

**Subcommittee on Financial Reporting Council (Amendment)  
Ordinance 2019 (Commencement) Notice**

**Commencement of the New Auditor Regulatory Regime**

**PURPOSE**

This paper briefs the Subcommittee on the background of the Financial Reporting Council (Amendment) Ordinance 2019 (Commencement) Notice (“the Commencement Notice”) and the progress of the preparatory work for implementation of the new auditor regulatory regime pursuant to the Financial Reporting Council (Amendment) Ordinance 2019 (“the Amendment Ordinance”).

**BACKGROUND**

2. The Amendment Ordinance was enacted by the Legislative Council (“LegCo”) and published in the Gazette on 30 January 2019 and 15 February 2019 respectively. The Amendment Ordinance, through amending the Financial Reporting Council Ordinance (Cap. 588) (“the FRCO”), enables the Financial Reporting Council (“the FRC”) to become a full-fledged and independent oversight body regulating auditors of public interest entities (“PIEs”)<sup>1</sup>, and be responsible for the inspection, investigation and disciplinary functions with regard to these auditors. Under the new regime, the Hong Kong Institute of Certified Public Accountants (“the HKICPA”) will continue to perform the statutory functions of registration, setting requirements for continuing professional development, and also setting standards on professional ethics, auditing and assurance in respect of relevant auditors, subject to oversight by the FRC.

3. The Amendment Ordinance enhances the independence of the existing regulatory regime for PIE auditors, provides better protection to

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<sup>1</sup> Under the Amendment Ordinance, a PIE is defined as a corporation with issued shares or stocks listed in Hong Kong or a collective investment scheme with interest listed in Hong Kong.

investors and ensures that Hong Kong’s auditor regulatory regime is benchmarked against the international standard and practice. It will also enable Hong Kong to be eligible for joining the International Forum of Independent Audit Regulators, which is an important forum for international co-operation on the regulation of auditors, and further strengthen Hong Kong’s status as an international financial centre and capital market.

## **THE COMMENCEMENT NOTICE**

4. Section 1(2) of the Amendment Ordinance provides that the Amendment Ordinance is to come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury (“SFST”) by a notice published in the Gazette.

5. In addition, the Financial Secretary announced in the 2019-20 Budget<sup>2</sup> that he had decided to increase the amount of seed capital for the FRC to \$400 million to help it migrate to the new regime, and exempt the levies<sup>3</sup> for the first two years upon the implementation of the new regime.

6. Taking into account the progress of the preparatory work for the new regime (please refer to paragraphs 7 to 10 below), SFST has made the Commencement Notice to appoint 1 October 2019 as the commencement date for the Amendment Ordinance, except for sections 62 and 85<sup>4</sup> concerning payment of levies to the FRC under the new regime. The two sections will be separately commenced on 1 January 2022.

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<sup>2</sup> Please refer to paragraph 44 of the Speech by the Financial Secretary for moving the Second Reading of the Appropriation Bill 2019.

<sup>3</sup> The FRC under the new regime will be funded by introducing three new levies on securities transactions, PIEs and PIE auditors respectively.

<sup>4</sup> Section 62 covers the new Part 4A of the FRCO which provides for the payment of levies and related issues under the new regime. Section 85 covers the new Schedule 7 to the FRCO which sets out the calculation methods of the levies under the new regime.

## PREPARATORY WORK

7. After the enactment of the Amendment Ordinance by LegCo, a Steering Group on Implementation of the New Auditor Regulatory Regime (“the Steering Group”) comprising representatives of the Financial Services and the Treasury Bureau, the FRC and the HKICPA was set up to monitor the progress of preparation for the new regime. The Steering Group has held a number of meetings, and is satisfied that all parties are ready to commence the new regime on 1 October 2019.

8. During the Bills Committee stage, some Members raised concerns about how the FRC would exercise its power to impose pecuniary penalty<sup>5</sup> under the new regime. The Amendment Ordinance provides for certain statutory obligations<sup>6</sup> which the FRC must observe in this regard, i.e. the FRC must not impose a pecuniary penalty unless it has published, in the Gazette and in any other manner it considers appropriate, guidelines to indicate the way in which it exercises the power to impose the penalty and that it has had regard to the guidelines so published in imposing the penalty. As explained at the Bills Committee meetings, the guidelines would be formulated to ensure that the FRC must have regard to the principles of fairness and proportionality when determining the pecuniary penalty to be imposed in individual cases. The guidelines would cover the factors to be considered by the FRC, including that the pecuniary penalty should not have the likely effect of putting a firm or an individual in financial jeopardy. In SFST’s speech for the resumption of second reading debate of the amendment bill on 30 January 2019, he indicated that the Government would ensure that the guidelines would be drawn up by the FRC in accordance with these principles and the new regime would be implemented after the publication of the guidelines.

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<sup>5</sup> Under the new sections 37D(3)(b)(iv) and 37E(3)(b)(iii) of the FRCO, the FRC may order a person who is or was a PIE auditor or a registered responsible person of a registered PIE auditor and has committed a misconduct to pay a pecuniary penalty. The maximum pecuniary penalty is the greater of \$10 million, or three times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

<sup>6</sup> The statutory obligations are stipulated in the new section 37H of the FRCO which also states that the guidelines are not subsidiary legislation.

9. From March to April 2019, the FRC conducted a consultation in relation to its proposed sanctions guidelines (a copy at **Annex A**) and arranged 15 meetings and briefings with relevant stakeholders including audit firms and professional bodies to explain the guidelines in detail and listen to their views. The FRC released the conclusions of the consultation on 31 May 2019 (a copy of which is at **Annex B**).

10. The FRC will take into account the responses gathered in the consultation exercise as well as the deliberation and views of Members of the Subcommittee before finalising the guidelines for publication before the commencement of the new regime, i.e. 1 October 2019. The Government will continue to closely monitor the finalisation of the guidelines and ensure that the principles as mentioned in paragraph 8 above are adhered to by the FRC.

**Financial Services and the Treasury Bureau**  
**3 June 2019**



# **Sanctions Guidelines**

## **A Consultation Paper**

March 2019

## **Invitation to comment**

Under the Financial Reporting Council (Amendment) Ordinance 2019, the Financial Reporting Council (**FRC**) must not impose a pecuniary penalty unless it has published, in the Gazette and in any other manner it considers appropriate, guidelines to indicate the way in which it exercises the power to impose the penalty and it has had regard to the guidelines so published in imposing such penalty.

The FRC would like to seek your views on the proposed Sanctions Guidelines which also include guidelines on how the FRC would exercise the power to impose a pecuniary penalty.

## **How to respond**

Please send your response by **17<sup>th</sup> April 2019** by one of the following means:

By mail to: Financial Reporting Council  
29<sup>th</sup> Floor, High Block  
Queensway Government Offices  
66 Queensway  
Hong Kong

By fax to: (852) 2810 6320

By email to: [reform@frc.org.hk](mailto:reform@frc.org.hk)

## **Representative groups**

Representative groups are asked to give a summary of the organisations or members they represent when they respond.

## **Confidentiality**

Information provided in response to this consultation, including personal information, may be published or may be disclosed. If you want the information that you provide to be treated as confidential or you do not wish your response to be published, please make this clear in your response. If you send an e-mail response which includes an automatically generated notice stating that the content is to be treated as confidential, you should make it clear in the body of your message whether or not you wish your comments to be treated as confidential.

## **Acknowledgement of response**

An acknowledgement will be sent to any individual or organisation submitting a response to this consultation.

## **Questions about this consultation**

Any questions about the issues raised in this consultation document should be directed to Ms Florence Wong, Senior Director - Investigation & Compliance at the above email address.

## **Our invitation**

The FRC invites comments on the proposed Sanctions Guidelines, particularly on the questions set out below. Comments are most helpful if they:

- (a) address the questions as stated;
- (b) indicate the specific paragraph(s) of the proposed Sanctions Guidelines to which they relate;
- (c) contain a clear rationale; and
- (d) include any alternative the FRC should consider, if applicable.

