit requirement as part of ongoing filing requirements as reporting issuers.

- A PIE is defined as (i) a Listed Entity; and (ii) an entity (a) defined by regulation or legislation as a PIE 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.

- 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 remedial actions imposed by the CPAB as provided in National Instrument 52-108, and (c) in compliance with the notice requirements as provided in National Instrument 52-108.

- Registration is on both a firm and an 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 including UK, Australia, Japan, the Netherlands, France, Germany and Switzerland.

- If the Board proposes to disallow a firm from registering, CPAB will provide the applicant firm with written reasons for the proposed disallowance, as well as an opportunity to participate in a hearing, where the firm could present its case for being allowed to register.
8.4.2 Canada – inspection

- Under Canadian Securities Administrators National Instrument 52-108, accounting firms that audit reporting issuers must be participants in CPAB’s oversight programme.

- CPAB coordinates inspection activities with the provincial institutes’ inspection units, which inspect all partners of public accounting firms in Canada over a set period, usually three years. The risk assessments, inspection methodologies and inspection results are shared between CPAB and the provincial institutes.

- Firms with 100 or more reporting issuer clients are subject to annual inspection, those with between 50 and 99 reporting issuer clients are subject to inspection every two years and other firms are subject to inspection every three years.

- Inspection is on both a firm basis and an individual basis.

- During 2014, CPAB’s 30-member inspection staff was supported by eight contract consultants who are used on an as-needed basis for inspection work relating to valuations, information technology, taxation, etc.

- Inspections are based on elements of CSQC 1 quality control for firms that perform audits.

- While the guidelines for the inspection team to follow are not public, they would typically cover a risk model, methodology, reporting, and 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, however CPAB will raise comments on a particular file. Comments are grouped into two categories, with responses required for significant comments, and not for insignificant. Except for significant comments that are required to be shared with the Audit Committee of a reporting issuer client if a firm voluntarily agrees to the 2014 CPAB Protocol, all findings are confidential and cannot be shared outside of the firms.

- At the conclusion of the firm inspection, CPAB holds an exit meeting with firm leadership to discuss the overall inspection results. CPAB then issues its inspection report, which is a private communication between CPAB and the firm. The inspection report includes a summary of the findings arising from the inspection, as well as recommendations to improve audit quality. In particular, CPAB highlights the top three to five recommendations that it believes will have the most impact on improving audit quality.

- The audit firm must implement the recommendations to CPAB’s satisfaction within a prescribed period of time, which is typically no more than 180 days. Most commonly, CPAB will identify specific actions that the firm must take in connection with its audits of the upcoming calendar year-ends. In all cases, CPAB follows up to ensure its recommendations have been satisfactorily implemented.
8.4.2 Canada – inspection (cont’d)

- CPAB publishes an annual inspection report on the Big Four firms as well as a publication on Big Four firms as highlights for audit committees. In addition, CPAB publishes an annual report on all firms inspected.

- 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 can include limiting the scope of the audit work the firm can undertake until the identified deficiencies have been corrected, within a specified timeframe, requiring the firm to engage an external monitor to review its audit work prior to the release of an audit opinion, prohibiting a partner from acting as an engagement partner on a reporting issuer audit and requiring partners and staff to take training in areas where they are deemed to be deficient.
  - 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 certain Restrictions 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 CPAB’s proposal of a remedial action, file with the Secretary of the Board a petition for a review proceeding. In the event of a dispute, CPAB 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

- CPAB may issue an order for an Investigation if it considers that a Violation Event* may have occurred. In an Investigation order, members of CPAB staff may be designated to issue demands and 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. CPAB shall provide to the participating audit firm a copy of its Investigation order, subject to receiving from the firm signed consent to such limits on dissemination as it 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 CPAB in connection with such Investigations, shall be confidential in the hands of CPAB, provided however that it 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 CPAB shall inform the recipient that the information is confidential.

- Deregistration, sanctions, restrictions and/or requirements 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 National Instrument 52-108, as well as the enactment of auditor oversight legislation by several Canadian provinces and territories including, Ontario, British Columbia, Yukon, Northwest Territories, Saskatchewan, Manitoba and New Brunswick. The legislation provides that CPAB is recognised as an auditor oversight body in each of these jurisdictions. In Québec, CPAB operates by way of an agreement with the Ordre des CPA du Quebec. The most extensive auditor oversight body legislation is the Canadian Public Accountability Board Act – Ontario.

- Sanctions include fines, public censures, suspension and/or termination of registration, directions on various 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 may sanction an audit firm, meaning it could no longer audit reporting issuers in Canada.

- CPAB 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 the Canadian Securities Administrators National Instrument 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, is provided in writing along with a notice of each party’s right to appeal the decision further.
8.4.5 Canada – standard setting

CPA Canada operates and funds the standard setting, subject to CPAB oversight (see section 3 of CPAB’s Strategic Plan 2016-18 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:

<table>
<thead>
<tr>
<th>Responsible body and comment on convergence</th>
<th>Auditing and Assurance Standards</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>The PTC of the CPA Canada monitors international developments with respect to the IFAC Code of Ethics and developing responses to changes, on behalf of the Canadian CPA profession, regarding any future changes to the Code of Ethics. Note: Canada has some rules/standards for independence that are more stringent than the IESBA code.</td>
<td>The AASB, overseen by the Auditing and Assurance Standards Oversight Council (AASOC). Note: In 2011, the Canadian auditing standards were replaced with international auditing standards that were adopted as new Canadian Auditing Standards (CASs).</td>
<td>The AcSB for Canadian companies and not-for-profit organisations. The Public Sector Accounting Board (PSAB) for the public sector. The Accounting Standards Oversight Council (AcSOC) oversees and provides input to both AcSB and PSAB. Note: Canadian reporting issuers are generally required to follow IFRS as issued by the IASB.</td>
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| Structure and staffing | | |
|------------------------|------------------------|
| PTC reports to the CPA Canada Board through the profession’s Council of Senior Executives (CSE). 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: • initiate, review and commission research, and consult with appropriate parties within and outside the profession; • authorise committees, task forces, etc. that it establishes to do the same; and • adopt harmonised independence standards for Chartered Accountants and ensure they are kept up to date. | AASOC comprises not fewer than 13 and not more than 17 volunteer voting members. Many of its members are prominent regulators and business leaders. AASOC membership consists of senior members from the accounting and legal professions, finance, academia, regulators, information technology and financial analyst communities, amongst others. The members have a broad perspective of the complex issues facing auditors. There are currently 15 voting members and five non-voting members. 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. | AcSOC normally comprises not fewer than 20 and not more than 25 volunteer voting members. The AcSOC consists of 11 voting members and two non-voting members from a variety of backgrounds. The AcSB is a full-time position; the remaining members are part-time volunteers. Members are appointed by the AcSOC, which ensures that the AcSB has an appropriate balance of competencies and experience to meet its objectives. PSAB consists of a maximum of 12 voting members including a Chair and a Vice Chair, and one non-voting member. PSAB serves the public interest by establishing high-quality accounting standards for public sector entities. |
## 8.4.5 Canada – standard setting (cont’d)

<table>
<thead>
<tr>
<th>Overview of standard setting process</th>
<th>Ethical standards</th>
<th>Auditing and Assurance Standards</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>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:</strong></td>
<td><strong>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:</strong></td>
<td><strong>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.</strong></td>
<td></td>
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<tr>
<td>- recommending policies and strategies to uphold the public’s confidence and trust in the profession;</td>
<td>- monitoring international developments in the area of ethics;</td>
<td>- With regard to adopting these standards, the AASB applies the following process:</td>
<td></td>
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<tr>
<td>- monitoring international developments in the area of ethics;</td>
<td>- reviewing, on behalf of the profession, and responding to any proposed changes to independence standards;</td>
<td>1. Develop a project strategy</td>
<td></td>
</tr>
<tr>
<td>- reviewing, on behalf of the profession, and responding to any proposed changes to independence standards;</td>
<td>- monitoring the development and renewal of the profession’s harmonised rules of professional conduct;</td>
<td>2. Review material presented at the IAASB meetings and consider possible Canadian modifications to draft ISAs for adoption as CASs</td>
<td></td>
</tr>
<tr>
<td>- monitoring the development and renewal of the profession’s harmonised rules of professional conduct;</td>
<td>- monitoring the development and renewal of the profession’s disciplinary and practice inspection processes;</td>
<td>3. Approve an exposure draft</td>
<td></td>
</tr>
<tr>
<td>- 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;</td>
<td>- 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;</td>
<td>4. Re-exposure considerations</td>
<td></td>
</tr>
<tr>
<td>- 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</td>
<td>- 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</td>
<td>5. Approve a standard</td>
<td></td>
</tr>
<tr>
<td>- approving the terms of reference of committees or task forces created under its auspices.</td>
<td>- approving the terms of reference of committees or task forces created under its auspices.</td>
<td>6. Basis for conclusions</td>
<td></td>
</tr>
</tbody>
</table>

The structure of the PTC is intended to assist the profession in identifying and addressing issues through a consultative and timely process.

The AcSB follows a rigorous set of procedures, known as due process built on the principles of transparency, consultation, accountability and different sets of standards in developing and adopting standards. 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.

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.

PSAB also follows a rigorous consultative procedure in the development and issuance of accounting standards and Statements of Recommended Practices for the public sector.
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 2014 CPAB’s base fee rate was two per cent of the audit fees both Canadian and foreign participating firms charged their reporting issuer clients, with a minimum fee of CAD$1,000. In 2014, 186 firms (2013 – 191) 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 that are engaged in an information-sharing agreement with CPAB. These reporting issuers are charged only 0.2 per cent of the firm’s audit fees. The rates did not change from 2013.

- CPAB had revenues of CAD$16.1 million in 2014 compared to revenues of CAD$16.9 million in 2013.

- CPA Canada operates and funds the Standard Setting Body. CPA Canada contributes CAD$2.5 million to standard setting through its support for the International Accounting Standards Board (IASB), International Public Sector Accounting Standards Board (IPSASB), and International Federation of Accountants (IFAC). The CPA Canada has more than 200,000 members.
8.5 Australia
8.5.1 Australia – registration

- Once an entity is required to prepare an annual financial report under the Corporations Act, 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 March 2016 there were 2,179 listed entities on the Australian Securities Exchange.

