

15 September 2005



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The HON Tam Heung-Man  
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Dear The HON Tam Heung-Man

### **Re: Bills Committee on Financial Reporting Council (FRC) Bill – Invitation for Submissions**

Thank you for inviting CPA Australia Hong Kong China Division to give our views on the FRC Bill. We understand that the objectives of the Bill are to provide for:

- the establishment of a FRC to oversee an Audit Investigation Board (AIB) and Financial Reporting Review Committee (FRRC);
- the establishment of an AIB to carry out investigations into suspected irregularities concerning auditors of corporations and collective investment schemes listed in Hong Kong; and
- the appointment by the FRC of a FRRC to enquire into non-compliance accounts and financial statements of corporations and collective investment schemes listed in Hong Kong with relevant legal and accounting requirements.

In regards to the Consultation Paper on Legislative Proposals to Establish FRC, CPA Australia Hong Kong China Division made a submission to the Financial Services and the Treasury Bureau of the Hong Kong Special Administrative Region (HKSAR) Government on 15 April 2005. The submission focused on presenting the Australian regulatory regime and is summarized in the following paragraphs. (Copy of the full submission attached)

#### **Australian Regulatory Regime**

Under the Australian regulatory regime, the Australian Securities and Investments Commission (ASIC) and the FRC carry out many functions that are being considered in the Consultation Paper. The FRC's functions include the supervision of the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB). Other bodies with interrelated functions include the Financial Reporting Panel (FRP) and the Companies Auditors and Liquidators Disciplinary Board (CALDB).

Except for the FRC, the Australian Government fund the regulatory regime. In regards to the FRC's funding, it is comprised of over half from the Government, a substantial amount from the professional bodies and a small amount comes from the business community.

#### **Regulation of Auditors**

Small proprietary companies are not required to prepare financial statements or to be audited in Australia. As a result, audit regulation focuses on large corporates. Regulators and their responsibilities are:

- The professional bodies monitor the overall quality assurance related to their members.
- The FRC monitor the independence of those auditors that are auditing entities covered by the Corporations Act.

- ASIC regulates auditors under the Corporations Act and has developed extensive material to address this issue.

### **Compliance of Financial Statements with Accounting Standards**

All entities governed by the Corporations Act are required to follow accounting standards.

ASIC monitors the compliance of financial statements with accounting standards and other reporting requirements contained in the Corporations Act with the prosecution and disciplinary functions delegated to the CADLB. The AASB and AUASB do not take part in compliance monitoring.

Should a dispute about the appropriate application of accounting standards arise between ASIC and a reporting entity, the dispute is usually addressed through negotiation. ASIC has the option to take the issue to court or to the FRP for resolution. The Australian Government is still in the process of establishing the FRP and as a result there is no current disputes addressed by the FRP.

### **Hong Kong an Unique Jurisdiction**

Hong Kong is an unique jurisdiction and the FRC can not be entirely modelled on any other framework in overseas jurisdictions. Other models should be considered for the structure of the establishment of the FRC but modified to fit with Hong Kong's needs.

### **Comments on the Major Views and Concerns**

#### *Duplication of Efforts & Overlapping Functions of the FRC*

The majority views revealed in the Consultation in September 2003 were that the FRC should remain purely investigatory. The outcome of the investigation by the AIB and the Financial Reporting Review Committee (FRRRC) will be referred by the FRC to a relevant enforcement agency or a professional body for necessary legal and/or disciplinary action.

CPA Australia is of the view that to enhance the interaction and communication between the investigatory function and subsequent prosecution, it is important for the FRC and the relevant enforcement agency or professional body to have a good understanding and consensus of the terms of reference as well as the scope of investigation. This could be facilitated by a memorandum of understanding between the FRC and the relevant bodies to outline the details of cooperation including the criteria to be adopted by the FRC in determining the basis for prosecution. We are also of the opinion that the FRC's decision to refer the case to further action should be based on three key functions:- materiality, public interest and the likelihood of successful case to facilitate the prosecution process. It is essential for the FRC and the relevant parties to agree to a comprehensive set of criteria covering the assistance required for the FRC.