The FRC is requesting comment only on matters addressed in this set of proposed Sanctions Guidelines.

## **List of questions for consultation**

- 1. Do you agree with the FRC's objectives of imposing sanctions as set out in paragraph 10? If not, please state the particular objective(s) that you do not agree with and the reasons for your disagreement.**
- 2. Do you agree with the FRC's approach to determining sanctions summarised in paragraph 19? If not, please explain any alternative you would propose and the reasons therefor.**
- 3. Have we included the sorts of factors (paragraphs 21 to 24) in the Sanctions Guidelines that you would expect the FRC to consider in assessing the nature and seriousness of the misconduct and determining the sanctions to be imposed? Are there any other factors you believe the FRC should take into account when determining the sanctions to be imposed?**
- 4. Do you agree that the sanctions, including a pecuniary penalty, to be imposed by the FRC should act as an effective deterrent and be proportionate to the misconduct and have regard to all the circumstances of the case, including the financial resources of the regulated persons? If not, what would you propose? Please explain your rationale.**
- 5. Do you agree with the factors set out in paragraphs 37 to 43 that the FRC will normally take into consideration when determining the amount of a pecuniary penalty? If not, please explain any alternatives that you would propose and the reasons therefor.**
- 6. Do you have any other comments on the Sanctions Guidelines that would help the FRC as an independent auditor regulator to protect the investing public and the public interest?**

# SANCTIONS GUIDELINES

## Introduction

1. This document provides guidance for the Financial Reporting Council (**FRC**) when considering the imposition of sanctions on regulated persons (i.e. public interest entity (**PIE**) auditors and registered responsible persons of a registered PIE auditor), under the Financial Reporting Council Ordinance (Cap 588) (**FRCO**). Part 3B of the FRCO contains provisions relating to disciplinary matters regarding PIE auditors and registered responsible persons. Section 37H requires the FRC to have regard to these guidelines which indicate the manner in which the FRC will exercise its powers to impose a pecuniary penalty on (I) a PIE auditor under section 37D(3)(b)(iv), or (II) a registered responsible persons of a registered PIE auditor under section 37E(3)(b)(iii).
2. Although expressed as guidance for the FRC, this guidance will also be relevant to others discharging their respective responsibilities under the FRCO.
3. Terms defined in the FRCO shall have the same meaning in this guidance.
4. This policy has been approved by the FRC.
5. This document is intended to:
  - (a) promote proportionality, clarity, consistency and transparency in decision-making;
  - (b) ensure that all parties are aware from the outset of the approach which might be taken when determining what sanction to impose.
6. Nothing in the guidance is intended to be inconsistent with the FRCO and the FRC must proceed in accordance with the FRCO and the overriding requirements of natural justice.
7. This guidance is a public document. Periodically, it will be reviewed and (where appropriate) revised in the light of experience. The guidance cannot deal with every single situation and exceptions will sometimes arise. The guidance should be considered alongside any principles emerging from cases decided under the FRCO. The FRC may have regard to sanctions imposed in other cases. It must, however, determine the sanction which it thinks appropriate on the facts and circumstances of the case before them and should not feel constrained by the sanctions imposed (or not imposed) in earlier cases to impose a sanction which it does not think appropriate.



## **Aims and Objectives of the Sanctions Guidelines**

8. These guidelines have been developed to ensure that there is an effective system of sanctions to complement investigations and inspections.
9. Sanctions are intended to be effective, proportionate and dissuasive in respect of a misconduct as defined under sections 37A and 37B of the FRCO.
10. In determining the appropriate sanction, the FRC should have regard to the reasons for imposing sanctions for a misconduct in the context of the FRCO. Sanctions are imposed to achieve a number of purposes, namely:
  - (a) to deter regulated persons from committing misconduct relating to PIE audits;
  - (b) to protect the public from regulated persons whose conduct has fallen short of the relevant requirements set out in the FRCO;
  - (c) to maintain and promote public and market confidence in regulated persons and the quality of their audits;
  - (d) to declare and uphold proper standards of conduct amongst regulated persons and to maintain and enhance the quality and reliability of future audits.
11. The primary purpose of imposing sanctions for misconduct is not to punish, but to protect the public and the wider public interest.
12. This guidance has been developed to help the FRC achieve these objectives by imposing sanctions which:
  - (a) improve the behaviour or performance of the regulated persons concerned;
  - (b) are tailored to the facts of the particular case and take into account the nature of the misconduct and the circumstances of the regulated person concerned;
  - (c) are proportionate to the nature of the misconduct and the harm or potential harm caused;
  - (d) eliminate any financial gain or benefit derived as a result of the misconduct;
  - (e) deter misconduct by the regulated persons or others.
13. In connection with paragraph 12(a) above, the FRC should consider whether, and if so, to what extent, the sanctions proposed would be likely to lead to improvements in respect of the matters which gave rise to the proceedings and in the quality of work of the regulated persons concerned.

14. The FRC should also consider whether the sanction or combination of sanctions, financial and/or non-financial, achieve the objectives of the FRCO. There may be circumstances where the objectives can be achieved without a financial penalty.

### **Determination of Sanction**

15. The FRC should consider the full circumstances of each case and the seriousness of the misconduct involved before determining which sanction or combination of sanctions to impose on the regulated person(s). This guidance considers those factors that may be relevant to the FRC's consideration. The factors are not listed in any kind of hierarchy and it is for the FRC to decide on the weight to be allocated to each factor. The factors listed are not exhaustive; not all of the factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.
16. In deciding which sanction or combination of sanctions to impose, the FRC should have regard to the principle of proportionality. In assessing proportionality, the FRC should consider whether a particular sanction is commensurate with the circumstances of the case, including the seriousness of the misconduct found and the circumstances of the regulated person(s) concerned.
17. The sanctions available to the FRC are set out in sections 37D and 37E of the FRCO and are reproduced below for convenience:
  - (a) for a person who is a PIE auditor—
    - (i) to revoke the person's registration or recognition;
    - (ii) to suspend the person's registration or recognition for a period of time, or until the occurrence of an event, that the FRC considers appropriate; and
    - (iii) to impose a condition on the person's registration or recognition;
  - (b) for a person who is or was a PIE auditor—
    - (i) to reprimand the person publicly or privately;
    - (ii) to direct the person to carry out any remedial action specified by the FRC;
    - (iii) to prohibit the person from applying to be registered or recognized as a PIE auditor for a period of time, or until the occurrence of an event, that the FRC considers appropriate; and

- (iv) subject to section 37H, to order the person to pay a pecuniary penalty, not exceeding the amount which is the greater of—
  - (A) \$10,000,000; or
  - (B) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct;
- (c) for a person who is a registered responsible person of a registered PIE auditor—to remove the person’s name from the list of registered responsible persons of the auditor, either—
  - (i) permanently; or
  - (ii) for a period of time, or until the occurrence of an event, that the FRC considers appropriate;
- (d) for a person who is or was a registered responsible person of a registered PIE auditor—
  - (i) to reprimand the person publicly or privately;
  - (ii) to direct the person to carry out any remedial action specified by the FRC; and
  - (iii) subject to section 37H, to order the person to pay a pecuniary penalty, not exceeding the amount which is the greater of—
    - (A) \$10,000,000; or
    - (B) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

### **Combination of Sanctions**

18. Under section 37D or 37E of the FRCO, sanctions may be imposed singly or in combination. When imposing a combination, the FRC should assess, in the light of all the circumstances of the matter, the appropriateness of the proposed sanctions both individually and in combination. Set out below are some of the considerations that the FRC should have regard to when imposing sanctions in combination:
- (a) a pecuniary penalty can be ordered in conjunction with any other sanction(s);

- (b) dependent upon the circumstances of the particular regulated person, it may be appropriate to order prohibition from applying to be a PIE auditor or become a registered responsible person of a PIE auditor.

