



# **Financial Reporting Council**

## **Report on Independent Audit Oversight**

Press Briefing  
10 October 2013

# Agenda

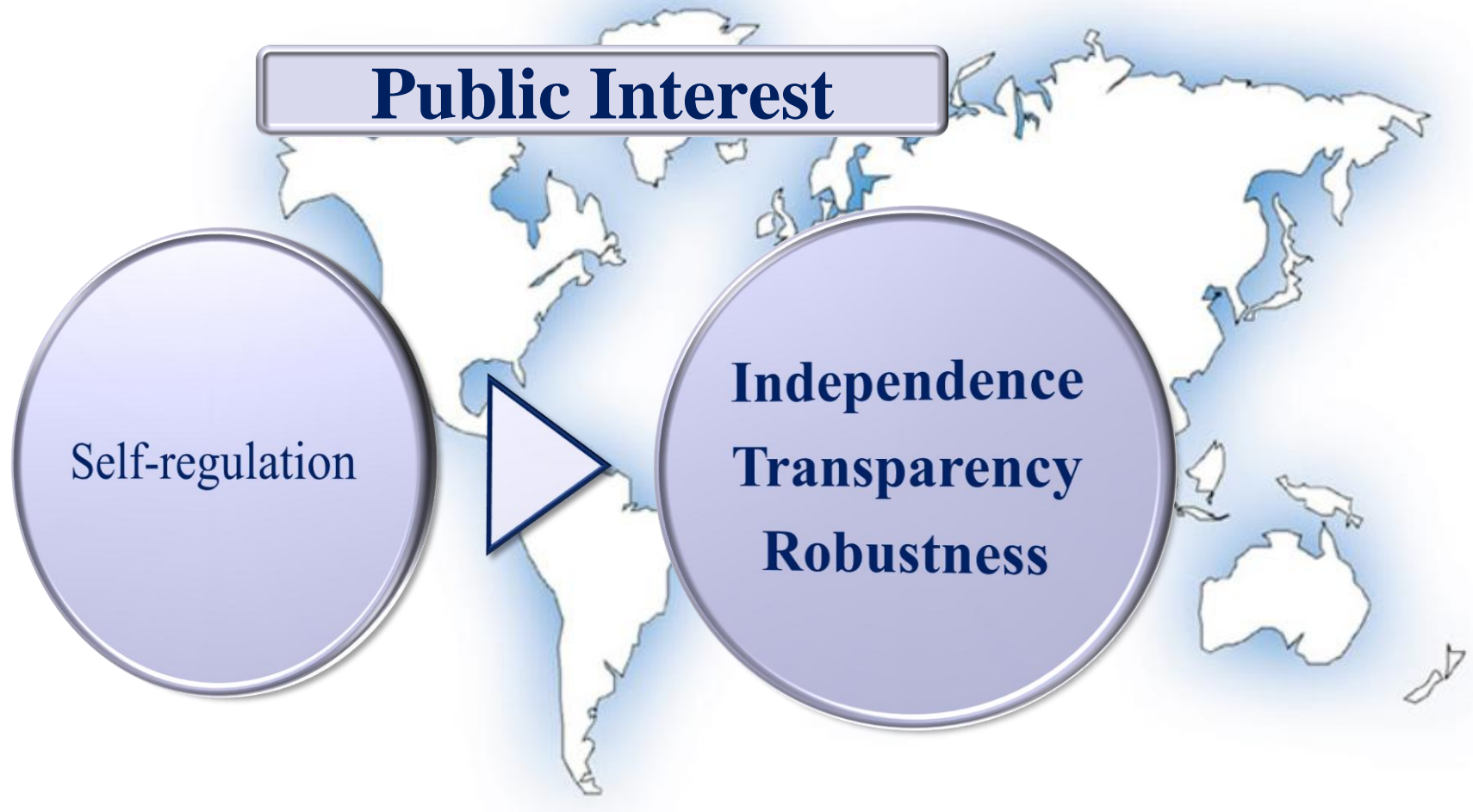
- Opening Remarks
- Preparation of the Report
- Report Findings
- Q&A Session



