

**立法會**  
*Legislative Council*

LC Paper No. CB(1)1020/04-05(05)

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**Panel on Financial Affairs  
Meeting on 7 March 2005**

**Background Brief  
on proposals to enhance the oversight of public interest activities of auditors  
and establish a Financial Reporting Council**

**Purpose**

This paper sets out the background of the Administration's proposal to establish a Financial Reporting Review Council, as well as summarizes the major views and concerns expressed by members when the relevant proposal was deliberated at meetings of the Panel on Financial Affairs (FA Panel) on 13 June 2003 and 2 April 2004.

**Background**

2. Quality and reliable financial reporting is of paramount importance for upgrading market quality and maintaining investors' confidence. The auditing profession is the first line of defence against defective financial reporting and in upholding corporate governance. Since 1973, the auditing profession has been subject to a self-regulatory regime under the Professional Accountants Ordinance (Cap. 50). However, the corporate scandals in the United States and suspected cases involving false financial reports of listed companies in Hong Kong in recent years have aroused considerable public concern about the integrity of the auditing profession and accuracy of financial reporting. In this connection, two parallel proposals for reform were raised, the first by the Hong Kong Institute of Certified Public Accountants (HKICPA) for the establishment of an Independent Investigation Board (IIB), and the second by the Standing Committee on Company Law Reform (SCCLR) for the establishment of a Financial Reporting Review Panel (FRRP).

## Two reform proposals

### Proposal of establishing an IIB

3. In response to public calls and the Administration's request for enhancing the independence and transparency of the regulatory regime of the accounting profession, the then Hong Kong Society of Accountants (HKSA)<sup>Note 1</sup> put forward in January 2003 four major reform proposals to open up its governance structure and improve the regulatory regime, including the proposal to establish an IIB to deal with alleged accounting, auditing and/or ethics irregularities related to listed companies. When the FA Panel was briefed on the reform proposals on 13 June 2003, members noted that while the Administration agreed that the proposal to establish an IIB was a move in the right direction, it considered appropriate to examine the proposal in detail and conduct public consultation. As regards the remaining three proposals, the Administration encouraged HKSA to pursue the proposals in the form of a Member's Bill<sup>Note 2</sup>.

4. In September 2003, the Administration issued a consultation paper to seek public views on the proposal to establish an IIB. Of the 20 submissions received, 16 supported the establishment of the IIB and 14 agreed that the IIB's functions should be confined to undertaking investigations and not extended to disciplinary decisions. In the light of the outcome of the public consultation, the Administration proposed that an IIB be set up to undertake investigations on irregularities of the auditing profession in cases involving public interest (i.e. those relating to listed companies) while investigation of accounting anomalies relating to non-listed companies would continue to be undertaken by HKSA, as would decision on discipline. As a start, the Administration proposed that the IIB should act only on referrals from other regulators and on complaints. It would undertake investigations and prepare investigation reports. Upon completion of an investigation, the IIB would refer the case to the relevant law enforcement agency if it appeared to involve criminal offences. If the case related only to a violation of the professional code of the auditors in question, the IIB would report the outcome of the investigation to HKSA.

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#### Note 1

The title of HKSA was changed to the "Hong Kong Institute of Certified Public Accountants" under the Professional Accountants (Amendment) Bill 2004 passed by the Legislative Council (LegCo) in July 2004.

#### Note 2

The three proposals were:

- (a) Increasing the lay members of HKSA's Council;
- (b) Expanding the membership of any Investigation Committee (IC) instigated by HKSA's Council, and altering the composition of the IC with the majority of members (including the chairman) being lay persons; and
- (c) Altering the composition of the Disciplinary Committee with the majority of members (including the chairman) being lay persons.

The three proposals were subsequently incorporated into the Professional Accountants (Amendment) Bill 2004 sponsored by Dr Hon Eric LI, and the Bill was passed by LegCo in July 2004.

### Proposal of establishing a FRRP

5. At present, there is no mechanism in Hong Kong's regulatory regime to provide for the making of enquiries into compliance of companies' financial statements with the accounting requirements of the Companies Ordinance (Cap. 32), nor there any requirement for directors to revise and re-issue financial statements. The SCCLR, in its Consultation Paper on Phase I of the Corporate Governance Review issued in July 2001, proposed the setting up of a body with authority to investigate financial statements and enforce any necessary changes to companies' financial statements. The submissions received by SCCLR indicated support for the establishment of a FRRP.

6. To take the proposal forward, the Administration issued in September 2003 a consultation paper to seek public views. Of the 20 submissions received, 16 supported the establishment of the FRRP, and 13 agreed that it should adopt a reactive approach, at least initially. The Administration then proposed that the FRRP's ambit should be to enquire into apparent departures from the law, accounting standards and listing rules in the annual accounts of companies, as well as to seek remedial action. FRRP's work should cover the financial statements of all listed companies initially.