### **Summary of Approach to Determining Sanctions**

19. It follows, therefore, that the normal approach to determining the sanction to be imposed in a particular case should be to:
  - (a) assess the nature and seriousness, gravity and duration of the misconduct found and the degree of responsibility of the regulated person for the misconduct (paragraphs 21 to 24);
  - (b) identify the sanction or combination of sanctions that the FRC considers potentially appropriate having regard to the misconduct identified in (a) above (paragraphs 25 to 54);
  - (c) consider any relevant aggravating or mitigating circumstances and how those circumstances affect the level, nature or combination of sanctions under consideration (paragraphs 55 to 60);
  - (d) consider any further adjustment necessary to achieve the appropriate deterrent effect (see paragraphs 61 and 62);
  - (e) consider whether a discount for admissions or early disposal is appropriate (paragraphs 63 to 71); and
  - (f) decide which sanction(s) to order and the level/duration of the sanction(s) where appropriate.
20. The FRC should ensure that its decisions give reasons which indicate what view they have reached on the matters above and why.

### **Undertaking the initial assessment of the potential sanctions to impose**

21. In assessing the nature and seriousness of the misconduct and in determining which sanction(s) might be appropriate, the FRC will normally consider the factors summarised in the next paragraph. This list is not exhaustive and not all factors will be applicable in a particular case. The FRC should also consider carefully whether there may be other factors, not listed, that are relevant. Having identified the factors that it regards as relevant, the FRC should decide the relative weight to ascribe to each relevant factor.

22. Factors which may be considered include:
- (a) the nature, extent and importance of any standards or regulations breached;
  - (b) the gravity and the duration of the misconduct;
  - (c) the financial benefit derived or intended to be derived from the misconduct (the amounts of the profits gained or losses avoided by the regulated person(s), in so far as they can be determined). This may include any loss avoided or intended to be avoided where it is practicable to quantify this (for example, this could be quantified in appropriate cases by the fees received by the regulated person(s), or by performance related pay, bonuses, or share options received by the regulated person(s)). The FRC may also allocate an amount in respect of interest on the benefit obtained;
  - (d) whether the misconduct caused or risked the loss of significant sums of money (for example, this could be quantified in appropriate cases by reference to the reduction in market value or loss to creditors);
  - (e) the financial strength of the regulated person(s), for example as indicated by the total turnover of the responsible undertaking or the annual income of the responsible person, if that person is a natural person;
  - (f) whether the misconduct was intentional or unintentional;
  - (g) whether the misconduct was dishonest, deliberate or reckless (see paragraphs 52 to 54);
  - (h) whether the misconduct adversely affected, or potentially adversely affected, a significant number of people (such as the public, investors or other market users, consumers, clients, employees, pensioners or creditors);
  - (i) whether the misconduct was isolated, or repeated or ongoing;
  - (j) if repeated or ongoing, the length of time over which the misconduct occurred;
  - (k) whether similar misconduct has been identified previously;
  - (l) whether steps had been taken to address any similar misconduct previously identified;
  - (m) other previous misconduct by the regulated person(s);
  - (n) whether the regulated person(s) has failed to comply with any previous direction or order relevant to this misconduct;

- (o) whether it is likely that the same type of misconduct will recur;
  - (p) whether the misconduct undermines the purpose or effectiveness of the FRCO;
  - (q) whether the misconduct could harm investor, market and public confidence in the truth and fairness of the financial statements of PIEs;
  - (r) whether the misconduct could undermine confidence in the standards of conduct in general of auditors or regulated persons;
  - (s) in the case of a PIE auditor, the effectiveness of its relevant procedures, systems or internal controls and/or its implementation of any relevant Hong Kong Standards on Quality Control (or their equivalent);
  - (t) in the case of a PIE auditor, when the PIE auditor's senior management became aware of the misconduct and what action was taken at that point;
  - (u) whether the regulated person(s) caused or encouraged other individuals to commit misconduct.
23. When considering a sanction to be imposed for a failure by a regulated person to comply with any of his or its obligations to co-operate with, and comply with directions of the FRC, the FRC should consider the reason(s) for and the significance of the failure to comply. Where the non-compliance is continuing, the FRC should consider whether to impose a pecuniary penalty that would promote compliance, such as a pecuniary penalty calculated on a daily or other periodic basis.
24. When determining the sanction to be imposed, the FRC will have due regard to the fact that sanctions have been, or may be, imposed by another regulator or other authority in respect of the misconduct or the events related to that misconduct to ensure that consideration is given to the need to be proportionate, where other sanctions may have addressed the purposes set out at paragraph 10 above.
25. The following sections provide guidance on the factors that the FRC may take into account when considering whether to impose a particular sanction, whether individually or in combination.

### Reprimand

26. A private reprimand may be appropriate in cases where there is no significant risk of damage to the public interest, but the FRC wishes to make clear that the behaviour was unacceptable. This sanction may be used by the FRC alone, when other sanctions available are not considered to be proportionate to a finding of misconduct taking into consideration all the circumstances, for example significant mitigating circumstances.

This sanction may also be used in conjunction with other sanctions in the FRC's absolute discretion. A private reprimand will not be disclosed to the public.

27. A public reprimand may be appropriate where the misconduct is of a serious nature. This sanction may be used alone or in conjunction with other sanctions in the FRC's absolute discretion, e.g. the imposition of wider conditions.

#### Order to carry out remedial actions

28. The FRC may make an order requiring a regulated person(s) to take action to mitigate the effect or prevent the recurrence of the misconduct, where it considers, in its absolute discretion, that such an order would be justified.
29. An order to mitigate the effect of the misconduct is intended to be used where there are ongoing adverse effects of the conduct and specific, measurable, achievable and realistic steps can be identified which would or might mitigate these effects.
30. In addition, where there is a reason to believe there may be a risk of recurrence of the misconduct, the FRC may identify steps that could be ordered to prevent the recurrence or reduce the likelihood of recurrence of the misconduct and may order the regulated person(s) to take such steps.
31. Orders should specify time lines for compliance and may address mitigation. They may be made in conjunction with other sanctions.

#### Conditions

##### *Introduction*

32. The FRC may order a regulated person to comply with any direction that it considers, in its absolute discretion, appropriate. By way of example, and without limitation to the FRC's general discretion, such direction may require a regulated person to undertake or implement education or training programmes, or to comply with particular requirements when practising (including restrictions on the nature of any work undertaken).

##### *Imposing conditions*

33. This sanction is intended to be used where the circumstances suggest that the public interest would be best served by requiring the regulated person to take particular actions with a view to:
  - (a) improving the professional competence of a particular regulated person;
  - (b) ensuring that partners or other personnel in a PIE auditor receive training in a particular area of practice;

- (c) ensuring that a PIE auditor implements organisational or administrative arrangements that would avoid a repetition of the misconduct;
  - (d) preventing a regulated person from undertaking engagements that, based on the misconduct established, the regulated person is not competent to undertake (for example by directing the regulated person not to undertake audits of entities of a particular character — for example, a bank);
  - (e) temporarily banning a PIE auditor from accepting new PIE clients.
34. The imposition of conditions will normally be accompanied by ancillary provisions that address such matters as:
- (a) the date by which any conditions must be complied with;
  - (b) the period during which any limitation on a regulated person's ability to undertake particular engagements shall remain in effect;
  - (c) the identity of any person or organisation responsible for overseeing compliance with the conditions.

### Pecuniary penalties

#### *Introduction*

35. A pecuniary penalty may be ordered either alone or in combination with one or more other sanctions. Given that it will normally be in the public interest for any misconduct warranting the imposition of a pecuniary penalty to be accompanied by some degree of censure, the FRC should not impose a pecuniary penalty in isolation (i.e. without any other sanction) without satisfying itself that that is the appropriate course and providing reasons for that decision.

#### *Ordering a pecuniary penalty*

36. In order to determine whether a pecuniary penalty is appropriate the factors to be considered will normally include whether:
- (a) deterrence can be achieved by a reprimand alone or other sanctions;
  - (b) the regulated person(s) has derived any financial gain or benefit (including avoidance of loss) as a result of the misconduct;
  - (c) the misconduct involved, caused or risked the loss of significant sums of money;
  - (d) a pecuniary penalty was ordered in similar previous cases.