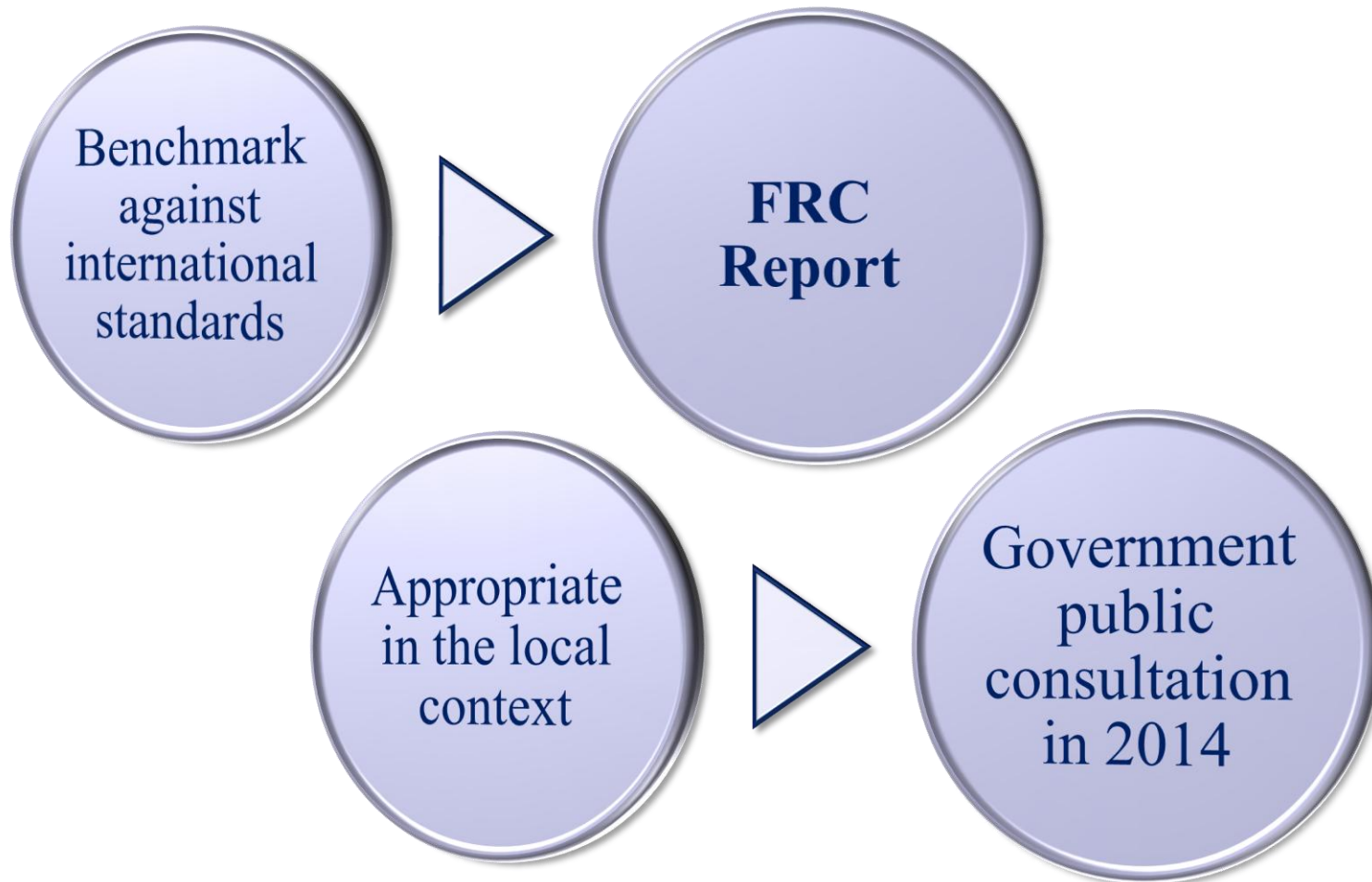
# **Opening Remarks**

**Mr John Poon, JP**  
Chairman  
Financial Reporting  
Council

# Evolution of audit oversight



# Independent audit oversight reform - for Hong Kong



# Independent Audit Oversight

- Independent of the profession
  - Governance of the audit regulator
    - Majority must be non-practitioners
  - Funding of the audit regulator
    - Free from influence by auditors and audit firms

