

Provisional regulations

Scope – Audits of Chinese enterprises listed overseas (CELO), including overseas listed enterprises with operating entities in China (OEOEC)

Key objectives:

1. To set up a system to fill the gap for cross-border audit services and regulate audits of CELO
2. To prevent non-PRC CPAs to carry out audits for CELO by way of provisional audit licenses
3. To improve the audit quality of CELO to better support them to go global
4. To facilitate business cooperation between PRC and non-PRC CPAs to help increase international service exposure of PRC CPAs

Key proposals:

1. Non-PRC CPAs are not allowed to carry out audits for OEOEC through provisional license arrangements.
2. Non-PRC CPAs should enter into co-operation arrangements with top 100 PRC CPA practices and/or those qualified for performing audits for listed entities in China. Under the arrangements, the non-PRC CPAs should take full responsibility for the audits. The audit reports issued by the non-PRC CPAs have no legal effect in China.

HKICPA questions the need and appropriateness to introduce the provisional regulations due to the following:

1. There have been CELO (e.g H shares co) and OEOEC (e.g Red chips co) on the Hong Kong stock market for many years and HK CPAs have been carrying out related audits without any major issues.
2. The key proposals would be against the objectives of CEPA, which include realizing liberalization of service trade and reducing or removing any discriminatory policies.
3. The proposals do not address any concerns over audit quality and would adversely affect the ability of the non-PRC CPAs to comply with auditing standards
 - Key proposal 2 precludes non-PRC CPAs from carrying out onsite audit work directly. HKSA 600 requires group auditors to carry out an analysis of audit risk across the group and determine an appropriate audit response, which might, in some circumstances, be to carry out audit work directly on the component. Key proposal 2 will not allow this, which might result in non-PRC CPAs not being able to address all audit risks or obtain sufficient appropriate audit evidence to support the group audit opinion.
 - Requiring non-PRC CPAs to rely solely on the work of PRC CPA practices while taking full responsibility for the audit opinion is contrary to the requirements of HKSA 600.

4. As the audit reports have no effect in China, it would be difficult for the non-PRC CPAs to go after the PRC CPAs for damages or compensation if the audits has gone wrong because of the work done by the PRC-CPAs.
5. It will widen the regulatory gap if as a result of more work being done by PRC CPAs even more working papers and audit evidence are inaccessible to relevant overseas regulators.
6. Notice 29 is already working well to prevent CPAs from releasing information that contain state secrets to outsiders. Our proposal made to the SIB to establish a supplementary MOU to (1) establish the authority of the HKICPA to access PRC working papers relating to audits carried out by Hong Kong auditors support to the audit reports issued, that do not contain state secrets and (2) to require SIB to assist in obtaining or reviewing PRC working papers with state secrets should be able to address our concern over access to PRC working papers.
7. HKICPA suggests non- PRC CPAs as group auditors should have discretion to decide whether to engage a PRC CPA firm and if, they so decide, to choose a PRC CPA based on the list of PRC CPA firms that are qualified for performing audits for listed entities in China.
8. There are also a number of issues in the ED that need further clarification:
 - a. What is the meaning of "operating entities in China"? Will a non-PRC CPA be able to exercise judgement and apply materiality to the scale of operations in China?
 - b. Can the non-PRC CPAs and PRC CPAs decide on the scope of work under the cooperation arrangements?
 - c. Can the non-PRC CPAs enter into China to review and observe work carried out by PRC CPAs and perform work not within the scope of the cooperation arrangements through a channel other than the provisional license arrangements?
 - d. If the MoF identifies and reports non-compliance with provisional regulations to an overseas regulator, what follow up actions are they expected to carry out?