### *Determining the amount of a pecuniary penalty*

37. In cases where the FRC considers that a pecuniary penalty is appropriate, it should aim to impose a pecuniary penalty that:
- (a) is proportionate to the misconduct and all the circumstances of the case;
  - (b) will act as an effective deterrent to future misconduct;
  - (c) will promote public confidence in the regulation of PIE audits and in the way in which misconduct is addressed.
38. In undertaking this assessment, the FRC will normally take into consideration:
- (a) the nature, extent and importance of the standards or regulations breached;
  - (b) the seriousness of the misconduct;
  - (c) in the case of a PIE auditor, its size/financial resources and financial strength, for example as indicated by the total turnover of the PIE auditor and the effect of a pecuniary penalty on its practice;
  - (d) in the case of a registered responsible person, his financial resources and annual income and the effect of a pecuniary penalty on that individual and his future employment;
  - (e) the factors set out in paragraph 22; and
  - (f) the upper limit on the pecuniary penalty that can be imposed.

### *Practice units*

39. In the majority of cases involving the imposition of a pecuniary penalty on a PIE auditor, the amount of revenue generated by the PIE auditor involved in the misconduct will be a factor to be taken into account when assessing the size of the pecuniary penalty which would be necessary, in the circumstances of the particular case, to act as a credible deterrent.
40. Where revenue is not an appropriate indicator of financial means, the FRC should seek an appropriate alternative measure. Other indicators of financial means include the level of profitability per partner<sup>1</sup>, market share, the number of audit and non-audit clients and the respective size of those clients, and the number of partners and registered responsible persons.

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<sup>1</sup> A partner in this context also includes directors in a corporate practice.

## *Individuals*

41. Having assessed the seriousness of the misconduct involved when considering the amount of any pecuniary penalty, the FRC will have regard to the registered responsible person's financial resources (including his income and assets) and employment prospects.
42. The remuneration of a registered responsible person is likely to be an appropriate starting point when considering the level of pecuniary penalty that would: (i) be appropriate to reflect the misconduct involved; and (ii) be necessary to act as a credible deterrent and which will serve to correct and prevent inadequate execution of an audit. The calculation of a registered responsible person's financial resources should take account of his annual gross income together with any benefits he derives from his current employment, including any bonus, pension contribution, share options and share schemes, and/or distributions of profit. Employment includes both employment and self-employment as an adviser, employee, director, partner or contractor or in any other capacity.
43. Where the registered responsible person concerned is no longer in employment, for example because he has left the PIE auditor, the FRC will need to obtain information about the registered responsible person's existing financial resources and future employment prospects.

## Other considerations

44. When deciding the level of pecuniary penalty to impose, the FRC should consider a regulated person's financial resources, establish whether there are any arrangements that would result in the pecuniary penalty or part thereof being paid or indemnified by insurers, or by a PIE auditor or employer. The existence of any such arrangements should not be a ground for increasing any pecuniary penalty beyond the level that would otherwise be considered appropriate.
45. Having arrived at a figure for the pecuniary penalty based on the nature and seriousness of the misconduct, the FRC should consider whether the amount of the pecuniary penalty should be adjusted:
  - (a) to take account of any aggravating and mitigating factors (paragraphs 55 to 57);
  - (b) to ensure the pecuniary penalty has the necessary deterrent effect (paragraphs 61 and 62);
  - (c) to reflect any discount for admissions and/or early disposal (paragraphs 63 to 71); and/or
  - (d) to avoid the likely effect of putting a regulated person in financial jeopardy. However, if a regulated person takes deliberate steps to create the false appearance that the pecuniary penalty will place it, him or her in financial

jeopardy, e.g. by transferring assets to third parties, this will be taken into account.

Revocation or suspension of PIE auditor's registration or recognition and/or prohibition from applying as a registered or recognised PIE auditor

46. The ability to revoke the PIE auditor's registration or recognition or remove the person's name from the list of registered responsible persons of the PIE auditor permanently exists because certain misconduct is so serious and damaging to the wider public and market confidence in the standards of conduct of PIE auditors and the quality of PIE audits, that the above sanctions are the appropriate outcome in order to protect the public or otherwise safeguard the public interest.
47. The FRC may suspend the person's registration or recognition or prohibit a person from applying to be registered or recognised as a PIE auditor or remove the person's name from the list of registered responsible persons of the PIE auditor for a period of time if it considers that other orders and/or conditions and/or a pecuniary penalty are not sufficient to address the FRC's concerns. These sanctions may be used if the FRC has serious concern about the competence and/or ability of the regulated person to comply with standards and regulations. They may also be used where the misconduct is so serious that it undermines public confidence in PIE auditors in general. The FRC must also be satisfied that the misconduct is capable of being rectified within a reasonable period of time; otherwise, the FRC may consider revocation of the person's registration or recognition or remove the person's name from the list of registered responsible persons of the PIE auditor permanently.
48. Prior to imposing an order to revoke the person's registration or recognition or remove the person's name from the list of registered responsible persons of the PIE auditor permanently, all other available sanctions should be considered to ensure that the revocation or removal is the most appropriate sanction (either on its own or in conjunction with another sanction or sanctions) and is proportionate taking into account all the circumstances of the case.
49. Where the misconduct is fundamentally incompatible with the role of a PIE auditor and allowing the regulated person to be a PIE auditor would be so damaging to the public, public interest and market confidence, revocation of registration or recognition /removal from the list of registered responsible persons of the PIE auditor permanently is likely to be the appropriate sanction. The factors set out in paragraphs 51 to 57 will normally be relevant considerations when considering whether to order revocation/prohibition.
50. Where a registered responsible person has been found to have been dishonest, the FRC may lodge a complaint to the relevant professional body for consideration of membership disqualification.

## Other factors to be taken into account when determining the sanction to be imposed

51. In the course of this guidance reference has been made to various factors that the FRC should consider when determining the level of sanction to impose. The characteristics of those factors are discussed below.

### *Intent*

52. Whether the FRC concludes that the misconduct was intentional will be a material factor when determining any sanction to be imposed.
53. Factors tending to show that the misconduct was intentional include where:
- (a) the regulated person(s) involved or the PIE auditor's senior management intended or foresaw that the likely or actual consequences of their actions or inaction would amount to a misconduct;
  - (b) the regulated person(s) involved or the PIE auditor's senior management permitted the misconduct to continue notwithstanding that they knew that their actions breached the relevant rules, standards or procedures or the PIE auditor's management or internal control systems;
  - (c) the regulated person(s) involved or the PIE auditor's senior management was influenced to commit the misconduct by the belief that it would be difficult to detect;
  - (d) the regulated person(s) deliberately took decisions relating to the misconduct knowing that he was acting outside his field of competence;
  - (e) the regulated person(s) intended to benefit financially from the misconduct, either directly or indirectly;
  - (f) the regulated person(s) repeated the misconduct notwithstanding being aware that to do so would involve breaching the relevant rules, standards, or procedures.

### *Recklessness*

54. The FRC may conclude that a regulated person(s) acted recklessly if the regulated person(s) or the PIE auditor's senior management: (i) knew or ought to have known that a proposed course of action or inaction might involve a misconduct; and (ii) proceeded nevertheless.

