

**For information**

**Bills Committee on  
Financial Reporting Council Bill**

**Copy of the Overseas Legislation upon which  
the Bill is Modelled**

**Purpose**

This note attaches the overseas legislation upon which the Financial Reporting Council Bill (the Bill) is modelled from the policy or drafting perspective, in response to the letter of 11 July 2005 from the Clerk to the Bills Committee.

**Explanation**

2. We have looked into the experiences of some overseas jurisdictions as appropriate in formulating the proposal to establish the Financial Reporting Council (FRC) that will suit the circumstances and needs of Hong Kong. Members may wish to refer to the Administration's paper entitled "The Legislative Proposals to Establish the Financial Reporting Council", which was discussed at the meeting of Panel on Financial Affairs on 6 May 2005 and is extracted at **Annex A**, for a comparison of these overseas experiences with the current proposal to establish the FRC.

3. However, the Bill as a whole is not modelled upon a particular piece of overseas legislation, save clauses 40, 43, 44, 45, 49, 50, 61, 62 and 63 of the Bill. The aforesaid clauses relate to the enquiry of a Financial Reporting Review Committee and the rectification of defective accounts, and are modelled on the relevant provisions in the United Kingdom's Companies Act 1985 as extracted at **Annex B**.

**Financial Services and the Treasury Bureau  
July 2005**

*(Extract of the Administration's paper entitled "The Legislative Proposals to Establish the Financial Reporting Council" for the meeting of Panel on Financial Affairs on 6 May 2005)*

***"Experience in Other Jurisdictions***

14. Internationally, we have looked into the practice of three other jurisdictions, namely Australia, the United Kingdom (UK) and the United States (US). A table summarizing our findings in this regard is (set out below).

15. As illustrated in (the table below), there are considerable differences between the regulatory regimes for the auditing/accounting in the three jurisdictions. For example, in Australia and the US, a person has to be registered with the financial regulator before he/she may become a company auditor. In the UK and Hong Kong, there is no such registration requirement. Having said this, there is a general trend in the relevant places towards greater independence from the accounting profession in the oversight of auditors and listed companies' financial reporting.

16. As far as our FRC proposal is concerned, the FRRC part of the proposal is generally modelled on the similar set-up in the UK, in terms of its functions, powers and composition. As for the proposed Audit Investigation Board (AIB), our proposals are similar to the other three jurisdictions in areas such as investigatory work being conducted by bodies other than the professional associations, but different in one aspect, i.e. AIB's role and functions being confined to investigation only rather than encompassing disciplinary proceedings against an auditor. In some other jurisdictions, their audit investigation bodies are also having disciplinary functions. Indeed, this matter had been discussed in considerable depth in the first public consultation in late 2003. The majority view at that time was that AIB's role should be investigatory only, and that disciplinary proceedings should continue to be vested with the relevant professional bodies, such as the HKICPA. In this regard, it is relevant to point out that with the commencement of the Professional Accountants (Amendment) Ordinance 2004 in November 2004, the participation of people from outside the accounting profession in and the transparency of the disciplinary proceedings of the HKICPA have been substantially enhanced. The majority of the members of a Disciplinary Committee and its Chairman under the HKICPA must now be lay persons, and in general the proceedings of the Committee are open to the public."