- A PIE is defined as a listed entity (see above) or any entity (a) defined by regulation or legislation as a PIE; 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;
  - 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 required by the CA 2001 and some other regulatory audits, such as for the Australian Prudential Regulatory Authority, may only be performed 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 only conduct registered company audits in Australia after registering with ASIC. However, the registration process with ASIC is very straightforward; requiring the individual to prove that they are registered with the Financial Markets Authority in New Zealand.
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 (see upcoming changes as set out in 8.5.6).
- Per the most recent annual report, ASIC had 227 FTE staff in its registry 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 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 mandates that all audits or reviews of financial reports (whether at full year or half year) must be conducted in accordance with auditing standards. ASIC is responsible for monitoring compliance with the Corporations Act, and accordingly conducts inspections of audits of PIEs in Australia. ASIC does not delegate the performance of its inspection activity to others although it can conduct joint inspections with the PCAOB and the CPAB.

- The ASIC inspection activity runs on an 18 month cycle. The most recent one covered 21 firms, being the four large national firms (which are inspected every 18 months), seven 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 CAANZ 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. There has been no separate evaluation of audit quality in the larger firms since that time.

- According to ASIC’s 2014-15 annual report, its Financial Reporting and Audit team has 32 FTEs. We do not know how many of these are dedicated to its audit inspection activity. The annual report notes that 25 FTEs are allocated to surveillance activity being Financial Reporting Surveillance and audit inspection activity.

- Inspections cover both the review of an auditor’s system of quality control and working papers of Corporations Act audit engagements (but ASIC’S focus is primarily on the individual file review). In the case of the larger firms, the work on the system of quality control focusses on any updates to policies since the previous inspection. There are no published guidelines on the inspection approach.

- Each inspection team is structured in a similar way to an audit team.

- In mid-2014, ASIC changed the manner in which it conducts inspections. Rather than being on-site at a firm for a period of five-six weeks, it commenced a program whereby it reviews files on a more continuous basis throughout the inspection period. One audit engagement file is inspected at each Big Four firm per month. Mid-tier firms’ audit files may be reviewed every quarter. Small firms that only audit one or two listed companies may be reviewed once every 12 years.

- At the conclusion of each file, where ASIC has observations in relation to its inspection activity, they issue a comment form to the firm. Comment forms are finalised progressively throughout the period. The issuance and finalisation of comment forms can take some time after the conclusion of the on-site file review.

- The Overall Inspection Report to the firm includes:
  - Executive Summary
  - Overall inspection findings (Audit Quality Findings, Quality Control Findings and Recommendations for improving Audit Quality)
  - Individual file review findings (either the executive summary, or a summary of the executive summaries for each of the files reviewed)

- ASIC issues a consolidated public report every 18 months. The most recent report was issued in December 2015.
8.5.2 Australia – inspection (cont’d)

- No individual inspection reports are published, however a change in law allows 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). 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;
  - any applicable code of professional conduct; or
  - the provisions of the Corporations Act 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; and
  - 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. As from June 2012, if and when a deficiency report is issued, it will feature the relevant firm’s comments in reply.
8.5.3 Australia – investigation

- ASIC is responsible for administering 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; and
  - 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 (ref. upcoming cuts; see 8.5.1). The Government can also provide additional funding to ASIC for it to undertake specific projects.

- Exact ASIC staff numbers are unknown, as is the number of staff allocated to audit investigation. 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; and
  - 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)

- 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 CALBD 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 are made by the Deputy Prime Minister and Treasurer. The CALDB 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) (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.

- Since our 2013 report, there have been three CALDB decisions against auditors (in November 2013, July 2015 and October 2015). The period of licence suspension varied from 6 months to 3 years.

ASIC’s enforceable undertakings

- ASIC either pursues an enforceable undertaking itself, or refers the matter to the CALDB. While the CALDB is the recognised ‘disciplinary body’ for Australian auditors, much 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). As well as being able to refer 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 has been a historical trend of ASIC entering into enforceable undertakings with auditors, often at the investigation stage (i.e. before matters progress to enforcement), or at enforcement before the matter is referred to the CALDB. The enforceable undertaking is one of a number of remedies available to ASIC for contraventions of the legislation that it administers.

- It is noted that in the period since our 2013 report, three matters have been referred to the CALDB by ASIC and there have been five enforceable undertakings accepted by ASIC from registered company auditors.

- Section 93AA of the ASIC Act gives ASIC the power to accept a written enforceable undertaking 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 enforceable undertakings offered by responsible managers of registered schemes.

- ASIC does not have any power to compel a person to offer or enter into an enforceable undertaking. An enforceable undertaking 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 CALDB.

- The usual process is that there are discussions between the parties, an enforceable undertaking is negotiated and then “offered” to ASIC by the subject.

- ASIC has used enforceable undertakings 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 enforceable undertaking 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 enforceable undertaking is the most effective regulatory outcome.
8.5.4 Australia – enforcement (cont’d)

ASIC’s enforceable undertakings (cont’d)

- An enforceable undertaking 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 enforceable undertaking (e.g. a delinquent auditor) is known as the “promisor” (as they agree / promise to do a number of things in the enforceable undertaking).