To ensure the functions of the FRC are not overlapped, the terms of reference for the three organisations (HKICPA, SFC & FRC) need to be clearly defined. The FRC via the AIB would be responsible for the investigation of the suspected irregularities of auditors of listed corporations and the preparation of any auditors' reports. The FRC via the FRRRC would enquire into suspected non-compliance of the accounts and financial statements of corporations and collective investment schemes listed in Hong Kong. The HKICPA would continue to be responsible for the investigation of the non-listed sector and misconduct of the accounting profession and the SFC would investigate auditors and other persons involved in market misconducts.

To ensure there is a high defence of equity in the proposed framework, we suggest that an appeal process should be in place and the FRC budget and funding be modified to reflect the additional costs.

### *Composition of Members*

Specifically to the functions of the AIB, it is important for FRC staff and members to have the relevant experience and expertise in listed companies to enable them to have a good understanding of the case issues. For flexibility, it is suggested that members can be appointed from a pool of experts which consists of a balanced number of accountants and lay persons. As the accounting profession is unique and encompasses various industries and sectors, the professional accounting standards can not be comparable to other professions. For cost and experience consideration, the pool of experts may include retired audit partners who can take up volunteer advisory roles.

### *Funding Arrangement*

We suggest that the funding should come from the Government, the professional body and the business community in particular from listed companies in Hong Kong by enforcing a levy to be charged to them which will be maintained in a segregated account by the FRC to support the prosecution expenses. Following the cost-sharing approach would benefit all parties and concur with international trends. Subsequently, higher fees of compliance will raise the quality of standards and increase transparency.

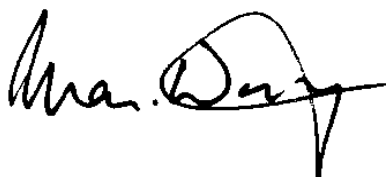
### **Conclusion**

We do recognise in Hong Kong that the local accountancy body HKICPA is self-regulated. The challenge of the HKSAR Government to establish the FRC would be an important step to enhance the transparency of a self-regulatory regime and to follow the international trend of upgrading market quality and maintaining investors' confidence.

CPA Australia has been in Hong Kong for more than 50 years now with over 8,500 members. There are many other internationally recognised accounting bodies in Hong Kong and it is crucial that we work together to enhance the accounting profession and the economy of Hong Kong.

Should you have any further questions or require more details, please contact Ms Deborah Leung, CPA Australia Hong Kong China Division Director, or Ms Lillian Lee, Committees & Marketing Manger, on 2891 3312, by fax 2832 9167 or by email [deborah.leung@cpaaustralia.com.au](mailto:deborah.leung@cpaaustralia.com.au) / [lillian.lee@cpaaustralia.com.au](mailto:lillian.lee@cpaaustralia.com.au).

Yours sincerely



**MARCELLUS WONG, FCPA (AUST.)**  
DIRECTOR OF NATIONAL BOARD  
CPA AUSTRALIA

15 April 2005

ATTACHMENT

ATTN: Consultation Paper on Legislative Proposals to Establish  
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Financial Services and the Treasury Bureau  
Government of the Hong Kong Special Administrative Region  
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Dear Sir / Madam

**Re: Consultation Paper on Legislative Proposals to Establish Financial Reporting Council**

The Consultation Paper proposes the establishment of a new body to be named the Financial Reporting Council to oversee an Audit Investigation Board and Financial Reporting Review Committee(s).

The proposed functions of the Financial Reporting Council are:

- Through the Audit Investigation Board, to carry out investigations into suspected irregularities concerning auditors of corporations and collective investment schemes listed in Hong Kong
- Through the Financial Reporting Review Committee(s), to enquire into non-compliance of the accounts and financial statements of corporations and collective investment schemes listed in Hong Kong with relevant legal and accounting requirements.

**Australian regulatory regime**

This paper outlines those aspects of the Australian regulatory regime that correspond to the proposals in the Consultation Paper. The Australian regime applies to all companies. Although small proprietary companies are not required to prepare financial statements, they are governed by other provisions of the law. In principle, all companies are treated the same way but, in practice, more regulatory attention is paid to listed companies.

The two key players in the Australian regulatory regime are:

- Australian Securities and Investments Commission (ASIC)
- Financial Reporting Council (FRC). Members of the FRC have a general business background and are not required to be accountants. They are appointed by the Treasurer following nominations from a wide range of organisations including professional bodies and preparer and user lobby groups<sup>1</sup>.