# Independent **Audit** Oversight

- Listed entities in Hong Kong
  - 1,600 companies listed on Hong Kong Stock Exchange
  - Market capitalisation: approx. HK\$22 trillion (approx. US\$2.8 trillion)
- Auditors in Hong Kong
  - 4,200 practising certificate holders
  - Over 30,000 non-practising CPAs in Hong Kong
- Approximately 60 audit practices/firms engaged in audits of listed entities

# Independent Audit Oversight

- A public oversight body which has the ultimate responsibility and authority for overseeing auditors and audit firms
  - Inspection
  - Investigation
  - Enforcement
  - Registration
  - Standard setting
  - Continuing education



# US – over 5,000 listed entities; market capitalisation: approx. US\$20 trillion

- Public Company Accounting Oversight Board (PCAOB)

- A statutory body under Sarbanes-Oxley Act

- Oversees six areas

Directly responsible for		
Registration	Inspection	Investigation
Enforcement	Standard setting (audit and ethics)	Continuing education

- 2013 Budget: approx. US\$250 million

- Headcount: 770

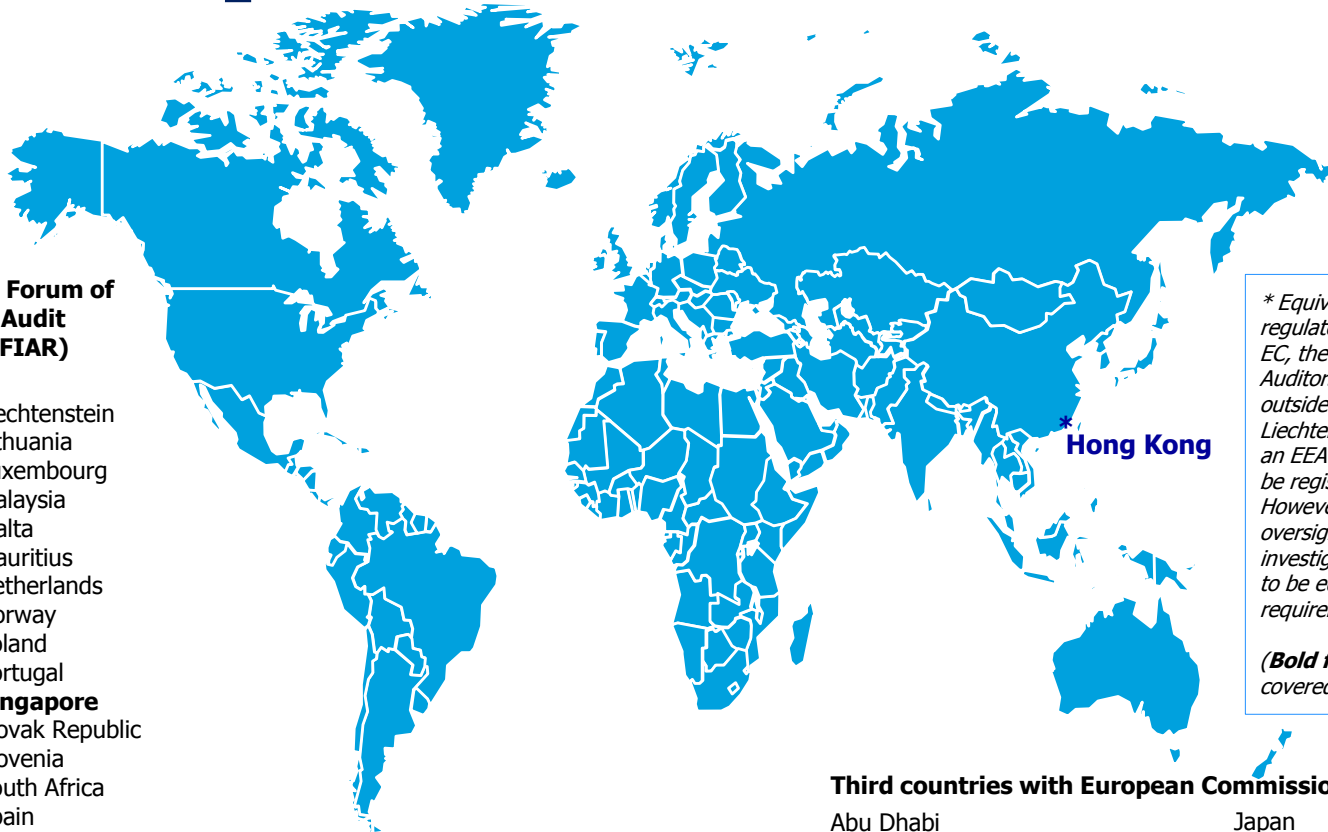
# UK – over 2,400 listed entities; market capitalisation: approx. £4 trillion (approx. US\$6.4 trillion)