- If ASIC believes that an enforceable undertaking 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 enforceable undertaking if ASIC has proven the breach. For example the Court might:
  - order the promisor to comply with the enforceable undertaking, 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

<table>
<thead>
<tr>
<th>Ethical standards</th>
<th>Auditing and Assurance Standards</th>
<th>Accounting Standards</th>
<th>Financial Reporting Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Responsible body</strong></td>
<td>Australian Professional and Ethical Standards Board (APESB)</td>
<td>Australian Auditing and Assurance Standard Board (AUASB)</td>
<td>Australian Accounting Standards Board (AASB)</td>
</tr>
<tr>
<td><strong>Function, powers and jurisdiction</strong></td>
<td>Established as an initiative of CPA Australia and CAANZ. The third professional body in Australia, the Institute of Public Accountants is also a member of the APESB.</td>
<td>An independent statutory agency of the Australian Government responsible for developing, issuing and maintaining high quality auditing standards in the public interest.</td>
<td>Financial Reporting Council (AU FRC)</td>
</tr>
<tr>
<td><strong>Operated and funded by</strong></td>
<td>Funded by CPA Australia, CAANZ and the Institute of Public Accountants.</td>
<td>Operated by the Australian Government and primarily funded by the Australian Government. The AU FRC, whilst not a standard setting body, has oversight.</td>
<td>The Australian Government funds the operation of the AU FRC and expenditure is included in the Treasury’s annual financial statements.</td>
</tr>
<tr>
<td><strong>Level of funding</strong></td>
<td>Funding from the accounting bodies was A$1.4m in the last two financial years.</td>
<td>Funding varies from year to year. 2014/15 funding was A$2.2m.</td>
<td>Funding varies from year to year. In 2014/15 funding from the Federal Government was A$3.7m and A$0.5m from State and Territory Governments.</td>
</tr>
<tr>
<td><strong>Structure and staffing</strong></td>
<td>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.</td>
<td>The Chairman is appointed by the Minister, while other board members are appointed by the AU FRC. Appointments may be made for a period of up to five years and retiring members are eligible for reappointment.</td>
<td>The AU FRC's Secretariat is provided by staff of the Treasury's Markets Group. The AU FRC has two board committees who advise it.</td>
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</table>
8.5.5 Australia – standard setting (cont’d)

<table>
<thead>
<tr>
<th>Overview of standard setting process</th>
<th>Ethical standards</th>
<th>Auditing and Assurance Standards</th>
<th>Accounting Standards</th>
<th>Financial Reporting Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>APESB or an external party initiates development of a new standard. APESB considers the proposal, has a taskforce draft a proposal; this is sent out for consultation before APESB considers a revised draft and determines whether a final pronouncement is made.</td>
<td>When an issue is identified, it is added to the AUASB’s agenda and researched; stakeholders are consulted before a new standard is issued.</td>
<td>When an issue is identified, it is added to the AASB’s agenda and researched; stakeholders are consulted before a new standard is issued.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comment on level of convergence with international standards</td>
<td>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 PIEs that are audit clients) and a few local additional requirements. 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. The APESB has issued standards for professional services for which there are no international pronouncements e.g. valuation services.</td>
<td>The AUASB followed AU FRC directive (see right) on using international standards as a base point. 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. 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.</td>
<td>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. In July 2004, the AASB issued the initial Australian equivalents to International Financial Reporting Standards (IFRSs) that applied from 2005. 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.</td>
<td>In 2002 the AU FRC 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. AU FRC issued strategic directive that AUASB should use, as appropriate, International Standards on Auditing (ISAs) of the IAASB as a base from which to develop Australian Auditing Standards.</td>
</tr>
</tbody>
</table>
8.5.6 Australia – funding model options

- New development: move towards an industry funding model
  - In the 2014 budget it was announced that over the next five years, A$120 million will be pulled from ASIC’s funding from Government. While ASIC would continue to be funded from the Commonwealth Budget, a much larger share of its budget would be offset by charging industry levies and fees. Indeed, the proposed industry funding model suggests that costs of A$6m are to be recouped from auditors in 2016/17 - we understand that these are based on the cost of current inspection and enforcement activity. The proposed industry funding model would be based on the Government’s Cost Recovery Guidelines where the cost of ASIC’s regulation would be recovered directly from sectors and entities that create the need for regulation via a system of industry levies and fees.

- Inspection
  - The ASIC inspection activity is currently funded by the Federal Government. 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 allocated funding by the Federal Government through ASIC’s budget. All appointments are made by the Deputy Prime Minister and Treasurer. The CALDB consists of 14 paid members; eight must be non-accountants. The Chair and Deputy Chair are members of the legal profession.

- Standard setting
  - 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$1.4m in each of the last two financial years.
  - The AUASB and AASB are primarily funded by the Australian Government; funding varies from year to year. AUASB: 2014/15 and 2013/14 funding was A$2.2m; AASB: 2014/15 funding from the Federal Government was A$3.7m, A$0.5m from State and Territory Governments.

- Financial reporting framework overseen by AU FRC
  - The Australian Government funds the operation of the AU FRC and expenditure is included in the Treasury’s annual financial statements. Expenditure in connection with the AU FRC is not disclosed in the Treasury financial statements at a sufficiently detailed level to identify.
8.6 Singapore
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.

- In January 2015, ACRA issued the Revised Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (the ACRA Code) which took effect from July 2015. The revised ACRA Code defines PIEs as the following:
  
a) All listed entities;

b) Entity incorporated in Singapore with securities listed on an overseas exchange;

c) Entity in the process of issuing its debt or equity on Singapore exchange;

d) Financial Institutions; and

e) Large charities and large Institutions of Public Character (IPC) (Charities with gross annual receipts in each financial year of not less than S$10 million in the two financial years immediately preceding the current financial year of the charity).

- ACRA is the independent regulatory body responsible for registration of auditors for Singapore publicly listed companies and PIEs, 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.

- ISCA [formerly 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 they are a member of ISCA.