### Institutional and funding arrangements

7. When the FA Panel was briefed on 2 April 2004 on the outcome of the public consultation on the two reform proposals, members noted the Administration's proposal to establish an independent governing board to oversee both the IIB and FRRP so that there would be one independent entity overseeing auditors and financial statements preparers. To minimize cost, the Administration also proposed that the governing board would comprise not more than ten members and its executive arm would employ about ten staff. With such a structure, the estimated annual operating cost would be about \$8 million to \$10 million. The governing board should comprise members from the Financial Services and the Treasury Bureau, the Companies Registry, persons nominated by the Securities and Futures Commission (SFC) and Hong Kong Exchanges and Clearing Limited (HKEx). Consideration would be given as to whether the accounting profession should be represented on the board. The Government might also appoint other members to broaden the representation of public interest.

8. As regards the funding arrangements, the Administration's initial proposal was that the cost would be shared equally among SFC, HKEx, the accounting profession and the Government. The Government's contribution would be borne by the Companies Registry Trading Fund (CRTF). The Administration indicated that it would continue the discussion with the parties concerned on the details regarding the structure, functions and funding of the IIB and FRRP, and

prepare the legislative amendments for implementing the proposals. The Administration planned to present the relevant legislative proposals to LegCo in the 2004-05 session.

### **Major views and concerns expressed by members of the Panel on Financial Affairs**

9. At the FA Panel meetings on 13 June 2003 and 2 April 2004, some members expressed support for the establishment of the IIB and FRRP to enhance public oversight of the accounting profession and compliance of companies' financial statements with statutory accounting requirements. However, the following major views and concerns were raised -

- (a) There might be possible overlap of the investigation duties of SFC, the Investigation Committee of HKICPA, and the IIB in respect of misconduct and irregularities involving the accounting profession;
- (b) The relevant legislative proposal should provide a mechanism for instigating investigations under the IIB, ensuring transparency of investigations and accountability of members of the new governing board, and avoiding prolonged investigation on cases; and
- (c) Given that the two proposals were related to listed companies rather than non-listed companies, and that enhancement of market quality would ultimately benefit listed companies, it was appropriate to require listed companies to share the costs of the IIB and FRRP. The costs involved should be shared among SFC, HKEx, listed companies and the accounting profession. If the Government was required to share the costs, its contribution should be borne by fees collected from listed companies in CRTF. It was unfair to require non-listed companies to share the costs involved.

10. The extracts of the minutes of the FA Panel meetings on 13 June 2003 and 2 April 2004 are in **Appendix I** and **II** respectively.

### **Recent developments**

11. At the LegCo meeting on 13 October 2004, the Chief Secretary for Administration presented the Legislative Programme for the 2004-05 session. The Legislative Programme includes the Independent Investigation Board and Financial Review Panel Bill.

12. On 28 February 2005, the Administration issued the "Consultation Paper on the Legislative Proposals to Establish the Financial Reporting Council" for

public consultation. It will brief the FA Panel on latest developments on the proposals at the meeting to be held on 7 March 2005.

### **References**

13. A list of relevant papers is in **Appendix III**.

Council Business Division  
Legislative Council Secretariat  
2 March 2005

**Extract from the minutes of meeting  
of the Panel on Financial Affairs on 13 June 2003**

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**I Briefing on the Hong Kong Society of Accountants' Private Member's Bill on amendments to the Professional Accountants Ordinance**  
(LC Paper Nos. CB(1)1908/02-03(01) & (02))

Briefing on the proposed legislative amendments

Dr Eric LI, in his capacity of the sponsor of the Private Member's Bill on amendments to the Professional Accountants Ordinance (PAO), briefly set out the four major components of the legislative proposals initiated by the Hong Kong Society of Accountants (HKSA). These included: changing the title of HKSA to the "Hong Kong Institute of Certified Public Accountants" while the Chinese title remained unchanged; improving the existing regime on the regulation of accountants; proposing an immunity provision covering the acts of persons performing statutory functions in good faith under the PAO; and providing for certain technical amendments to the PAO and the subsidiary legislation.

2. At the Chairman's invitation, Mr David SUN, President of HKSA, highlighted a series of measures proposed by the HKSA in late January 2003 to open up its governance structure and to improve the present regulatory process enshrined in the law. The proposals were summarized below:

- (a) increase the lay members and Government appointed officials in the HKSA Council from two to six;
- (b) expand the membership of an Investigation Committee instigated by the HKSA Council from three to five, altering its composition with majority of members (including the chairman) being lay persons;
- (c) alter the composition of the five-member Disciplinary Committee instigated by the HKSA Council, with the majority of members (including the chairman) being lay persons; and

- (d) as a variation of (b) above, establish an Independent Investigation Board (IIB) to deal with alleged accounting, auditing and/or ethical irregularities related to companies listed on the Stock Exchange of Hong Kong.