Both of these bodies are established by the *Australian Securities and Investments Commission Act 2001*<sup>2</sup>, and many of their activities are governed by the *Corporations Act 2001*<sup>3</sup>. Both ASIC and the FRC have a broad range of functions which include the functions being considered in the Consultation Paper. The FRC's functions include the oversight of the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB) as listed in the Appendix.

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<sup>1</sup> The members of the FRC are listed on the FRC website at <http://www.frc.gov.au/content/about.asp>  
<sup>2</sup> The ASIC Act is available at [http://www.austlii.edu.au/au/legis/cth/consol\\_act/asaica2001529/](http://www.austlii.edu.au/au/legis/cth/consol_act/asaica2001529/)  
<sup>3</sup> The Corporations Act is available at [http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca2001172/](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/)

Other relevant bodies established by the ASIC Act and governed by the Corporations Act, but with very limited functions are:

- Financial Reporting Panel (FRP)<sup>4</sup>.
- Companies Auditors and Liquidators Disciplinary Board (CALDB)<sup>5</sup>.

Except for the FRC, the Government funds the regulatory regime. In the case of the FRC, the original proposal was that funding should come equally from three parties: Government (both Federal and State), the business community and the professional bodies. The government did not establish any mechanisms to collect the contributions from the business community and the professional bodies – they assumed that this would be voluntary. As a result, over half of the FRC's funding comes from the Government, the professional bodies contribute substantially and a small amount comes from the business community<sup>6</sup>.

This paper does not cover the regulation of entities governed by legislation other than the Corporations Act, such as incorporated associations and partnerships. Many such entities are governed by legislation promulgated in each Australian State or Territory, rather than by federal legislation. Generally each State or Territory develops similar legislation to help reduce the regulatory difficulties inherent in a federal system.

### Regulation of auditors

In Australia, small proprietary companies are not required to prepare financial statements or be audited. As a result, audit regulation focuses on larger companies. Regulators and their responsibilities are:

- The professional bodies (CPA Australia and The Institute of Chartered Accountants in Australia) are responsible for the overall quality assurance (including auditor independence) related to their members. Quality assurance includes compliance with professional statements and standards as well as legislative requirements
- The FRC is responsible for monitoring the independence of those auditors that are auditing entities covered by the Corporations Act<sup>7</sup>
- ASIC is responsible for the regulation of auditors under the Corporations Act and has developed extensive material addressing this issue<sup>8</sup>. The Corporations Act:
  - Gives ASIC the power to appoint auditors as Registered Company Auditors for the purpose of auditing under the Corporations Act<sup>9</sup>
  - Gives ASIC the power to cancel an auditor's registration if requested by the auditor to do so<sup>10</sup>
  - Gives ASIC the power to register and cancel authorised audit companies<sup>11</sup>
  - Gives the CALDB the power to reprimand or deregister auditors that audit entities covered by the Corporations Act<sup>12</sup>
  - Requires auditors to be independent (thus giving ASIC the power to enforce independence)<sup>13</sup>
  - Gives auditing standards the force of law. As the entity responsible for administering the Corporations Act, ASIC has the power to supervise the application of auditing standards (and hence can examine the actions of auditors in relation to their audits of entities governed by

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<sup>4</sup> The FRP is a statutory body established under the ASIC Act ss. 239AA 239CL and its activities are governed by the Corporations Act ss. 323EA – 323EM

<sup>5</sup> The CALDB is established under the ASIC Act ss. 203 – 223

<sup>6</sup> Details of the FRC's funding for 2003-2004 is available on page 57 of its annual financial statements at [http://www.frc.gov.au/content/Reports/2003\\_2004/downloads/03\\_04.pdf](http://www.frc.gov.au/content/Reports/2003_2004/downloads/03_04.pdf)

<sup>7</sup> ASIC Act s. 225(2B)

<sup>8</sup> Auditor-related material can be found on ASIC's website at [http://www.asic.gov.au/asic/asic\\_infoco.nsf/byheadline/Auditors+homepage?openDocument](http://www.asic.gov.au/asic/asic_infoco.nsf/byheadline/Auditors+homepage?openDocument)

<sup>9</sup> Corporations Act ss. 324AA – 324BD, 1279(1) – 1281, 1285

<sup>10</sup> Corporations Act s. 1290

<sup>11</sup> Corporations Act ss. 1299A – 1299M

<sup>12</sup> Corporations Act ss. 1292 -- 1298

<sup>13</sup> Corporations Act ss. 324CA – 324CK

the Corporations Act). As a result, ASIC has the power to take appropriate disciplinary action.