## A Comparison of the Proposed FRC in Hong Kong vis-à-vis Similar Bodies in Other Jurisdictions<sup>1</sup>

	<b>Hong Kong</b>	<b>The United Kingdom (UK)</b>	<b>Australia</b>	<b>The United States (US)</b>
<b>Accounting Profession Regulatory Regime</b>	<ul style="list-style-type: none"> <li>● The accounting profession is primarily self-regulated by Hong Kong Institute of Certified Public Accountants (HKICPA).</li> <li>● No person shall be appointed as an auditor of a company unless he is a member of HKICPA.</li> </ul>	<ul style="list-style-type: none"> <li>● The accounting profession is primarily self-regulated by six recognized professional accounting bodies.</li> <li>● No person shall be appointed as a company auditor unless he is a member of a recognized professional body and is eligible for the appointment under the rules of that body.</li> </ul>	<ul style="list-style-type: none"> <li>● There are several professional accounting bodies in the accounting sector.</li> <li>● Every accountant who is to undertake an audit for a company must be registered with the Australian Securities and Investments Commission (ASIC) (similar to the Securities and Futures Commission in Hong Kong) as a registered company auditor (RCA). ASIC may cancel or suspend the registration of a person as a RCA.</li> </ul>	<ul style="list-style-type: none"> <li>● The accounting profession is regulated along state lines. American Institute of CPAs (AICPA) is a nationwide voluntary professional body for accountants.</li> <li>● Every public accounting firm is required to be registered with the Public Company Accounting Oversight Board (PCAOB) appointed by the Securities and Exchange Commission (SEC) as a registered public accounting firm before it can prepare or issue audit report with respect to any company registered with the SEC.</li> </ul>

<sup>1</sup> Sources of information: Relevant overseas legislation and the websites of the bodies concerned.

	<b>Hong Kong</b>	<b>The United Kingdom (UK)</b>	<b>Australia</b>	<b>The United States (US)</b>
<b>Accounting Profession Regulatory Regime (Cont'd)</b>	<ul style="list-style-type: none"> <li>● HKICPA has its membership requirements and code of professional conducts. The Professional Accountants Ordinance empowers Investigation Committees and Disciplinary Committees constituted by the Council of HKICPA to conduct investigation and disciplinary proceedings in respect of any misconduct of a professional accountant.</li> </ul>	<ul style="list-style-type: none"> <li>● The recognized professional bodies have their own membership requirements, code of professional conduct, expulsion and disciplinary proceedings. The arrangements for regulating and disciplining their members are overseen by the UK Professional Oversight Board for Accountancy (POBA) of the UK Financial Reporting Council.</li> </ul>	<ul style="list-style-type: none"> <li>● Each professional body has its own membership requirements, code of conduct, expulsion and disciplinary proceedings. The arrangements for regulating and disciplining their members are overseen by the Financial Reporting Council<sup>2</sup>.</li> </ul>	<ul style="list-style-type: none"> <li>● Although expulsion from the AICPA would entail a certain degree of opprobrium, it would not prevent an accountant from practicing.</li> </ul>
<b>FRC or similar body</b>	<ul style="list-style-type: none"> <li>● Financial Reporting Council (FRC)</li> </ul>	<ul style="list-style-type: none"> <li>● Financial Reporting Council (UKFRC)</li> </ul>	<ul style="list-style-type: none"> <li>● Companies Auditors and Liquidators Disciplinary Board (CALDB)</li> <li>● Financial Reporting Panel (FRP)(being established in 2005)<sup>3</sup></li> </ul>	<ul style="list-style-type: none"> <li>● Public Company Accounting Oversight Board (PCAOB)</li> </ul>

<sup>2</sup> The Financial Reporting Council in Australia is a statutory body responsible for providing broad oversight of the process for setting accounting and auditing standards as well as monitoring the effectiveness of auditor independence requirements in Australia.

<sup>3</sup> The Financial Reporting Panel is to be established under the Australian Securities and Investments Commission Act as amended in 2004 to resolve disputes between ASIC and any company concerning the company's accounting treatments in its financial report. According to our understanding, the FRP is being established in 2005.