### *Aggravating and Mitigating Factors*

55. Having assessed the seriousness of the misconduct and reached a view on the sanction that would be appropriate, the FRC should consider whether to adjust that sanction to reflect any aggravating or mitigating factors that may exist (to the extent those factors have not already been taken into account in the FRC's assessment of the seriousness of the misconduct).
56. Examples of events or behaviour that the FRC may conclude aggravated the misconduct, and so should be taken into account when deciding the sanction or combination of sanctions to be imposed, include where:
- (a) the regulated person failed to bring the misconduct to the attention of the FRC (or to the attention of another appropriate regulatory, disciplinary or enforcement authority) quickly, effectively or completely;
  - (b) the regulated person failed to cooperate with, or hindered, the investigation of the misconduct by the FRC, or by another regulatory, disciplinary or enforcement authority (especially if the investigation was prejudiced or delayed thereby);
  - (c) in the case of a PIE auditor, that PIE auditor's senior management were aware of the misconduct, or that such misconduct was likely to occur, but failed to take steps to stop or otherwise prevent the misconduct;
  - (d) the regulated person involved or the PIE auditor's senior management sought to conceal the misconduct or reduce the risk that the misconduct would be discovered;
  - (e) no remedial steps have been taken since the misconduct was identified, either on the regulated person's or PIE auditor's own initiative or as directed by the FRC or another regulatory authority;
  - (f) the misconduct involved an abuse of a position of trust;
  - (g) the misconduct was repeated and/or occurred over an extended period of time;
  - (h) the misconduct was committed with a view to profit (or avoidance of loss);
  - (i) the regulated person facilitated wrongdoing by a third party or collusion with a client;
  - (j) the regulated person was acting without the necessary authorisations, licences or registrations;

- (k) the regulated person has a poor disciplinary record (for example, where a finding of misconduct has previously been handed down against the regulated person by the FRC or another disciplinary or regulatory body). The more serious and/or similar the previous misconduct, the greater the aggravating factor. The fact that a sanction has previously been imposed will not automatically be regarded as a significant aggravating factor. Much will depend on the degree of similarity, the time that has elapsed since the earlier sanction was imposed, the changes that have taken place since then, and the response (or lack of it) to any previous finding or sanction imposed;
- (l) the FRC (or another disciplinary or regulatory body) has previously brought to the regulated person's attention, including by way of a private advice or warning, issues similar or related to the conduct that gave rise to the finding of misconduct in respect of which the sanction is to be imposed;
- (m) similar misconduct has been identified previously;
- (n) the regulated person has failed to comply with any previous direction or order relevant to this misconduct;
- (o) in the case of an individual, if that individual held a senior position and/or supervisory responsibilities.

57. Examples of events or behaviour that the FRC may conclude mitigate the misconduct, and so should be taken into account when deciding the sanction or combination of sanctions to be imposed, include where:

- (a) the regulated person brought the misconduct to the attention of the FRC (or to the attention of another appropriate regulatory, disciplinary or enforcement authorities) quickly, effectively and completely<sup>2</sup>;
- (b) the regulated person provided an exceptional level of cooperation during the investigation of the misconduct by the FRC, or another appropriate regulatory, disciplinary or enforcement authority;
- (c) in the case of a PIE auditor, that PIE auditor's senior management were aware of the misconduct or that such misconduct was likely to occur, and took appropriate steps to try to stop or prevent the misconduct;
- (d) appropriate remedial steps were taken once the misconduct was identified, irrespective of whether such steps were taken on the regulated person's own

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<sup>2</sup> Self-reporting breaches to the relevant regulatory, disciplinary or enforcement authorities will attract greater credit than co-operation with an investigation which has been prompted by someone or something else.

initiative or that of the FRC or another regulatory authority<sup>3</sup>;

- (e) the regulated person was deliberately misled by a third party;
- (f) the misconduct was an isolated event that is most unlikely to be repeated;
- (g) the regulated person did not gain any profit or benefit beyond the fee chargeable from the misconduct;
- (h) the regulated person was subject to duress;
- (i) the regulated person has a good compliance history and disciplinary record;
- (j) in the case of an individual, that individual held a junior position;
- (k) in the case of an individual, personal mitigating circumstances;
- (l) the regulated person has demonstrated contrition and/or apologised for the misconduct.

### *Cooperation*

58. A regulated person is expected to cooperate with the FRC in any regulatory activities including inquiries, investigations or sanctions procedures. In order for cooperation to be considered as a mitigating factor at the point of determining appropriate sanction it will therefore be necessary for the regulated person(s) to have provided an exceptional level of cooperation. Non-exhaustive examples of conduct which may constitute such cooperation include:

- (a) self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters which may constitute an allegation of a misconduct; and
- (b) volunteering information or documentation not specifically requested but which the regulated person nevertheless considers may assist the investigation.

59. Conversely, a failure to provide the level of cooperation required will be considered as an aggravating factor at the point of determining appropriate sanction. Non-exhaustive examples of such failures would include:

- (a) incomplete provision of documents and information in response to requirements and requests;

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<sup>3</sup> Examples include establishing whether the regulated person's client or others have suffered loss and voluntarily compensating them; correcting any misleading statement or impression; taking disciplinary action against staff involved, if appropriate; and taking steps to prevent similar misconduct from arising in the future.

- (b) failure to provide adequate explanation of information provided;
  - (c) failure to comply with deadlines specified in requirements under the FRCO or other written requests;
  - (d) failure to prepare properly for interviews conducted under the FRCO (including failure to review material provided by the FRC's staff in advance of such interviews); and
  - (e) failure to conduct an adequate search for documents and information.
60. It is important to recognise that the examples at paragraphs 58 and 59 above are merely illustrative and that the FRC will consider the overall level of cooperation provided during the course of the investigation and disciplinary process at the point of determining sanction.

#### Adjustment for deterrence

61. If the FRC considers that the sanction or combination of sanctions arrived at, after making any adjustment to reflect any aggravating and mitigating factors, is insufficient to deter the regulated person who committed the misconduct, or other regulated persons, from committing further or similar misconduct, the FRC may adjust the sanction(s) to ensure that the intended deterrent effect will be achieved. The FRC should have regard to the need to impose effective, proportionate and dissuasive sanctions in respect of regulated persons.
62. Examples of the circumstances where the FRC may consider it appropriate to make such an adjustment include where the FRC considers that:
- (a) the regulated person already has a disciplinary record for misconduct of a similar nature;
  - (b) sanctions imposed or agreed previously in respect of similar misconduct have failed to achieve an improvement in the relevant standards of regulated persons;
  - (c) there is a risk of similar misconduct in the future, whether by the regulated person, or by other regulated persons, in the absence of a sufficient deterrent;
  - (d) the sanction is too small to meet the objective of credible deterrence.



## Discount for Admissions and Early Disposal

### *Admissions*

63. Where regulated persons admit some or all of the facts of a case, it is appropriate that any pecuniary penalty and/or other sanction that might otherwise be imposed should be adjusted to reflect the extent, significance and timing of those admissions.
64. However, no discount should be applied to the amount of any pecuniary penalty that equates to the disgorgement of any benefit gained or loss avoided.

### *Acceptance of orders*

65. The Discipline Department will set out the findings and proposed sanctions in writing, and give the regulated person a reasonable opportunity to comment and indicate its agreement or otherwise on the proposed sanctions. In recognition of the benefits of early disposal of matters, where the regulated person accepts the proposed sanctions, it is appropriate to adjust the amount of any pecuniary penalty and/or other sanction that might otherwise have been imposed.
66. Normally, it will be inappropriate to reduce the period during which a regulated person is to be prohibited to reflect early disposal or resolution because the primary purpose of such a sanction is to protect the public. Therefore, any adjustment will generally apply only to any pecuniary penalty to be imposed.
67. In general, a larger adjustment will be appropriate if the regulated person admits substantially all the findings or does so at an early stage of the case. If the regulated person is prepared to admit some but not all of the findings, the discount applicable will depend on the extent and significance of the admissions as well as the stage at which those admissions were made. The exercise of any discount is within the discretion of the FRC.

### *Partial Admissions*

68. A regulated person may make partial admissions to the findings set out by the Discipline Department. Such admissions may relate to factual matters and as to whether the facts amount to a misconduct.
69. In the absence of early disposal, such admissions will still necessitate the matter proceeding through the disciplinary procedure. However, partial admissions may assist to reduce the disputed issues and achieve savings of time in the process.
70. Where the parties agree, the FRC will be informed of any partial admissions and will adjudicate on the remaining disputed allegations.

71. Partial admissions may be relevant to the factors considered at the point the FRC determines sanction but there is no formal adjustment of sanction to be applied in cases where there has not been early disposal. Nevertheless, where the regulated person agrees the facts and liability but not the level of pecuniary penalty or the appropriate discount, the FRC should allow such discount as is thought appropriate having regard to all the circumstances and in particular the time when that was agreed.