- Financial Reporting Council
  - Independent audit regulator
  - Oversees six areas

Directly responsible for			
Inspection	Investigation	Enforcement	Standard setting (audit and ethics)
Delegated to professional bodies subject to FRC's oversight			
Registration		Continuing education	

- 2013 Budget: £25 million (approx. US\$40 million)
- Headcount: 110

# 40 jurisdictions worldwide are both EC compliant and IFIAR members



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

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

## European Union (EU) member states:

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

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

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

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

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

# EC and IFIAR foster cross border co-operation and reciprocity in enforcement between independent audit regulators

## Requirements

### EC

- *Registration*
- *Inspection*
- *Investigation*
- *Enforcement*
- *Standard setting*
- *Continuing education*

### IFIAR

- *Registration*
- *Inspection*
- *Investigation*
- *Enforcement*



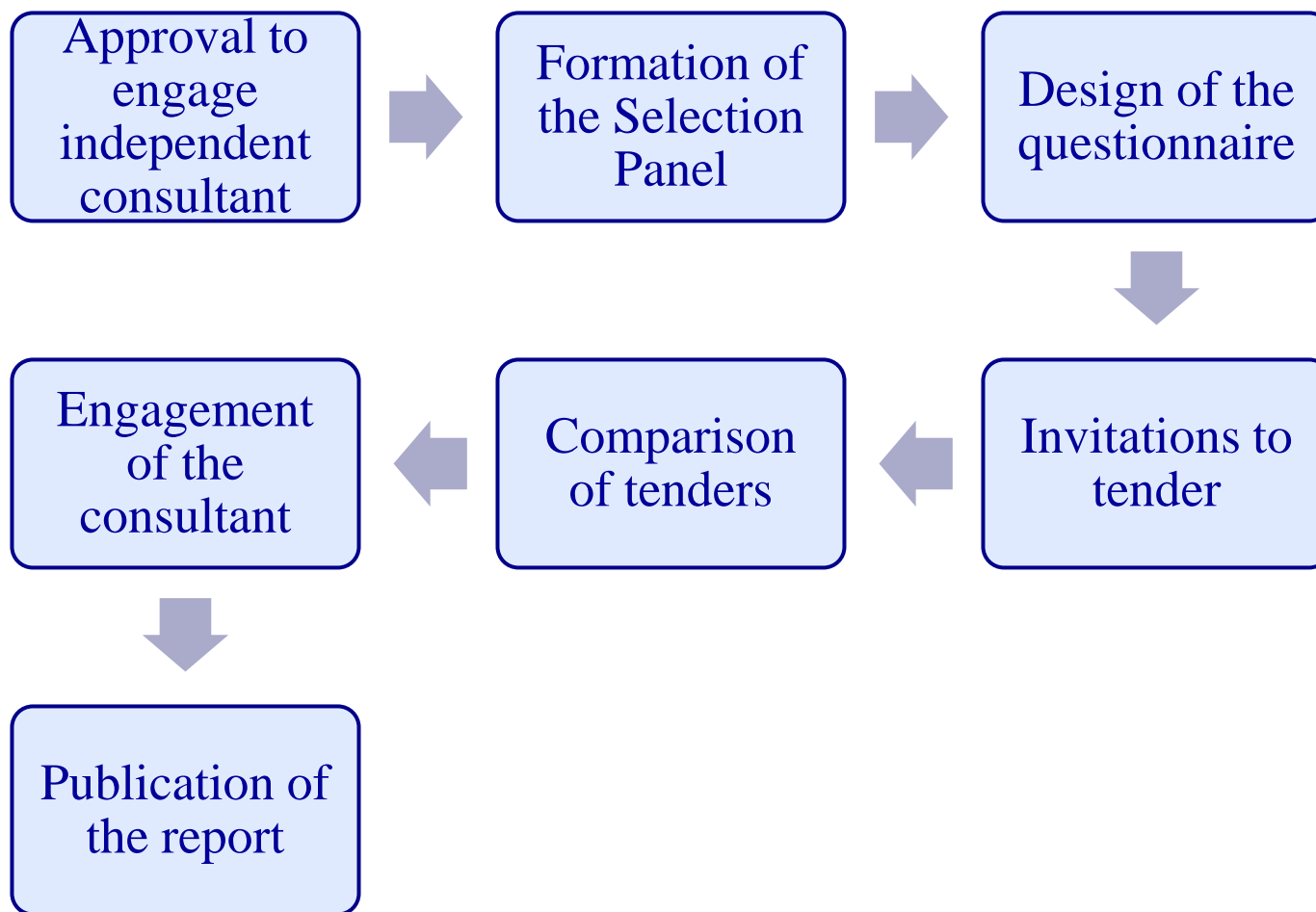
# **Preparation of the Report**

**Mr Mark Dickens, JP**

Chief Executive  
Officer

Financial Reporting  
Council

# Preparation of the report



# Deloitte LLP (UK)

Name	Position	Relevant experience
David Barnes (Lead UK Partner)	Partner	<ul style="list-style-type: none"><li>• Managing Partner for Public Policy</li><li>• Former Head of London Audit Financial Services</li><li>• Former Chairman of the Deloitte Audit Committee</li></ul>