- 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.
8.6.1 Singapore – registration (cont’d)

- 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 CPE 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.

- ACRA carries out offsite monitoring on a bi-annual basis and onsite review is on an annual basis.

- For PIEs, inspections are now on an annual basis for firms that audit over 10% share of market capitalisation of listed companies; and take place every three years for firms auditing less than 10% (unless significant control lapses require more frequent inspection).

- Inspections of firms that audit non-PIEs are carried out with the assistance of ISCA, under the direct oversight of ACRA. Public accountants that do not audit PIEs are inspected by practice reviewers employed by ISCA and appointed by the PAOC. Non-PIE engagements reviewed may be group rather than individual engagements.

- ACRA issues the public accountant/accounting firm with a private report which includes a discussion on the findings raised, a reference to the relevant prescribed standards, as well as recommendations of areas for improvements. It also informs each firm how it fared in the respective SSQC area (against a three colour ‘traffic light’ system) – this is not made public – and the colour result determines the frequency of ACRA’s review on that SSQC area.

- 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.

- 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 SSQC 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 SSQC 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 on a regular basis 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.

- ACRA believes that a strong system of firm-level quality controls is key to ensuring a sustainable, consistent high standard of audit quality in the long term. This has led ACRA to propose amendments to the Accountants Act to institutionalise firm-level inspections as a statutory requirement.
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 ISCA 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 ISCA, 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 oversees both companies and accountants, and can pursue both company directors and accountants in cases of fraud, dishonesty or non-compliance in financial reporting for example.

- In July 2014, ACRA expanded the scope of its Financial Reporting Surveillance Programme (FRSP) to include reviews of financial statements with ‘clean’ audit reports of listed companies. Previously, the FRSP focus centered on accounting issues highlighted in the modified audit reports of listed companies. The primary objective of the FRSP is to guide companies to meet the requirements in the prescribed Accounting Standards in Singapore. Regulatory sanction is taken against company directors only for non-compliance(s) that has a severe impact on the financial statements.
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:
  - cancel the registration of the public accountant or revoke the approval granted to the accounting corporation, accounting firm or accounting LLP;
  - suspend the public accountant from practice or 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 practice of the public accountant or 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 public accountant a penalty not exceeding S$10,000 or on the accounting corporation, accounting firm or accounting LLP a penalty not exceeding S$100,000;
  - censure the public accountant or the accounting corporation, accounting firm or accounting LLP;
  - require the public accountant or 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.

- ISCA’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 total amount spent by the 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 UK FRC updated the UK Corporate Governance Code (Code), which included a provision for FTSE 350 companies to tender their external audit every 10 years on a 'comply or explain' basis (now superseded; see below). It also incorporated changes originally announced in October 2011 to require companies to publish - and report annually against - their policy on boardroom diversity. The revised Code became effective for periods commencing on or after 1 October 2012. Since then, the UK FRC has consulted on further changes as follows:
  - In 2015, as part of its ongoing work to enhance justifiable confidence in audit, the UK FRC issued a consultation on revisions to Ethical and Auditing Standards, the UK Corporate Governance Code and related Guidance on Audit Committees. The FRC did not introduce any additional gold-plating in respect of the audit committee's oversight of the audit and the auditor beyond that required to implement the amended SAD and AR. The changes related to the tenure of the auditor where the 2012 Code change introducing ten year retendering became redundant; and to changes in the composition and role of the audit committee. The UK FRC also consulted on the recommendations of the CMA – see below - relating to increasing shareholder engagement on audit matters through changes to both the Code and the UK Stewardship Code; however the UK FRC concluded that sufficient coverage was already given to this topic in both codes.
  - In 2014, the UK FRC consulted on proposed revisions to the UK Corporate Governance Code regarding executive remuneration, going concern and risk management reporting and related guidance.

- Other notable/ongoing developments in the UK since 2013 include:
  - The introduction of AQIs, voluntarily identified and reported against by the six largest audit firms since 2014.
  - Enhanced auditor reporting (also soon to be introduced across the EU through the 2014 audit legislation revisions) which has now bedded in since its introduction by the UK FRC for auditor’s reports on annual accounts of listed companies for periods commencing on or after 1 October 2012. As in the Netherlands, another ‘early adopter’ within the EU, enhanced auditor reporting has led to positive reactions from stakeholders, fostering enhanced dialogue between market participants.
  - The UK FRC is currently updating the Audit Firm Governance Code, originally published in January 2010 by the UK FRC and the ICAEW. The proposed changes respond to feedback received in 2015 regarding: clarifying the purpose of the Code; strengthening the role of independent non-executives; firms considering adopting provisions of the Corporate Governance Code not currently in the Audit Firm Governance Code; firms maintaining and growing the efforts they have built to engage with investors.

**Department for Business Innovation and Skills (BIS)**

- BIS published its final consultation on the EU audit reforms in October 2015. It covered the definition of PIE; the regulation of auditors (the UK FRC was designated as the ‘single competent authority’ with ultimate responsibility for most matters of audit regulation and oversight); rotation and tendering (for PIEs, audits should be tendered at least every ten years; the maximum length of appointment is twenty years); standards and standard setting (whereby the UK FRC standards were given legal standing); and the banning of ‘Big Four only’ clauses (from 17 June 2016).
9.1 Regulatory reform in the UK (cont’d)

ICAEW

- In 2016, the ICAEW consulted on guidance on aspects of its Code of Ethics, following an earlier Tribunal which had judged that if an accountant fulfils his/her requirements of integrity, honesty, objectivity and competence, there is no requirement for a separate test of acting in the public interest. Note that those four requirements are however proposed to be replaced by five fundamental principles of ethical behaviour (in both the ICAEW and IESBA codes), namely: confidentiality, professional behaviour, integrity, objectivity and competence. The ICAEW will finalise its position after consideration of the responses to the consultation.