### **Disclosure of Sanction**

72. Under section 37K, where the FRC imposes sanctions other than a private reprimand on a regulated person, it must disclose to the public the following:
- (a) the material facts relating to the case;
  - (b) its decision to impose a sanction, and the reasons for the decision; and
  - (c) the sanction imposed.
73. The disclosure may only be made after:
- (a) the expiry of the period for lodging an application for review to the Tribunal in relation to the FRC's decision; or
  - (b) if such application is lodged, the review has been disposed of.
74. The FRC must not make the above disclosure if the disclosure may adversely affect any criminal proceedings before a court or magistrate or if the disclosure, in the FRC's opinion, is not in the interest of the investing public or in the public interest.



Consultation Conclusions on

**Proposed Sanctions Guidelines**

May 2019

**Financial Reporting Council  
 Consultation Conclusions on the Proposed Sanctions Guidelines**

*Unless otherwise specified, the paragraph numbers refer to those of the Proposed Sanctions Guidelines.*

<b>Questions</b>	<b>Summary of Respondents' Views</b>	<b>FRC's Responses</b>
1.	<i>Do you agree with the FRC's objectives of imposing sanctions as set out in paragraph 10? If not, please state the particular objective(s) that you do not agree with and the reasons for your disagreement.</i>	
	(a) All respondents agreed or did not express negative views on the proposed objectives of imposing sanctions as set out in paragraph 10.	(a) & (b) We are pleased to note the respondents' overwhelming support for the objectives of imposing sanctions as set out in the proposed Sanctions Guidelines.
	(b) A majority of respondents pointed out that they also agreed with the principle set out in paragraph 11 that the primary purpose of imposing sanctions for misconduct is not to punish but to protect the public and the wider public interest.	
	(c) Some respondents suggested the greater use of non-financial penalties which would help change and improve behaviour of the regulated persons and thereby help maintain and enhance audit quality.	(c) We recognise that any sanction or combination of sanctions imposed should be fair and proportionate to the misconduct and aim at achieving the objectives as set out in the proposed Sanctions Guidelines.
2.	<i>Do you agree with the FRC's approach to determining sanctions summarised in paragraph 19? If not, please explain any alternative you would propose and the reasons therefor.</i>	
	(a) All respondents supported or did not express negative views on the proposed approach to determining sanctions summarised in paragraph 19.	(a) We are pleased to note the respondents' overwhelming support for the proposed approach to determining sanctions summarised in paragraph 19.
	(b) Some respondents requested the FRC to provide guidance on how and what sanctions may be applied to different regulated persons of a public interest entity auditor (the "PIE auditor") (i.e. a PIE auditor, an engagement partner, an engagement quality control	(b) As mentioned in paragraph 16, the FRC should consider whether a particular sanction is commensurate with the circumstances of the case, including the seriousness of the misconduct found and the

Questions	Summary of Respondents' Views	FRC's Responses
	<p>reviewer and a quality control system responsible person).</p>	<p>circumstances of the regulated person(s) concerned. The FRC recognises that a sanction or a combination of sanctions must be proportionate to the misconduct. The FRC will have regard to whether the firm is also an individual (for example, a sole proprietor) in determining whether a sanction is disproportionate. We emphasize that whether a sanction should be imposed on a firm or the individuals or both depends on the particular facts and the degree of responsibility for the misconduct as between the firm and the individuals.</p>
	<p>(c) A respondent, while supporting the proposed approach, considered that since one of the overriding objectives when imposing sanctions for a misconduct already include the purpose of deterring future misconduct (paragraphs 10(a) and 37(b)), making further adjustments to achieve the appropriate deterrent effect under paragraph 19(d) would seem to have a double penalty effect.</p>	<p>(c) As one of the purposes of imposing sanctions is to deter future misconduct, we consider that paragraph 19(d) is specifically designed to achieve the stated objective, irrespective of whether a pecuniary penalty would be imposed (as paragraph 37(b) is applicable to determining the amount of a pecuniary penalty). In any event, there will be no “double penalty effect”.</p>
	<p>(d) Two respondents suggested that the FRC should consider past sanction orders with similar case features, including the disciplinary cases of the Hong Kong Institute of Certified Public Accountants (“HKICPA”) over the past 46 years, in particular cases referred by the FRC in recent years before the finalisation of sanctions.</p>	<p>(d) We note the view expressed by the respondents. We have set out in paragraph 7 that the FRC may have regard to sanctions imposed in other cases and should not feel constrained by the sanctions imposed (or not imposed) in earlier cases to impose a sanction which it does not think appropriate. Since the facts, factors and circumstances may vary widely from case to case, following past cases may run the risk that a sanction or a combination of sanctions is disproportionate (in either</p>

Questions	Summary of Respondents' Views	FRC's Responses
		<p>direction) or otherwise may not meet the stated objectives.</p> <p>As a matter of fact, the new legislation has brought significant changes to the existing sanctioning regime under the Professional Accountants Ordinance by introducing a variety of available sanctions and increasing the maximum amount of pecuniary penalty which may be imposed on a regulated person. We recognise that while sanction orders under the Professional Accountants Ordinance may provide some useful reference, they should be considered in the light of the new legislative framework.</p> <p>In light of the above, it is imperative that the FRC consider all facts and circumstances of the case when determining the appropriate sanction(s).</p>
	<p>(e) Two respondents suggested that the FRC should consider adopting a separate set of sanctions guidelines for investigations and inspections; and a separate set of sanctions guidelines for registered responsible persons (i.e. engagement partner, engagement quality control reviewer and quality control system responsible person).</p>	<p>(e) We do not consider it necessary to develop a separate set of sanctions guidelines for investigations and inspections or a separate set of sanctions guidelines for registered responsible persons. We consider that the proposed Sanctions Guidelines provide the relevant principles that the FRC will consider in determining sanctions and these principles are applicable irrespective of whether the evidence of misconduct originates from an investigation or an inspection; and whether the regulated person under consideration is a PIE auditor or a registered responsible person. In so far as the role played by each regulated person in a particular</p>

Questions	Summary of Respondents' Views	FRC's Responses
		<p>case is a relevant factor in determining sanction, it will be taken into consideration in applying the relevant principles in the Sanctions Guidelines.</p>
3.	<p><i>Have we included the sorts of factors (paragraphs 21 to 24) in the Sanctions Guidelines that you would expect the FRC to consider in assessing the nature and seriousness of the misconduct and determining the sanctions to be imposed? Are there any other factors you believe the FRC should take into account when determining the sanctions to be imposed?</i></p>	
	<p>(a) All respondents considered that the factors set out in paragraphs 21 to 24 are appropriate and comprehensive in assessing the nature and seriousness of the misconduct and determining the sanctions to be imposed.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposed factors set out in paragraphs 21 to 24 in assessing the nature and seriousness of the misconduct and determining the sanctions to be imposed.</p>
	<p>(b) Some respondents expressed concerns that the proposed guidelines do not give sufficient explanation and guidance on how to decide the relative weight to be given to each relevant factor. They requested additional guidelines to illustrate the suggested sanctions that may be imposed based on the seriousness of the misconduct, like the table set out in paragraph 6.1 of the Guideline to Disciplinary Committee for Determining Disciplinary Orders issued by the HKICPA (the "HKICPA Guideline to DC").</p>	<p>(b) We note the concerns of the respondents and would like to reiterate that the factors set out in paragraphs 21 to 24 are those factors that may be relevant to the FRC's consideration in assessing the nature and seriousness of the misconduct and determining the sanctions, and therefore the relative weight to be given to each factor depends on the facts and circumstances of the case.</p> <p>In determining whether a regulated person has committed a misconduct, and, if so, what sanction to impose, the FRC has to consider the facts, factors, and circumstances of the case which may differ widely from case to case. Based on the experience of the FRC of the United Kingdom and the Public Company Accounting Oversight Board of the United States with whom the FRC concurs, we do not think it possible to create a useful tariff or</p>