	Hong Kong	The United Kingdom (UK)	Australia	The United States (US)
<b>Composition</b>	<ul style="list-style-type: none"> <li>● The FRC would comprise not more than 11 members, including one Chairman and one Chief Executive Officer (CEO).</li> <li>● Save for an ex-officio member from the Administration, all other members would be appointed by the Chief Executive (CE) as below.</li> <li>● The CE would appoint on an “<i>ad personam</i>” basis 3 members nominated by the SFC, HKEx and HKICPA respectively, 4 to 6 other members, and the CEO.</li> </ul>	<ul style="list-style-type: none"> <li>● The UKFRC has up to 30 members (including the 5 Directors of UKFRC) and in addition a number of observers from other bodies with an interest in corporate reporting and governance.</li> <li>● The 5 Directors of UKFRC (including Chair and Deputy Chair) are all appointed by the Secretary of State for Trade and Industry.</li> <li>● Other members are appointed by the Directors.</li> </ul>	<ul style="list-style-type: none"> <li>● The CALDB consists of 14 members, including a Chairperson and a Deputy Chairperson. The Chairperson and Deputy Chairperson of the CALDB are appointed by the Minister. As for the remaining members, the Minister selects 6 members from two panels of persons nominated by two accounting bodies and appoints 6 members as representatives of the business community.</li> <li>● The FRP consists of such members not fewer than 5, including the Chairperson.</li> <li>● All members of the FRP are to be appointed by the Minister.</li> </ul>	<ul style="list-style-type: none"> <li>● The PCAOB comprises 5 independent members, not more than two of whom may be professional accountants.</li> <li>● The members of the PCAOB are appointed by the SEC after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury.</li> </ul>

	Hong Kong	The United Kingdom (UK)	Australia	The United States (US)
<b>Organization Structure</b>	<ul style="list-style-type: none"> <li>• Statutory body</li> <li>• The FRC would oversee the Audit Investigation Board (AIB) and the Financial Reporting Review Committee (FRRP).</li> </ul>	<ul style="list-style-type: none"> <li>• Company limited by guarantee.</li> <li>• UKFRC oversees the following regulatory bodies: Professional Oversight Board for Accountancy (POBA), Financial Reporting Review Panel (FRRP), Accountancy Investigation and Discipline Board (AIDB), Auditing Practices Board (APB), and Accounting Standards Board (ASB)<sup>4</sup>.</li> </ul>	<ul style="list-style-type: none"> <li>• Both of the CALDB and the FRP are statutory bodies established under Australian Securities and Investments Commission Act.</li> </ul>	<ul style="list-style-type: none"> <li>• Statutory body established under the Sarbanes-Oxley Act (Act).</li> </ul>
<b>Funding</b>	<ul style="list-style-type: none"> <li>• Funded by SFC, HKEx, HKICPA and CR Trading Fund on an equal share basis.</li> </ul>	<ul style="list-style-type: none"> <li>• Funded by the accounting professions, the business community and the government in equal proportion.</li> </ul>	<ul style="list-style-type: none"> <li>• Both of the CALDB and the FRP are funded by the Government.</li> </ul>	<ul style="list-style-type: none"> <li>• The PCAOB is funded by annual accounting support fees levied on companies registered with SEC.</li> </ul>

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<sup>4</sup> Financial Reporting Review Panel (FRRP) is responsible for seeking to ensure that the financial information by public and large private companies complies with Companies Act requirements; Accountancy Investigation and Discipline Board (AIDB) is responsible for providing an independent investigation and discipline scheme in relation to accounting profession for matters which raise important issues affecting the public interest; Auditing Practices Board (APB) is responsible for establishing auditing standards; Accounting Standards Board (ASB) is responsible for developing accounting standards; and Professional Oversight Board For Accountancy (POBA) is responsible for overseeing the regulations of the auditing and accounting profession.