### **Compliance of financial statements with accounting standards**

All entities governed by the Corporations Act are required to follow accounting standards<sup>14</sup>.

As part of its responsibilities for the Corporations Act, ASIC monitors the compliance of financial statements with accounting standards and other reporting requirements contained in the Corporations Act. ASIC conducts a regular and detailed "surveillance program" which has principally focussed on listed companies, but is expected to be extended to unlisted companies<sup>15</sup>. The AASB and AUASB play no part in compliance monitoring.

Where ASIC and a reporting entity have a dispute about the appropriate application of accounting standards, the dispute is usually addressed initially through negotiation. ASIC has the power to take the issue to court if it considers such action appropriate. To provide an option to avoid court proceedings, the Corporations Act was changed recently to permit ASIC (or reporting entities with ASIC's consent) to take disputes to the FRP for resolution. The government is still in the process of setting up the FRP so we have not seen its operation in practice.

### **Conclusion**

We do recognise that Hong Kong has a different structure for accountants in that much reliance has hitherto been placed on self-regulation by the HKICPA. This attempt by the government to establish the Financial Reporting Council would appear to be an important step moving away from the pre-dominance of self-regulation.

In this connection, we would point out that there are many internationally recognised accounting bodies in Hong Kong with strong presence. CPA Australia, for example, has been in Hong Kong for more than half a century, with over 8,500 members. We are the second largest overseas accountancy body in Hong Kong and an active member of the International Federation of Accountants and the Confederation of Asian and Pacific Accountants. Our global membership of 105,000 work in a wide diversity of industries in finance, accounting and business advice. We will be more than happy to support and contribute to the establishment of the Financial Reporting Council.

Should you require further details or have any questions, please contact the Ms Deborah Leung, CPA Australia Hong Kong China Division Director, or Ms Lillian Lee, Committees & Marketing Manger, on 2891 3312, by fax 2832 9167 or by email [deborah.leung@cpaaustralia.com.au](mailto:deborah.leung@cpaaustralia.com.au) / [lillian.lee@cpaaustralia.com.au](mailto:lillian.lee@cpaaustralia.com.au).