Competition and Markets Authority (CMA) (formerly known as the Competition Commission (CC))

- The CMA published its final order on the mandatory use of competitive tender processes and Audit Committee responsibilities in September 2014, taking into account the market reforms introduced through the EU legislation and duly concluding the CMA (former CC) process. The order entered into force on 1 January 2015 and applies to financial years beginning on or after this date. Key changes include:
  - Mandatory tendering every ten years for FTSE 350 companies in line with the EU Regulation;
  - Transitional arrangements confirmed in line with those in the EU Regulation; and
  - Increased responsibilities for audit committee supervision of the external audit relationship largely put existing best practice on a statutory basis, but will see audit committees more engaged in the detail.
9.2 Regulatory reform in Europe

**EU audit reform**

- In November 2011, the EC proposed measures to reform the statutory audit of PIEs across Europe.

- Two and a half years of regulatory and political discussion and negotiation later, the 2014 EU audit reform legislation came into force on 17 June 2014 (except for transitional measures around mandatory firm rotation); the SAD and AR having been published in the Official Journal of the EU on 27 May 2014, when they became part of EU law. The Regulation applies directly on 17 June 2016, which is also the deadline for implementation of the Directive by Member States.

- Key provisions, some of which are referred to elsewhere in this study, include:
  - Mandatory firm rotation for auditors of PIEs at least every 10 years (Member States may extend this to 20 years where a public tender is conducted after the first maximum period)
  - Transitional measures for rotation took effect when the regulation entered into force in June 2014. They require audit firm rotation within 6 years for existing audit mandates of 20 years’ duration or more and within 9 years for mandates of 11 to 20 years’ duration. Where the auditor-client relationship is less than 11 years' duration, the auditor may continue until the end of the initial maximum period (that may vary in length per Member State, but is no longer than ten years) plus any extended period (see above) that a Member State may opt for
  - A 70% cap on NAS provided to audit clients
  - A list of prohibited NAS, including tax advice and services linked to the financing and investment strategy of the audit client (but with a Member State option to allow certain tax services, providing they have no direct / an immaterial effect on the audited financial statements)
  - The prohibition of clauses limiting choice of auditor
  - EU Member States are still implementing the reforms (see examples in section 9.3); the complete picture across the EU is not yet known (in terms of decisions that are to be made at Member State level around some of the optional elements of the SAD). In the meantime, the EC is already seeking input from industry participants and other stakeholders on the reforms, and issues guidance to assist their implementation.
9.3 Regulatory reform worldwide

This section includes updates on jurisdictions featured in the 2013 study, as well as information on some additional jurisdictions. Rotation references are to audit firm (rather than partner) rotation, unless otherwise stated.

Americas

- **Brazil** – five year rotation for Brazilian (non-bank) listed companies (10-year if the company has a statutory audit committee in place before appointing the auditor); five-year rotation for investment funds and for insurance companies. For all other audits, five year rotation for key members of the engagement team.

- **Argentina** - all mandatory firm rotation requirements have been eliminated.

- **Canada**: 
  - Discussions on mandatory firm rotation and mandatory tendering have been held in the past, though they are not considered as the preferred course of action.
  - The audit regulator (CPAB) and Canadian Institute (CPA Canada) jointly led an Enhancing Audit Quality initiative in 2013, focused on three main areas: ‘Auditor Independence’, ‘Auditor Reporting’ and the ‘Role of the Audit Committee’. As a result – and in addition to an annual assessment that assesses the engagement partner and team – a (voluntary) comprehensive review of the external auditor by the audit committee at least every five years is viewed as an effective approach to addressing threats arising from long tenure of the audit firm and providing increased transparency to audit committees. CPA Canada developed guidance and tools that can be used by the audit committee in performing an annual and comprehensive review. Note that the process is driven by the audit committee, not company management.
  - Also voluntary, the 2014 CPAB Protocol sets out how audit firms communicate CPAB’s inspection findings to audit committees. It applies to audit file inspections commencing on or after March 1, 2014 and requires the audit firm to provide the CPAB annual Public Report that highlights its common findings across all its inspections. If the issuer’s file was selected for an inspection in the current year, the report to the audit committee should also include the description of focus areas selected for inspection by CPAB, whether there were any significant findings, and actions taken in response to the CPAB’s findings.
  - For NAS, Canada continues to use a principles-based approach to evaluating threats to, and safeguards for, the provision of NAS, with appropriate rule-based prohibitions for services when threats cannot be overcome. Canada has also aligned 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.
9.3 Regulatory reform worldwide (cont’d)

- **US:**
  - In 2011, the PCAOB began a public discussion of the relevance of auditor tenure in its Concept Release on Auditor Independence and Audit Firm Rotation. However, after receiving much public input from a variety of stakeholder groups, the PCAOB has publicly stated that it is no longer actively considering mandating audit firm rotation.
  - In December 2015, the PCAOB Board approved new rules and amendments to auditing standards to require audit firms to name the engagement partner and certain other accounting firms that participated in an audit. Rules 3210 and 3211 will require disclosure of the name of the audit engagement partner on a new PCAOB form, Auditor Reporting of Certain Audit Participants, or Form AP. Firms will also be required to use Form AP to disclose information about other accounting firms participating in an audit, including the names of the firms and the extent of their participation. The effective dates will be phased in as follows: engagement partner name is to be disclosed on Form AP for all audit reports issued on or after 31 January 2017 (or three months after the SEC approval, whichever is later); participating firms will need to be disclosed for the audit reports issued on or after 30 June 2017. The information filed on the form will be available through a searchable database.