Stuart Diack (Lead Engagement Partner)	Partner	<ul style="list-style-type: none"><li>• Involved in Deloitte's UK Audit Public Policy, Quality &amp; Risk Management function, with a focus on the evolving regulatory landscape in the UK, Europe and globally</li><li>• Member of the Investigations Committee of the Institute of Chartered Accountants in England and Wales</li></ul>

# Scope of the study

- Jurisdictions covered in the report
  - Hong Kong, European Union, the United Kingdom, the United States, Canada, Australia and Singapore
- The gap analyses include:
  - Hong Kong versus IFIAR and EC
  - Hong Kong versus five jurisdictions
- Possible approaches to audit oversight
- Overview of global audit regulatory reform





Independent audit oversight  
Report briefing

David Barnes \ 10<sup>th</sup> October 2013

# Agenda

- Background and scope
- Key IFIAR / EC requirements
- Key gaps and possible approaches

# Background and scope

- Deloitte's study comprises gap analyses between Hong Kong and:
  1. International Forum of Independent Audit Regulators (IFIAR) and European Commission (EC) equivalence requirements
  2. Other key jurisdictions
- The study sets out possible approaches to various areas of auditor oversight by those major jurisdictions, and comparisons between those approaches
- It focuses on the following areas:
  - Registration
  - Inspection
  - Investigation
  - Enforcement
  - Standard setting
  - Continuing professional education (CPE)
  - Funding models

# Key IFIAR / EC requirements

The oversight system must:

<b>Registration</b>	<ul style="list-style-type: none"><li>• have ultimate responsibility for the oversight of approval and registration, and the right to remove registration</li></ul>
<b>Inspection</b>	<ul style="list-style-type: none"><li>• be responsible for the inspection of auditors of public interest entities (PIEs), including at least listed entities</li><li>• be mainly governed by non-practitioners and operationally independent</li></ul>
<b>Investigation</b>	<ul style="list-style-type: none"><li>• have the right to investigate ...</li></ul>
<b>Enforcement</b>	<ul style="list-style-type: none"><li>• ... and enforce penalties / sanctions and the capability to ensure findings / recommendations are appropriately addressed</li><li>• have access to effective, proportionate and dissuasive penalties</li></ul>
<b>Standard setting</b>	<ul style="list-style-type: none"><li>• have ultimate responsibility for adoption of standards on professional ethics, internal quality control and auditing</li></ul>
<b>CPE</b>	<ul style="list-style-type: none"><li>• have ultimate responsibility for oversight</li></ul>
<b>Funding</b>	<ul style="list-style-type: none"><li>• have a stable source of funds which is secured and free from any undue influence by the profession</li></ul>

# Key gaps and possible approaches

Hong Kong's current audit regulatory system has served the market well but it does not meet certain key IFIAR / EC requirements

## 1. Funding - Source of funding of HKICPA

- The HKICPA's funding is mainly sourced from its members and students and the subscription fee is determined by the HKICPA Council.
- The regulator is intended to be independent and self-funding. Funding options might include: a levy on companies whose audits are regulated or a subset thereof; a levy on professional bodies; a levy on individual firms or practitioners; government subsidy.

## 2. Inspection - Frequency of reviews

- Auditors of listed entities are reviewed every three years, meeting EC criteria. But other audit firms are not reviewed on a regular basis (IFIAR requirement).
- Many regimes impose shorter inspection cycles. For example:
  - US: annual inspection for firms auditing over 100 issuers; at least once every three years for others.
  - UK: annual inspection of four largest firms; other major firms auditing PIEs reviewed on cycle of up to three years; auditors that do not audit PIEs reviewed at least every six years (size-dependent).

# Key gaps and possible approaches (continued)

## 3. Inspection - Composition of the Practice Review Committee

- The Quality Assurance Department carries out practice reviews following the Committee's instructions and reports to it. The Committee mainly comprises practising members. This creates a gap in relation to (perceived) objectivity and independence of the quality assurance system.
- UK and Singapore: Independent regulatory body performs inspections of PIEs and delegates inspections of non-PIEs audits to professional bodies.

## 4. Enforcement - Disciplinary mechanism

- The Professional Conduct Committee (PCC) which is comprised mainly of practising CPAs has the sole power to dismiss complaint cases or recommend the HKICPA Council to refer more serious complaints to the Disciplinary Panels. This creates a gap as there is no independent public oversight body with specific oversight of the PCC and the ability to enforce disciplinary actions.
- Independent regulatory body has the right to investigate and impose sanctions or establish tribunal to do so or delegate to professional body for non-PIEs.

# Key gaps and possible approaches (continued)

## 5. System of public oversight and Governance structure of the HKICPA Council

- No independent public oversight body with ultimate responsibility for oversight of registration, inspection, standard setting, CPE and disciplinary systems.
- The composition of the HKICPA Council, the governing body, does not guarantee that the membership of the Council would always have a 'non-practitioner' majority.

**In major jurisdictions, audit regulatory oversight of at least registration, inspection, investigation, enforcement, standard setting and continuing professional education is vested in an independent regulatory body.**

**Delegation in certain cases may be permissible provided that there is oversight by the independent regulatory body.**

# Key gaps and possible approaches (continued)

## Oversight bodies vs delegation

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





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# Independent Audit Oversight

**Public Interest**  
(including investing public)

**Self-  
regulation**

## Hong Kong's Auditors Regulatory Regime

- Independent -
- Transparent -
- Robust -
- EC equivalence -
- IFIAR membership -

**[www.frc.org.hk](http://www.frc.org.hk)**