Questions	Summary of Respondents' Views	FRC's Responses
		<p>guideline system which (i) will be able to cater for every, or even most of, the individual cases; and (ii) does not result in an unduly restrictive approach that might constrain the FRC.</p> <p>Moreover, the sanctions available cannot be viewed as an entirely linear progression, starting, for example, with reprimand and ending with revocation of registration. The appropriate sanctions may be, for instance, a combination of suspension/imposition of conditions, pecuniary penalty, and a requirement of further training.</p>
	<p>(c) Some respondents pointed out that the examples used to determine financial benefit derived or loss of money from the misconduct are not relevant or appropriate in the context of the audit profession. In particular, some respondents mentioned that the amounts of the profits gained or losses avoided are difficult to measure consistently from firm to firm.</p>	<p>(c) We have considered the comments made by the respondents and have incorporated most of the comments in the revised Sanctions Guidelines.</p> <p>Paragraph 22 is revised as follows:</p> <p>“...  (c) the financial benefit derived or intended to be derived from the misconduct (the amounts of the profits gained or losses avoided by the regulated person(s), in so far as they can be determined). This may include any loss avoided or intended to be avoided where it is practicable to quantify this (for example, this could be quantified in appropriate cases by the fees received by the regulated person(s), <del>or by performance related pay, bonuses, or share options</del>”</p>



Questions	Summary of Respondents' Views	FRC's Responses
		<p><del>received by the regulated person(s)</del>). The FRC may also allocate an amount in respect of interest on the benefit obtained;</p> <p>(d) whether the misconduct caused or risked the loss of significant sums of money <del>(for example, this could be quantified in appropriate cases by reference to the reduction in market value or loss to creditors); ...</del>"</p> <p>We acknowledge that the amounts of the profits gained or losses avoided may be difficult to measure consistently from firm to firm. We will exercise due care in evaluating whether such amounts are relevant in determining the seriousness of the misconduct in question and will not automatically link the penalty imposed in any particular case with the profits gained or losses avoided.</p>
	<p>(d) A respondent considered that "intentional" and "deliberate" bear the same meaning and should not be two separate factors.</p>	<p>(d) While the meanings of "intentional" and "deliberate" are similar, the latter usually involves careful consideration of relevant factors before committing the conduct. Therefore, we consider it appropriate to present them as two separate factors.</p>
	<p>(e) A respondent suggested that "ongoing" misconduct should be based on whether the relevant misconduct was known to the regulated persons.</p>	<p>(e) The fact that the misconduct was "ongoing" is itself a relevant factor in assessing the extent and seriousness of the misconduct, irrespective of whether the regulated persons were aware that the misconduct was ongoing. If the regulated persons were aware of the misconduct but failed to take appropriate steps to address</p>

Questions	Summary of Respondents' Views	FRC's Responses
		the misconduct, this would be an aggravating factor.
	(f) Some respondents questioned how the FRC assesses the likelihood of re-occurrence of the same type of misconduct as this involves subjective test. A respondent held the view that the likelihood of re-occurrence of the same type of misconduct should not be considered as a factor in assessing the nature and seriousness of the misconduct and determining the sanctions to be imposed.	(f) We acknowledge that the assessment of the likelihood of re-occurrence of the same type of misconduct involves judgement, like many of the other factors. However, the assessment should be an objective exercise based on all the available facts of the case. For example, if a regulated person has committed the same misconduct on previous occasions, the likelihood of him/her committing the same misconduct in the future may objectively be said to be higher than someone who has never done the same act before.
	(g) A respondent suggested adding "how long ago the misconduct occurred and the passage of time that has lapsed" as a relevant factor.	(g) We have considered the suggestion and have incorporated it in the revised Sanctions Guidelines.  The following text is added after 22(d):  “(e) the passage of time since the misconduct occurred;”.
	(h) A respondent suggested adding “fraud committed by the other party” as a relevant factor.	(h) In general, we agree that fraud committed by the other party is a relevant factor in assessing the seriousness of a misconduct. Since the proposed Sanctions Guidelines have already included “the regulated person was deliberately misled by a third party” as an example of mitigating factor, we consider that the concern raised by the respondent has been addressed.
	(i) A respondent requested further elaboration of the nature of breaches (technical breaches vs ethical non-	(i) The proposed Sanctions Guidelines provide the relevant principles that the FRC will

Questions	Summary of Respondents' Views	FRC's Responses
	<p>compliances) and further guidelines and application examples on sanction where there is a disagreement over technical judgements.</p>	<p>consider in determining sanctions where there is a finding of misconduct. Whether the misconduct is described as “technical breaches”, “ethical non-compliances” or otherwise, it remains the duty of the FRC to determine, on the facts and circumstances of each particular case, what failings the misconduct involved so as to assess the seriousness of the misconduct and the appropriate sanction(s) in accordance with those relevant principles.</p>
4.	<p><i>Do you agree that the sanctions, including a pecuniary penalty, to be imposed by the FRC should act as an effective deterrent and be proportionate to the misconduct and have regard to all the circumstances of the case, including the financial resources of the regulated persons? If not, what would you propose? Please explain your rationale.</i></p>	
	<p>(a) A vast majority of respondents supported or did not express negative views on the proposal that sanctions, including a pecuniary penalty, to be imposed by the FRC should act as an effective deterrent and be proportionate to the misconduct.</p>	<p>(a) We are pleased to note the overwhelming support for the proposal that sanctions, including a pecuniary penalty, to be imposed by the FRC should act as an effective deterrent and be proportionate to the misconduct.</p>
	<p>(b) A respondent pointed out that the financial resources of regulated persons should not be taken into consideration when imposing sanctions as there is no direct connection between financial resources and misconduct. The respondent was of the view this may encourage smaller audit firms to take more risk with transgressions because of the smaller sanctions on them.</p>	<p>(b) We would like to clarify that a firm with more financial resources will not automatically receive a higher pecuniary penalty for the same misconduct. As set out in paragraph 45, the FRC, having arrived at a figure for the pecuniary penalty based on the nature and seriousness of the misconduct, will have to consider whether such a pecuniary penalty will put a regulated person in financial jeopardy and if so, adjust the penalty.</p>

Questions	Summary of Respondents' Views	FRC's Responses
5.	<i>Do you agree with the factors set out in paragraphs 37 to 43 that the FRC will normally take into consideration when determining the amount of a pecuniary penalty? If not, please explain any alternatives that you would propose and the reasons therefor.</i>	
	(a) All respondents supported or did not express negative views on the proposal that the FRC should normally consider factors set out in paragraphs 37 to 43 in determining the amount of a pecuniary penalty.	(a) We are pleased to note the overwhelming support for the proposal that the FRC should normally consider factors set out in paragraphs 37 to 43 in determining the amount of a pecuniary penalty.
	(b) Some respondents expressed concerns about the size of financial resources and general financial strength of an auditor being used in determining the amount of a pecuniary penalty (paragraph 38(c)) which may imply that larger firms will automatically receive larger pecuniary penalties for the same misconduct. They also questioned the basis used to measure financial resources, e.g. revenue generated by the PIE auditor, market share and profitability per partner. A respondent suggested that the Sanctions Guidelines should clarify that the factors as set out in paragraphs 38(c) to (d) and paragraphs 39 to 43 are only relevant in circumstances where the regulated person submits that the pecuniary penalty may put him in financial jeopardy and he is invited to provide the relevant information on a voluntary basis to support his case for FRC's consideration.	(b) The FRC has considered the comments and suggestions made by the respondents and has incorporated some of them in the revised Sanctions Guidelines.  Paragraph 22(e) "the financial strength of the regulated person(s), for example as indicated by the total turnover of the responsible undertaking or the annual income of the responsible person, if that person is a natural person" and paragraphs 38(c) to (d) and 39 to 43 are deleted. A new paragraph 39 is added:  "Where a regulated person submits that the pecuniary penalty may put him in financial jeopardy and provides relevant information in support of such submission, the FRC may consider the following factors. In the case of a PIE auditor, the FRC will have regard to the PIE auditor's size/financial resources and financial strength, for example as indicated by the total turnover of the PIE auditor and the effect of a pecuniary penalty on its practice. In the case of a registered responsible person, the FRC will have regard to the registered responsible person's financial resources (including his