	<b>Hong Kong</b>	<b>The United Kingdom (UK)</b>	<b>Australia</b>	<b>The United States (US)</b>
<b>Oversight of the auditing profession</b>	<ul style="list-style-type: none"> <li>● The AIB consists of employees of the FRC and other consultants, agents or advisers engaged by the FRC.</li> <li>● The AIB is responsible for carrying out investigation into suspected irregularities committed by auditors of listed entities.</li> <li>● The AIB may request information, explanation and assistance from relevant persons in the course of investigation.</li> <li>● The AIB will submit an investigation report to the FRC for the latter's determination as to whether or not the case should be referred to other regulatory authorities or professional bodies.</li> </ul>	<ul style="list-style-type: none"> <li>● The AIDB has 8 members, majority of which are non-accountants.</li> <li>● The AIDB is responsible for investigating cases which raise or appear to raise serious issue affecting the public interest in the UK to determine whether or not there has been any misconduct by an accountant.</li> <li>● The AIDB has the power to seek information and documents from accountants and require them to give evidence to a tribunal.</li> <li>● If the investigation reveals that the accountant should be subject to disciplinary proceedings, the AIDB will appoint a Disciplinary Tribunal to hear the case.</li> </ul>	<ul style="list-style-type: none"> <li>● The CALDB consists of 14 members, including a Chairperson and a Deputy Chairperson.</li> <li>● The CALDB is responsible for determining, inter alia, whether a person has failed to perform adequately and properly the duties of an auditor or any functions required by the Australian law to be carried out by a registered company auditor or is otherwise not a fit and proper person to remain registered as an auditor.</li> <li>● The CALDB does not directly conduct investigation, and rely on ASIC in this regard.</li> <li>● The CALDB shall give an opportunity to appear at a hearing and to make submissions.</li> </ul>	<ul style="list-style-type: none"> <li>● The PCAOB comprises 5 independent members, not more than two of whom may be professional accountants.</li> <li>● The PCAOB is responsible for overseeing auditors of public companies. It has the authority to, inter alia, conduct investigations and disciplinary proceedings in respect of any non-compliance of the Act and the rules of the PCAOB and SEC by an audit firm.</li> <li>● The PCAOB may require testimony of and production of any document from relevant person during investigation.</li> <li>● The PCAOB shall provide opportunity to defend in disciplinary proceedings.</li> </ul>

	<b>Hong Kong</b>	<b>The United Kingdom (UK)</b>	<b>Australia</b>	<b>The United States (US)</b>
<b>Oversight of the auditing profession (Cont'd)</b>	<ul style="list-style-type: none"> <li>● AIB will not have disciplinary function.</li> </ul>	<ul style="list-style-type: none"> <li>● The AIDB may impose sanctions such as reprimand, fine and suspension of licence. Every recognized professional body must recognize the ruling of the AIDB.</li> </ul>	<ul style="list-style-type: none"> <li>● The CALDB may reprimand the person; cancel, or suspend for a specified period the registration of the person as an auditor; require the person to undertake to engage in or refrain from engaging in a specified conduct.</li> </ul>	<ul style="list-style-type: none"> <li>● The PCAOB may impose sanctions, e.g. suspension/revocation of registration, fine, censure. It may also refer an investigation to the SEC and any other regulators.</li> </ul>
<b>Oversight of the quality of Corporate Financial Reporting</b>	<ul style="list-style-type: none"> <li>● The FRRP will comprise not less than 20 members of a wide range of financial reporting, auditing, banking, financial services and commercial expertise, appointed by the CE.</li> <li>● At least five members drawn from the FRRP will constitute a FRRP to enquire into an individual case.</li> <li>● The FRRP would enquire into suspected non-compliance of the accounts and financial statements of listed entities with relevant legal and accounting requirements.</li> </ul>	<ul style="list-style-type: none"> <li>● At present, the FRRP comprises 24 members appointed by the FRC.</li> <li>● A group of FRRP members (Group), normally 5, will conduct an enquiry.</li> <li>● The Group considers whether the accounts of a public company and a large private company comply with relevant legal and accounting requirements<sup>5</sup>.</li> </ul>	<ul style="list-style-type: none"> <li>● The FRP will consist of such members not fewer than 5.</li> <li>● Three members will be drawn from the FRP to form a dedicated panel (Panel) to consider a case</li> <li>● The Panel will see whether the financial reports comply with the relevant financial reporting requirements, and if not, the changes need to be made to ensure compliance and prepare a report.</li> </ul>	<ul style="list-style-type: none"> <li>● Not applicable, the corporate reporting of listed companies remains under the oversight of the SEC.</li> </ul>

<sup>5</sup> In addition, the FRRP is also appointed under the Supervision of Accounts and Reports (Prescribed Body) Order 2005 to keep under review Reports produced by certain issuers of listed securities that are required to comply with accounting requirements of listing rules and, if it thinks fit, to inform the Financial Services Authority of any conclusions it reaches in relation to any such reports.