- **EU**
  - **Hungary** – in July 2015, Hungary adopted new legislation which includes mandatory firm rotation after five years, with a four year cooling-off period. After adoption of legislation implementing the EU AR (it is pending publication in the Hungarian Official Gazette), Hungary may retain five year mandatory firm rotation for PIEs, the list of prohibited NAS for PIEs based on the new EU AR text but allowing tax and valuation services and the PIE definition may be expanded compared to the SAD.
  - **Italy** – mandatory rotation every nine years for all listed companies. After adoption of legislation implementing the EU AR, Italy may move to mandatory rotation every ten years for PIEs; some non-PIEs may also be captured by new restrictions (draft law being discussed – final legislation may be effective 17 June 2016).
  - **The 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 NAS for PIEs (effective 1 January 2013). After adoption of legislation implementing the EU AR, the Netherlands may move to mandatory firm rotation every ten years for PIEs, a list of prohibited NAS for PIEs based on the new EU AR text with additional prohibitions and a possible list of allowed services. Also, the PIE definition may be expanded as compared to the SAD (draft law being discussed – final legislation may be effective 17 June 2016).
  - **Poland** – after adoption of legislation implementing the EU AR, Poland may have mandatory firm rotation for PIEs every eight years; a list of prohibited NAS for PIEs based on the new EU AR text but allowing tax and valuation services and the PIE definition may be expanded compared to the SAD (no draft law text yet – final legislation may be ready in September 2016).
  - **Portugal** – list of prohibited NAS for PIEs based on the text of the new EU AR (effective 1 January 2016, but when audit mandates are in progress on 1 January 2016, auditors/audit firms have an additional 18 months to conform); mandatory firm rotation every eight or nine years for PIEs (effective 1 January 2016 but auditors / audit firms have until 1 January 2017 to regularise situations which are contrary to the law); expanded PIE definition compared to the SAD.
  - **Spain** – list of prohibited NAS for PIEs based on the new EU AR text, allowing tax and valuation services but with a broad range of independence restrictions related to the key auditor; mandatory firm rotation every ten years for PIEs which can be extended by four years in case of joint audit (effective 17 June 2016, applies to the audit of financial statements for financial years beginning on or after that date, and with transition measures for rotation depending on the length of the audit mandate); expanded PIE definition compared to the SAD.
9.3 Regulatory reform worldwide (cont’d)

Other EMEA

- **Bahrain** – audit partner rotation every five years for financial services companies.
- **Egypt** - for non-public sector banks, the Central Bank has a ten year rule for firm rotation.
- **Saudi Arabia** – five-year rotation for listed companies (although banks are likely to get an exemption). Effective April 2016, five-year rotation for limited liability companies (private companies) too, with transitional provisions.
- **South Africa:**
  - The Independent Regulatory Board for Auditors initiated a consultation process in 2015 to identify appropriate measures to enhance audit quality, guarantee auditor independence and transform the audit environment e.g. increase the number of black auditors and audit firms; open the market to mid-tier firms. A proposal in this regard is expected in 2016.
  - Section 90(2) of the Companies Act prohibits an auditor from providing audit and certain specified NAS to the same client. Where any of the prohibited services are provided during the preceding five years, this would disqualify the individual (audit partner) and the audit firm from appointment as auditor. The Department of Trade and Industry initiated a public consultation process in December 2015 on possible amendments to the Companies Act. One of the proposed changes is to reduce the current five year disqualification period to two years. It is anticipated that the Companies Amendment Bill will be tabled in Parliament during the latter part of 2016.
  - The Institute of Directors recently published the draft King IV Code on Corporate Governance Code for South Africa. The final Code will be published in November 2016.
- **Turkey** – maximum seven-year audit service term for all companies in any 10-year time period.
- **UAE:**
  - Dubai – three-year rotation for all listed companies. Proposal by the Central Bank for five-year rotation for local and foreign banks.
  - Abu Dhabi – four-year rotation for entities with at least 50% government ownership; three-year rotation for all listed companies implemented prospectively (first rotations in 2019).
9.3 Regulatory reform worldwide (cont’d)

Asia Pacific

- **Australia** – mandatory rotation and tendering are not currently envisaged. Auditors are allowed to provide NAS to their clients subject to conformity with the IESBA code.