Questions	Summary of Respondents' Views	FRC's Responses
		<p>annual income and assets) and the effect of a pecuniary penalty on that individual and his future employment.”</p> <p>Please also refer to our response at item (b) to respondent's comments on Question 4.</p>
	<p>(c) Some respondents considered that the maximum pecuniary penalty for each case should not exceed the amount which is the greater of (i) HK\$10,000,000; or (ii) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct, irrespective of the number of charges for each case.</p>	<p>(c) Under sections 37D(3)(b)(iv) and 37E(3)(b)(iii) of the FRC Ordinance, the FRC may order the PIE auditor and each of the registered responsible persons to pay a pecuniary penalty not exceeding the amount which is the greater of (i) HK\$10,000,000; or (ii) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct. This is in line with other financial regulators and the existing practice of the HKICPA that a pecuniary penalty is calculated per misconduct and per respondent. Where a case potentially gives rise to multiple pecuniary penalties, the FRC will look at the totality of the penalties to ensure it is not disproportionate to the gravity of the misconduct in question.</p> <p>A new paragraph 40 is added:</p> <p>“Where a case potentially gives rise to multiple pecuniary penalties, the FRC will look at the totality of the penalties to ensure that it is not disproportionate to the seriousness of the misconduct in question for each of the regulated persons.”</p>
	<p>(d) A respondent was of the view that there may be circumstances where the proportionality to the misconduct and deterrence against future</p>	<p>(d) Any sanction or combination of sanctions imposed should be fair and aim at achieving the objectives as set out in the</p>

Questions	Summary of Respondents' Views	FRC's Responses
	<p>misconduct might have opposing effects on sanctions and suggested that deterrence be subordinate to the proportionality principle.</p>	<p>proposed Sanctions Guidelines which include proportionality to the misconduct and deterrence against future misconduct. We are confident that the FRC will follow the stated objectives and determine the appropriate sanctions.</p>
6.	<p><i>Do you have any other comments on the Sanctions Guidelines that would help the FRC as an independent auditor regulator to protect the investing public and the public interest?</i></p>	
	<p>(a) Some respondents suggested that financial sanctions should be imposed in exceptional circumstances and only for severe cases of wrongdoing.</p>	<p>(a) We do not accept the proposal as we consider that a sanction or a combination of sanctions should be: commensurate with the circumstances of the case, including the seriousness of the misconduct found and the circumstances of the regulated person(s) concerned; a meaningful deterrent; and sufficient to meet the primary objectives of sanctions.</p>
	<p>(b) Some respondents suggested that the guidelines should clarify explicitly that a reasonable defence of a charge of misconduct (such as using experts and legal advisors) and inability to cooperate due to legal restrictions (such as legal professional privilege and legal impediments) will not be considered as uncooperative behaviour.</p>	<p>(b) The FRC will have regard to all facts and circumstances before concluding on whether a particular event or behaviour or course of conduct should be considered as uncooperative behaviour.</p>
	<p>(c) A few respondents suggested an amendment to paragraph 44 to clarify that there is no need to establish whether professional indemnity insurance or indemnification arrangements exist because their existence or non-existence is not a ground for either increasing or reducing the pecuniary penalty.</p>	<p>(c) While the existence of insurance or indemnification arrangements will not be a ground for increasing any pecuniary penalty that would otherwise be considered appropriate, the absence of such an arrangement may reduce the pecuniary penalty if it would put the regulated person in financial jeopardy.</p>

Questions	Summary of Respondents' Views	FRC's Responses
	<p>(d) A respondent suggested (i) adding that seeking expert opinion should be included as a mitigating factor, and (ii) removing “deliberately” in paragraph 57(e) as being misled by a third party should in itself be considered as a mitigating factor, without any condition.</p>	<p>(d) We do not see any strong justification to adopt the suggestions raised by the respondent. The mere seeking of expert opinion and the mere fact of being misled by a third party should not, without more, constitute a mitigating factor. Whether a mitigating factor exists arising out of these two factors depend on all the facts and circumstances, including but not limited to, the complexity of the issue(s) requiring the obtaining of expert opinion, and the nature of the information provided by the third party.</p>
	<p>(e) A few respondents provided comments on the section of “Discount for Admission and Early Disposal”, which include the appropriateness of the terminology of “discount” and the need for further guidance on discounts to sanctions for cooperation and the likely level of discount.</p>	<p>(e) The FRC has considered the comments and incorporated some of them in the revised Sanctions Guidelines. Paragraph 71 (now paragraph 68) is revised as follows:</p> <p><del>“Partial admissions may be relevant to the factors considered at the point the FRC determines sanction but there is no formal adjustment of sanction to be applied in cases where there has not been early disposal. Nevertheless, w</del>Where the regulated person agrees the facts and liability but not the level of pecuniary penalty or the appropriate discount, the FRC should allow such discount as is thought appropriate having regard to all the circumstances and in particular the time when that was agreed.”</p> <p>We will work out the details of further guidance on cooperation</p>

Questions	Summary of Respondents' Views	FRC's Responses
		and discounts and will publish the guidance in due course.
	(f) A respondent requested the FRC to set out the threshold and circumstances for issues arising from an inspection that would trigger disciplinary action and also the circumstances an audit firm would be regarded as having systemic failure in its system of quality control that would lead the person(s) in charge of the system of quality control being subject to disciplinary action.	(f) Since the proposed Sanctions Guidelines deal with the imposition of sanctions on regulated persons after a misconduct has been identified, we do not consider it appropriate to include the threshold and circumstances for issues arising from an inspection that would result in sanctions and the circumstances under which an audit firm would be regarded as having systemic failure in its system of quality control. Nevertheless, we will consider whether it is appropriate to provide such guidance by other means.
	(g) Two respondents noted that at least one-third of the FRC members should be appointed because of their knowledge and experience in PIE engagements. They requested that there should be a guideline to set out the requirement in this respect.	(g) All appointments of members of the FRC are made by the Chief Executive and such appointments are outside the scope of the proposed Sanctions Guidelines.
	(h) A respondent referred to the Legislative Council Brief dated 17 January 2018 (the "LegCo Brief") prepared by the Financial Services and the Treasury Bureau (the "FSTB") and noted that it was imperative the FRC establish a panel of audit experts who are independent of the FRC and the regulated person to provide expert opinions and assistance to the FRC when the FRC is considering disciplinary action against a regulated person. Also, the FRC should establish a panel of legal experts who are independent of the FRC and the regulated person to provide expert opinions on whether the principles of due process and	(h) While the comments are outside the scope of the proposed Sanctions Guidelines, we are committed to the adoption of the administrative arrangements suggested by the FSTB in the LegCo Brief.



Questions	Summary of Respondents' Views	FRC's Responses
	<p>natural justice have been observed in the disciplinary process and whether the recommended sanction is appropriate.</p>	
	<p>(i) Some respondents reminded the FRC to put in place administrative arrangements to ensure that the executives who have participated in the investigation/inspection or disciplinary processes of a case would not take part in making a disciplinary decision of the case.</p>	<p>(i) While the comments are outside the scope of the proposed Sanctions Guidelines, we are committed to the adoption of the administrative arrangements suggested by the FSTB in the LegCo Brief.</p>
	<p>(j) Two respondents held the view that the FRC should not only regulate the PIE auditors, but also need to focus more in regulating the PIEs and the persons responsible for the preparation of financial statements of PIEs, such as financial controller and finance director.</p>	<p>(j) The FRC does not have the power to impose sanctions on persons responsible for the preparation of financial statements of PIEs. However, the FRC may initiate an enquiry into a possible relevant non-compliance with accounting requirements on the part of PIEs. Where the FRC finds that there is a relevant non-compliance in the financial statements, the FRC may give a notice to the PIE concerned to remove the non-compliance in the manner and within a period as specified in the notice.</p>