Yours sincerely



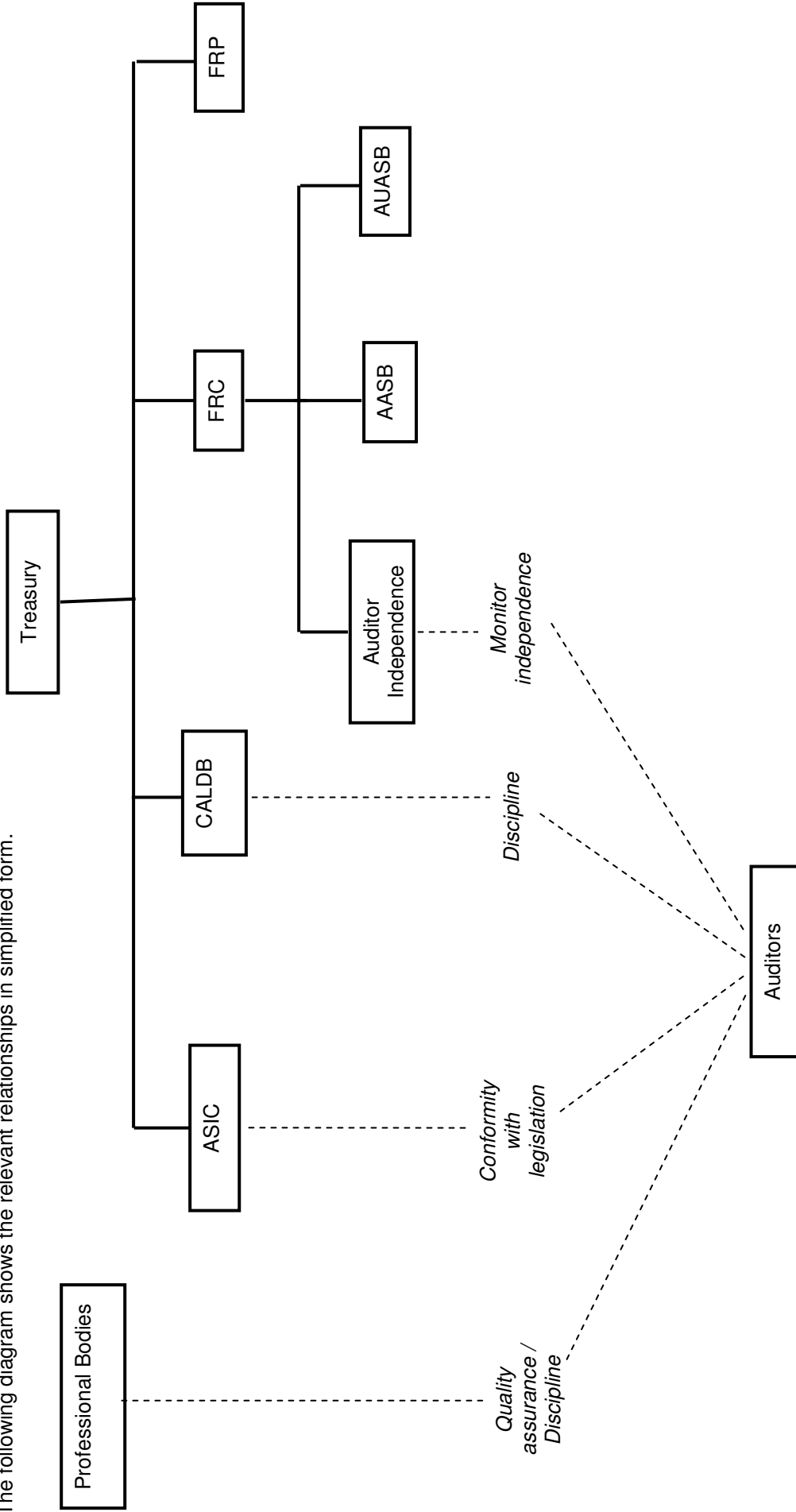
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PRESIDENT  
HONG KONG CHINA DIVISION

<sup>14</sup> Corporations Act ss. 296, 304

<sup>15</sup> Results of ASIC's surveillance program can be found on its website <http://www.asic.gov.au>. The most recent media release is at [http://www.asic.gov.au/asic/asic\\_pub.nsf/byheadline/05-31+ASIC+releases+preliminary+results+of+2004-05+financial+reporting+surveillance+project?openDocument](http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/05-31+ASIC+releases+preliminary+results+of+2004-05+financial+reporting+surveillance+project?openDocument)

**Relationships between bodies**

The following diagram shows the relevant relationships in simplified form.



## Appendix: Functions and powers of the Financial Reporting Council

### ASIC Act s 225 Functions and powers of the Financial Reporting Council

#### *Functions generally*

- (1) The FRC functions are:
- (a) to provide broad oversight of the processes for setting accounting standards in Australia; and
  - (b) to provide broad oversight of the processes for setting auditing standards in Australia; and
  - (c) to monitor the effectiveness of auditor independence requirements in Australia; and
  - (d) to give the Minister reports and advice about the matters referred to in paragraphs (a), (b) and (c); and
  - (e) the functions specified in subsections (2) (specific accounting standards functions), (2A) (specific auditing standards functions) and (2B) (specific auditor independence functions); and
  - (f) to establish appropriate consultative mechanisms; and
  - (g) to advance and promote the main objects of this Part; and
  - (h) any other functions that the Minister confers on the FRC by written notice to the FRC Chair.

Note: The FRC was established by subsection 225(1) of the *Australian Securities and Investments Commission Act 1989* and is continued in existence by section 261 of this Act.