- **China**:
  - In general, five-year rotation for state-owned entities (SOE) and financial institutions in China
  - Accounting firms which are ranked among the top 15 firms in Mainland China can audit the same SOE for maximum 8 years. Also, accounting firms that are authorised to audit H-share listed companies in Hong Kong can serve as auditor of an SOE for maximum 10 years
  - The China MOF has recently changed the mandatory firm rotation rule for financial institutions. According to the rule, accounting firms which are ranked among the top 15 firms in Mainland China can audit the same financial institution for maximum eight years

- **India** – in August 2013, the Indian Parliament approved the Companies Act 2013 - replacing the Companies Act, 1956 - effective 1 April 2014 (other than for mandatory firm rotation transitional provisions and for sections where the Rules are yet to become effective). It includes:
  - Mandatory audit firm rotation where an audit firm tenure lasts five years and a maximum of two consecutive terms (five years) may be served by an audit firm.
  - Limits on number of audits per partner in India (20).
  - Restrictions on NAS provision to audit clients, the clients’ holding companies and subsidiaries.
  - Auditor penalties (fines and other penalties for non-compliance of regulations by auditors including, under certain circumstances, imprisonment).
  - Enhanced auditor reporting

- **Indonesia** – five-year rotation for banks; six-year rotation for public companies required by Financial Service Authority and capital markets regulator.

- **Japan** – the Advisory Council established by the regulator (Financial Services Agency) recently issued a proposal outlining several reforms under the following headings (it concluded that more research is needed around mandatory firm rotation):
  - Reinforcing the management of audit firms
  - Enhancing the provision of information regarding audit to shareholders and others
  - Strengthening the ability to detect corporate fraud
  - Assessing audit quality from the viewpoint of third parties
  - Improving the environment for high quality audit
9.3 Regulatory reform worldwide (cont’d)

Asia Pacific (cont’d)

- **Malaysia** - no legal requirement or proposals for mandatory rotation of audit firms or mandatory tendering.
- **Mongolia** - five year rotation period for all companies.
- **Singapore** - mandatory rotation every five years for banks was suspended during the financial crisis and has not yet been reinstated. However, the Monetary Authority is considering 10 year rotation with five year mandatory tendering for the three largest banks.
- **South Korea** – auditors of companies which commit accounting fraud will henceforth face sanctions such as, in the worst case, being removed from their posts if they fail to uncover 'intentional and critical' accounting fraud. Managers of accounting firms will also face charges if significant accounting errors come from companies they supervise. They can be suspended from their duties and excluded from supervision work of listed companies for a fixed period. The new regulation was due to become effective in February 2016 but has been delayed to, probably, February 2017.
- **Taiwan** – no proposals or legislations/regulations on mandatory firm rotation or mandatory tendering in place.
- **Vietnam** – five-year rotation for banks and credit institutions.
Appendix 1: Glossary
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EU

- Audit Regulation (AR)
- Committee of European Audit Oversight Bodies (CEAOB)
- European Audit Inspection Group (EAIG)
- European Commission (EC)
- European Economic Area (EEA)
- European Securities and Markets Authority (ESMA)
- European Union (EU)
- Statutory Audit Directive (SAD)

UK

- Auditing Practices Board (APB)
- Audit Quality Review Team (AQRT)
- Competition Commission (CC)
- Competition and Markets Authority (CMA)
- Department for Business Innovation and Skills (BIS)
- Financial Reporting Council (UK FRC)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Recognised Qualifying Body (RQB)
- Recognised Supervisory Body (RSB)
Glossary (cont’d)

US

- American Institute of Certified Public Accountants (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)

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 Public Accountability Board (CPAB)
- Canadian Standard on Quality Control (CSQC)
- Certified General Accountants (CGAs)
- Chartered Professional Accountants (CPAs)
- Chartered Professional Accountants Canada (CPA Canada) [Replaced Canadian Institute of Chartered Accountants (CICA)]
- Council of Senior Executives (CSE)
- Ontario Securities Commission (OSC)
- Public Sector Accounting Board (PSAB)
- Public Trust Committee (PTC)
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 and Investments Commission Act (ASIC Act)
- Authorised Audit Companies (AAC)
- Authorised Deposit-Taking Institution (ADI)
- Authorised Non-Operating Holding Company (NOHC)
- Chartered Accountants Australia and New Zealand (CAANZ) [replaced Institute of Chartered Accountants in Australia (ICAA)]
- Companies Auditors and Liquidators Disciplinary Board (CALDB)
- Corporations Act 2001 (The Corporations Act)
- Financial Reporting Council (AU FRC)
- 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 Singapore Chartered Accountants (ISCA) [replaced 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)
- Singapore Standard on Quality Control (SSQC)

Hong Kong

- Chief Executive of the Hong Kong Special Administrative Region (CE)
- Financial Reporting Council (FRC / HK FRC)
- Financial Reporting Council Ordinance (FRCO)
- Hong Kong Exchanges and Clearing Limited (HKEx)
- Hong Kong Institute of Certified Public Accountants (HKICPA)
- Practice Review Committee (PRC)
- Professional Accountants Ordinance (PAO)
- Professional Conduct Committee (PCC)
- Quality Assurance Department (QAD)
- Stock Exchange of Hong Kong (SEHK)
Glossary (cont’d)

People’s Republic of China

- Chinese Institute of Certified Public Accountants (CICPA)
- Ministry of Finance in the People’s Republic of China (China MOF)

Other

- Audit Quality Indicators (AQIs)
- Consulting Advisory Group (CAG)
- Continuing Professional Development (CPD)
- Continuing Professional Education (CPE)
- Generally accepted accounting principles (GAAP)
- Global Depositary Receipts (GDRs)
- 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)
- Listed entity auditor (LEA)
- Memoranda[um] of Understanding (MOU)
- Non-audit services (NAS)
- Public Interest Entity[ies] (PIE[s])