	<b>Hong Kong</b>	<b>The United Kingdom (UK)</b>	<b>Australia</b>	<b>The United States (US)</b>
<b>Oversight of the quality of Corporate Financial Reporting (Cont'd)</b>	<ul style="list-style-type: none"> <li>● The FRRC would have the power to require documents, information and explanations.</li> <li>● The FRRC may request voluntary rectification of accounts.</li> <li>● Failing voluntary rectification, the FRRC may seek a court order to secure mandatory rectification.</li> </ul>	<ul style="list-style-type: none"> <li>● The FRRP may ask directors to explain apparent departure from the accounting requirements.</li> <li>● The FRRP may request voluntary rectification of accounts.</li> <li>● Failing voluntary rectification, the FRRP may seek a court order to secure mandatory rectification.</li> </ul>	<ul style="list-style-type: none"> <li>● The Panel may by written summons require a staff of ASIC, an officer of the company, the relevant auditor, and any other person involved to give evidence, answer questions and produce documents.</li> <li>● A Court, or a tribunal of fact, may have regard to the Panel's report in determining whether the financial report complied with the relevant financial reporting requirement.</li> </ul>	

## **UK Companies Act 1985**

Current through 21 March 2005

### **245 Voluntary revision of annual accounts or directors' report<sup>1</sup>**

(1) If it appears to the directors of a company that any annual accounts or summary financial statement of the company, or any directors' report, operating and financial review or directors' remuneration report, did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation), they may prepare revised accounts or a revised statement, report or review.

(2) Where copies of the previous accounts, report or review have been laid before the company in general meeting or delivered to the registrar, the revisions shall be confined to--

(a) the correction of those respects in which the previous accounts, report or review did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation), and

(b) the making of any necessary consequential alterations.

(3) The Secretary of State may make provision by regulations as to the application of the provisions of this Act in relation to revised annual accounts or a revised summary financial statement or a revised directors' report, a revised operating and financial review or a revised directors' remuneration report.

(4) The regulations may, in particular--

(a) make different provision according to whether the previous accounts, statement, report or review are replaced or are supplemented by a document indicating the corrections to be made;

(b) make provision with respect to the functions of the company's auditors or reporting accountant in relation to the revised accounts, statement, report or review;

(c) require the directors to take such steps as may be specified in the regulations where the previous accounts, report or review have been--

(i) sent out to members and others under section 238(1),

(ii) laid before the company in general meeting, or

(iii) delivered to the registrar,

or where a summary financial statement containing information derived from the previous accounts, report or review has been sent to members under section 251;

(d) apply the provisions of this Act (including those creating criminal offences) subject to such additions, exceptions and modifications as are specified in the regulations.

(5) Regulations under this section shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

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<sup>1</sup> Clauses 61 to 63 of the Bill are modelled on section 245 of the UK Companies Act 1985.

## **245A Secretary of State's notice in respect of annual accounts<sup>2</sup>**

**(1)** Where--

(a) copies of a company's annual accounts, directors' report or operating and financial review have been sent out under section 238, or

(b) a copy of a company's annual accounts, directors' report or operating and financial review has been laid before the company in general meeting or delivered to the registrar, and it appears to the Secretary of State that there is, or may be, a question whether the accounts, report or review comply with the requirements of this Act, he may give notice to the directors of the company indicating the respects in which it appears to him that such a question arises or may arise.

**(2)** The notice shall specify a period of not less than one month for the directors to give him an explanation of the accounts, report or review or prepare revised accounts or a revised report or review.

**(3)** If at the end of the specified period, or such longer period as he may allow, it appears to the Secretary of State that the directors have not--

(a) given a satisfactory explanation of the accounts, report or review, or

(b) revised the accounts, report or review so as to comply with the requirements of this Act, he may if he thinks fit apply to the court.

**(4)** The provisions of this section apply equally to revised annual accounts, revised directors' reports and revised operating and financial reviews, in which case they have effect as if the references to revised accounts, reports or reviews were references to further revised accounts, reports or reviews.

