



22 September 2005

By Email and By Hand

Our Ref: FRC, M36619

Miss Salumi Chan
Clerk to the Bills Committee on the
Financial Reporting Council Bill
Legislative Council Secretariat
3rd Floor, Citibank Tower
3 Garden Road
Hong Kong

Dear Madam,

Financial Reporting Council ("FRC") Bill

We thank you for your letters dated 27 July 2005 (seeking the Institute's submissions on the Bill) and 5 August 2005 (seeking the Institute's views on the Administration's proposal that the function of the FRC should be purely investigatory).

In 2003 the Institute advocated a number of significant changes to the regulatory and oversight structures that governed the activities of the auditing and accounting profession in Hong Kong. We did so in recognition of the need for a greater level of transparency in our activities and the need for the strengthening of public trust in the work of our members. One of our recommendations was the establishment of the FRC with the two functions that are now being promulgated in the Bill. In the intervening period we have worked closely with the Administration and the other sponsoring bodies to develop the Bill.

The Institute fully supports the legislative objectives of the Bill and believes that the benefits that the FRC will bring to the better regulation of the auditing profession and financial reporting by listed companies are significant. We would like to acknowledge the efforts of the Financial Services and the Treasury Bureau together with Hong Kong Exchanges and Clearing Limited, the Securities and Futures Commission and the Companies Registry in bringing the Bill to LegCo in such a timely manner and look forward to its enactment in an equally timely manner.

We now provide our submission as follows:

1. **THE INSTITUTE'S ROLE AS PROSECUTOR**

- 1.1 We reiterate our Council's determination that the Institute should continue to act as the profession's regulatory body and to be responsible for the disciplinary role of which the prosecution role is an integral part. This determination together with the views of Government and the other regulators form the bedrock of the Bill.



- 1.2 This said, we have been extremely mindful and continue to be so that the FRC's investigation role and the Institute's prosecution and disciplinary roles should be properly defined in order for the process to be co-ordinated. It is our understanding that as soon as the FRC is established, the FRC will work closely with the Institute to develop the non-statutory protocols, guidelines and/or Memorandum of Understanding ("MOU") in order to enable the Institute to discharge the prosecution role effectively.

2. **INTERPRETATIONS OF HONG KONG FINANCIAL REPORTING STANDARDS**

- 2.1 While it may be inappropriate for the Institute to be involved in the work of the Financial Reporting Review Committees (FRRRC), there is one particular aspect, namely the interpretation of Hong Kong Financial Reporting Standards, which the FRRRC should always consult with the Institute. As the Institute is the only body vested with the power and duty to set and interpret financial reporting standards, it would be inappropriate for the FRRRC to interpret Hong Kong Financial Reporting Standards. If the FRRRC were not to consult the Institute, the two bodies may have different interpretations.

- 2.2 We expect this obligation to be specified in the protocols, guidelines and/or MOU, as appropriate.

3. **POWER TO SEEK COURT ORDER TO SECURE REMOVAL OF RELEVANT NON-COMPLIANCE – SECTION 50**

- 3.1 The FRC is not empowered under section 50 of the Bill to seek a court order to mandate rectification of the annual financial statements generally. The Institute reiterates its previously expressed concern that, if this power is only to apply to Hong Kong incorporated companies, the effect will be that the FRC will be unable to oblige some 80% of listed companies which are incorporated outside Hong Kong to revise their financial statements.

- 3.2 We are advised that, because of an extra-territoriality aspect of imposing obligations on entities incorporated outside Hong Kong, the only manner in which these companies can be compelled to revise their financial statements would be by giving statutory force to the Listing Rules. If this is the case, then we strongly encourage all concerned to move forward with the legislation necessary to give such statutory backing to the Listing Rules so that all listed companies are subject to the same degree of regulation. Hong Kong does not need an uneven playing field when it comes to regulating listed companies.

4. **DRAFTING COMMENTS**

- 4.1 Annexed to this letter is a Schedule setting out some drafting comments identified during our internal discussions. We hope the Bills Committee could give these comments due consideration.



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

If you require clarifications on any of our above comments, please feel free to contact the undersigned at 2287 7026 or schan@hki CPA.org.hk.

Yours faithfully,

Stephen Chan
Executive Director
Hong Kong Institute of Certified Public Accountants

SSLC/TH/el

c.c. Hon. Tam Heung-man, Mandy
Chairperson of the Bills Committee



SCHEDULE – DRAFTING COMMENTS

- 4.(2)(a) At the end, instead of “and”, should it be “or”?
4. (3) This sub-clause is similar to but not the same as Section 34(1)(a) PAO.
There may be a danger of an event under the FRC Bill and not being such under the PAO and vice versa.
6. (2)(c) Here the Council can be sued. However, under Clause 53, the Council is immune or not liable.
Consideration needs to be given to the significance of any contradiction.
7. (1) There is no mention whether the Council Members should be paid.
10. (2)(a)(b) In (a), they are employed and (b) they are appointed.
Consideration needs to be given to the significance of any contradiction.
13. (1)(a) “performs” = “perform” (?)
25. (1)(2) There are differences between this provision and Clause 42D of the PAO, setting out the powers of an HKICPA Investigation Committee.

Other points

- Comparable obligations for retention of records.
- Section 52 of the Bill is an attempt to define potential conflicts in detail and, as such, is probably doomed to failure. Consideration should be given to enunciating the general principle of avoiding bias and then provide examples of conflicts.
- Consideration needs to be given to whether section 58 should be extended to require evidence to be kept upon the conclusion of an AIB/FRC investigation until either the Institute decides whether to prosecute or the prosecution (and any appeal) are concluded
- Guidance should be given under section 71 as to the level of costs to be awarded.
- Schedule 3. Consideration should be given to whether the provisions of clause 4(1)(d) are sufficiently stringent.