

Report on independent audit oversight

Q&As

1. Why did the FRC commission the study?

The Financial Reporting Council (FRC) commissioned the study to keep abreast with international standards and practices of independent audit oversight, so as to assist the Government in developing reform proposals to further enhance the independence of Hong Kong's audit regulatory regime.

2. What is the objective of the reform of the audit regulatory regime?

The objective of the reform is to ensure that Hong Kong's audit regulatory regime is benchmarked against international standards whilst being appropriate in the local context. It is imperative that our business and financial sector should continue to be underpinned by a robust regulatory regime for auditors which is key to investor confidence in financial reporting.

3. How was the study conducted?

The FRC placed a tender and selected Deloitte LLP (UK) as independent consultant to conduct the study. The independent consultant gathered information and data taking into account a questionnaire provided by the FRC and completed the study based on information as of June 2013.

4. What is the scope of the study?

This comparative study covered the audit regulatory systems of Hong Kong and six jurisdictions, namely the European Union (EU), the United Kingdom, the United States, Canada, Australia and Singapore; including the six functional areas of - registration, inspection, investigation, enforcement, standard setting, and continuing education; and funding models.

The study also reviewed the gaps between Hong Kong's existing audit regulatory regime and international standards by making comparison against (see question 6):

- (i) requirements for gaining regulatory equivalence¹ of the European Commission (EC) and membership of International Forum of Independent Audit Regulators (IFIAR)²; and
- (ii) the audit regulatory regimes of five jurisdictions (the United Kingdom, the United States, Canada, Australia and Singapore).

The study also identified certain gaps in the Hong Kong's audit regulatory regime and provided possible approaches to audit oversight, and an overview of global audit regulatory reform.

5. What are the major findings of the study?

Global audit regulatory reform

The audit profession and its oversight arrangements are under close scrutiny worldwide, moving from self-regulation to increasing independence, transparency and robustness.

The study reveals that audit regulators of major jurisdictions are independent of the profession with authority over at least auditors of listed entities. All relevant regulators in the jurisdictions covered in the study, amongst a total of 40 jurisdictions around the world, currently meet the regulatory or equivalence requirements of the EC and are members of IFIAR.

EC 'Equivalence' and IFIAR Membership requirements

To obtain regulatory equivalence with the EC, the audit regulators are required to have ultimate responsibility for the oversight of registration,

¹ 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.

² IFIAR is an organisation for independent audit regulators. The organisation's primary aim is to enable its members to share information on the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.

inspection, investigation, enforcement, standards on professional ethics and auditing, and continuing education. In addition, membership of IFIAR is confined to independent regulators that are responsible for inspection of audit firms and have investigative and enforcement powers which include fines and removal of an audit license and/or registration.

The report explains the audit regulatory regime of the six jurisdictions. For example, the United States passed the Sarbanes-Oxley Act and set up the Public Company Accounting Oversight Board which is directly responsible for the six functional areas (i.e. registration, inspection, investigation, enforcement, standards on professional ethics and auditing, and continuing education). On the other hand, the United Kingdom has decided to delegate the functions of registration and continuing education to professional bodies, subject to oversight of the Financial Reporting Council, which is also directly responsible for inspection, investigation, enforcement and standards on professional ethics and auditing.

6. What is the current status of independent audit oversight in Hong Kong?

As set out in the report, the audit regulatory regime in Hong Kong does not currently meet the requirements for EC Equivalence and membership of IFIAR.

Both EC Equivalence and IFIAR membership require audit regulators be independent of the profession and be governed by non practitioners. In June 2013, the EC amended Decision 2011/30/EU, in which the transitional period granted to Hong Kong has not been extended and will no longer be applicable to audit reports on financial years beginning on or after 1 August 2012.

Under the Professional Accountants Ordinance (Cap. 50) (PAO), the Hong Kong Institute of Certified Public Accountants (the HKICPA) is entrusted with the general responsibilities to regulate auditors and audit firms. The governing body of the HKICPA is its Council. However, the composition of the HKICPA Council, as set out in the PAO, does not guarantee that the membership of the Council would always have a 'non-practitioner' majority.

The FRC is an independent statutory body set up under the Financial Reporting Council Ordinance (Cap. 588) (FRCO) which is governed by a Council, a majority of whose members are non-practitioners.

However, the only function entrusted to the FRC by the FRCO is investigation of auditors of listed entities; and the remaining five functions are within the ambit of the HKICPA.

For further details, please refer to Hong Kong – IFIAR-EC gap analyses in Section 2 of the abridged version of the Report and Section 3 of the full version of the Report.

7. What will happen next for the reform?

The FRC has engaged in discussions on the broad framework for an independent audit regulatory system. We understand that the Government intends to conduct a public consultation in 2014 and if it deems appropriate, the usual legislative process will follow. We remain committed to actively supporting the process leading to the successful completion and implementation of independent audit regulatory reform in Hong Kong.

8. Where can I find the report?

The report (both abridged and full versions) is available on our website (www.frc.org.hk).