## **245B Application to court in respect of defective accounts<sup>3</sup>**

**(1)** An application may be made to the court--

(a) by the Secretary of State, after having complied with section 245A, or

(b) by a person authorised by the Secretary of State for the purposes of this section, for a declaration or declarator that the annual accounts of a company do not comply, or a directors' report or operating and financial review does not comply, with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation) and for an order requiring the directors of the company to prepare revised accounts or a revised report or review.

**(2)** Notice of the application, together with a general statement of the matters at issue in the proceedings, shall be given by the applicant to the registrar for registration.

**(3)** If the court orders the preparation of revised accounts, it may give directions with respect to--

(a) the auditing of the accounts,

(b) the revision of any directors' report, directors' remuneration report or summary financial statement, and

(c) the taking of steps by the directors to bring the making of the order to the notice of persons likely to rely on the previous accounts, and such other matters as the court thinks fit.

**(3A)** If the court orders the preparation of a revised directors' report or a revised operating and financial review it may give directions with respect to--

(a) the review of the directors' report or operating and financial review by the auditors,

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<sup>2</sup> Clause 49 of the Bill is modelled on section 245A of the UK Companies Act 1985.

<sup>3</sup> Clause 50 of the Bill is modelled on section 245B of the UK Companies Act 1985.

- (b) the revision of any directors' report, directors' remuneration report, operating and financial review or summary financial statement,
- (c) the taking of steps by the directors to bring the making of the order to the notice of persons likely to rely on the previous report or review, and
- (d) such other matters as the court thinks fit.

(4) If the court finds that the accounts, report or review did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation) it may order that all or part of--

- (a) the costs (or in Scotland expenses) of and incidental to the application, and
  - (b) any reasonable expenses incurred by the company in connection with or in consequence of the preparation of revised accounts or a revised report or review,
- shall be borne by such of the directors as were party to the approval of the defective accounts, report or review.

For this purpose every director of the company at the time of the approval of the accounts, report or review shall be taken to have been a party to the approval unless he shows that he took all reasonable steps to prevent that approval.

(5) Where the court makes an order under subsection (4) it shall have regard to whether the directors party to the approval of the defective accounts, report or review knew or ought to have known that the accounts, report or review did not comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation), and it may exclude one or more directors from the order or order the payment of different amounts by different directors.

(6) On the conclusion of proceedings on an application under this section, the applicant shall give to the registrar for registration an office copy of the court order or, as the case may be, notice that the application has failed or been withdrawn.

(7) The provisions of this section apply equally to revised annual accounts, revised directors' reports and revised operating and financial reviews, in which case they have effect as if the references to revised accounts, reports or reviews were references to further revised accounts, reports or reviews.

#### **245F Power of authorised persons to require documents, information and explanations<sup>4</sup>**

(1) This section applies where it appears to a person who is authorised under section 245C of this Act that there is, or may be, a question whether the a company's annual accounts, directors' report or operating and financial review comply with the requirements of this Act (or, where applicable, of Article 4 of the IAS Regulation).

(2) The authorised person may require any of the persons mentioned in subsection (3) to produce any document, or to provide him with any information or explanations, that he may reasonably require for the purpose of--

- (a) discovering whether there are grounds for an application to the court under section 245B; or
- (b) determining whether or not to make such an application.

(3) Those persons are--

- (a) the company;
- (b) any officer, employee, or auditor of the company;
- (c) any persons who fell within paragraph (b) at a time to which the document or information required by the authorised person relates.

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<sup>4</sup> Clauses 40, 43, 44 and 45 of the Bill are modelled on section 245F of the UK Companies Act 1985.

(4) If a person fails to comply with a requirement under subsection (2), the authorised person may apply to the court for an order under subsection (5).

(5) If on such an application the court decides that the person has failed to comply with the requirement under subsection (2), it may order the person to take such steps as it directs for securing that the documents are produced or the information or explanations are provided.

(6) A statement made by a person in response to a requirement under subsection (2) or an order under subsection (5) may not be used in evidence against him in any criminal proceedings.

(7) Nothing in this section compels any person to disclose documents or information in respect of which in an action in the High Court a claim to legal professional privilege, or in an action in the Court of Session a claim to confidentiality of communications, could be maintained.

(8) In this section "document" includes information recorded in any form.