#### *Specific accounting standards functions*

- (2) The FRC functions include:
- (a) appointing the members of the AASB (other than the Chair); and
  - (b) approving and monitoring the AASB's:
    - (i) priorities; and
    - (ii) business plans; and
    - (iii) budgets; and
    - (iv) staffing arrangements (including level, structure and composition of staffing); and
  - (c) determining the AASB's broad strategic direction; and
  - (d) giving the AASB directions, advice or feedback on matters of general policy and on the AASB's procedures; and
  - (e) monitoring the development of international accounting standards and the accounting standards that apply in major international financial centres; and
  - (f) furthering the development of a single set of accounting standards for world-wide use with appropriate regard to international developments; and
  - (g) promoting the continued adoption of international best practice accounting standards in the Australian accounting standard setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy; and
  - (h) monitoring:
    - (i) the operation of accounting standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy; and
    - (ii) the effectiveness of the consultative arrangements used by the AASB; and
  - (i) seeking contributions towards the costs of the Australian accounting standard setting processes; and
  - (j) monitoring and periodically reviewing the level of funding, and the funding arrangements, for the AASB.

#### *Specific auditing standards functions*

- (2A) The FRC functions include:
- (a) appointing the members of the AUASB (other than the Chair); and
  - (b) approving and monitoring the AUASB's:
    - (i) priorities; and
    - (ii) business plans; and
    - (iii) budgets; and
    - (iv) staffing arrangements (including level, structure and composition of staffing); and
  - (c) determining the AUASB's broad strategic direction; and
  - (d) giving the AUASB directions, advice or feedback on matters of general policy and on the AUASB's procedures; and



- (e) monitoring the development of international auditing standards and the auditing standards that apply in major international financial centres; and
- (f) furthering the development of a single set of auditing standards for world-wide use with appropriate regard to international developments; and
- (g) promoting the continued adoption of international best practice auditing standards in the Australian auditing standard setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy; and
- (h) monitoring:
  - (i) the operation of auditing standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy; and
  - (ii) the effectiveness of the consultative arrangements used by the AUASB; and
- (i) seeking contributions towards the costs of the Australian auditing standard setting processes; and
- (j) monitoring and periodically reviewing the level of funding, and the funding arrangements, for the AUASB.

#### *Specific auditor independence functions*

(2B) The FRC functions include:

- (a) monitoring and assessing the nature and overall adequacy of:
  - (i) the systems and processes used by Australian auditors to ensure compliance with auditor independence requirements; and
  - (ii) the systems and processes used by professional accounting bodies for planning and performing quality assurance reviews of audit work undertaken by Australian auditors to the extent to which those reviews relate to auditor independence requirements; and
  - (iii) the action that Australian auditors who have been subject to such quality assurance reviews have taken in response to the reports prepared as a result of those reviews; and
  - (iv) the action taken by professional accounting bodies to ensure that Australian auditors who have been subject to such quality assurance reviews respond appropriately to the reports prepared as a result of those reviews; and
  - (v) the investigation and disciplinary procedures of professional accounting bodies as those procedures apply to Australian auditors; and
- (b) monitoring the overall compliance by companies, registered schemes and disclosing entities with the audit-related disclosure requirements of the [Corporations Act](#) and the accounting standards; and
- (c) giving the Minister reports and advice about the matters referred to in paragraphs (a) and (b); and
- (d) giving professional accounting bodies reports and advice about the matters referred to in subparagraphs (a)(ii), (iii), (iv) and (v); and
- (e) monitoring international developments in auditor independence, assessing the adequacy of the Australian auditor independence requirements provided for in:
  - (i) the [Corporations Act](#); and
  - (ii) codes of professional conduct; in the light of those developments and giving the Minister, and professional accounting bodies, reports and advice on any additional measures needed to enhance the independence of Australian auditors; and
- (f) promoting, and monitoring the adequacy of, the teaching of professional and business ethics by, or on behalf of, professional accounting bodies to the extent to which the teaching of those subjects relates to auditor independence.

#### *Powers*

- (3) As well as any other powers conferred by [this Act](#), the FRC has power to do all things necessary or convenient [to be](#) done for or in connection with the performance of its functions.
- (4) Without limiting subsection (3), the FRC may establish committees and advisory groups.

#### *Restriction on powers*

- (5) The FRC does not have power to direct the AASB in relation to the development, or making, of a particular standard.
- (6) The FRC does not have power to veto a standard made, formulated or recommended by the AASB.
- (7) The FRC does not have power to direct the AUASB in relation to the development, or making, of a particular auditing standard.
- (8) The FRC does not have power to veto a standard made, formulated or recommended by the AUASB.