Mr David SUN advised that the HKSA was anxious to push ahead with the above reform proposals through legislative amendments and had taken the initiative to include the proposals in (a) to (c) above in the Private Member's Bill to be sponsored by Dr Eric LI. The proposal of establishing an IIB outlined in (d) above was however not included in the Private Member's Bill as the legislative changes to effect such a proposal would be the subject of a separate consultation and legislation by the Administration.

3. At the Chairman's invitation, the Permanent Secretary for Financial Services and the Treasury (Financial Services) (PSFS) set out the Administration's views on the proposals of the HKSA. He complimented the HKSA for its initiative to improve the existing regulatory regime for the accounting profession, with full recognition of public expectations for an effective, transparent and accountable regime in line with international developments. The Administration supported HKSA's proposals for legislative amendments. In relation to the IIB proposal, while the Administration considered that it was in the right direction, given the implications of the proposal, in particular, relating to the funding arrangements for IIB, the Administration considered it appropriate to consult the public before arriving at a decision. PSFS advised that the IIB proposal would form part of the consultation paper to be issued in July/August 2003, which would also seek public views on the proposed establishment of the Financial Reporting Review Panel.

#### Discussion with members

##### *Composition of the HKSA Council*

4. Mr Henry WU noted that according to HKSA's proposal, the Chief Executive (CE) was empowered to appoint four non-accountant lay members to the HKSA Council in addition to the two ex-officials. As there was no arrangement to stagger the period of appointment, there was a possibility that all lay members were new to the work of the Council in a new term. In this connection, Mr WU expressed concern about the continuity of the work of the HKSA Council and asked whether the election and appointment of members would be arranged in a staggered manner so that not all members would be replaced at the same time. Mr WU also pointed out that there was no guarantee that CE would appoint up to the maximum number of lay members.

5. Mr David SUN advised that under HKSA's proposal, the number of elected members would increase from 12 to 14. In addition to the 14 elected

members, it was also proposed that the immediate past president be appointed to serve a term of one year, without going through election, to provide continuity to the work of the Council. If HKSA's proposal was endorsed, the HKSA Council would comprise a maximum of 23 members, with a maximum of 17 professional accountants and six lay members (including two ex-officials - a representative of the Financial Secretary and the Director of Accounting Services). Appointment periods of the lay members could be staggered to provide continuity. PSFS added that the Administration intended to make full use of this appointment mechanism to appoint four lay members to the HKSA Council.

#### *Independent Investigation Board*

6. Mr Henry WU expressed concern about the operation of the proposed IIB, in particular, the mechanism to trigger off an IIB investigation. He opined that as the majority of the members on the HKSA Council were professional accountants, he was concerned about the degree of independence of IIB if investigation of alleged cases was to be decided by the HKSA Council. In reply, Mr David SUN said that the idea was to establish an IIB as a statutory body under the PAO that would take on referral cases of alleged accounting, auditing and/or ethical irregularities of professional accountants related to listed companies for investigation without routing through the HKSA. The composition of IIB had yet to be decided.

7. As to Mr Henry WU's concern over the role of other market regulators in investigation of cases of alleged misconduct and irregularities, PSFS explained that as provided under the Securities and Futures Ordinance (SFO), the Securities and Futures Commission (SFC) could refer relevant cases to the HKSA for investigation and disciplinary actions. The investigation and disciplinary proceedings taken by the HKSA in accordance with the PAO would not replace or impede the necessary actions to be taken by SFC under SFO. PSFS confirmed that the Hong Kong Exchanges and Clearing Limited (HKEx), as a market regulator, would also refer cases to the HKSA for investigation and/disciplinary actions, where appropriate.

8. Mr James TIEN sought clarification on the difference between the present investigation mechanism administered by the HKSA and that of the proposed IIB. Given the fact that the majority of HKSA members were working in companies incorporated in overseas jurisdictions, Mr TIEN opined that the proposed IIB might not be able to investigate cases involving overseas parties or with the accounting/auditing work conducted outside Hong Kong. Dr Philip WONG also expressed concern about the possible overlap of the investigation duties undertaken by SFC, the HKSA Investigation Committee and the proposed IIB.

9. In reply, Mr David SUN advised that at present, all cases of alleged misconduct or breaches of professional standards by professional accountants were investigated by the HKSA at its own cost. In the present set-up, there



were two panels, one comprising entirely members of the accounting profession and the other with lay members, to appoint committees on investigation and disciplinary cases respectively. The scope of these committees was confined to alleged misconduct or breaches of professional standards by its members. They could not carry out comprehensive investigation for cases of alleged accounting/auditing irregularities where other parties, such as the directors of listed companies, were involved. The proposal of establishing an IIB to deal with such alleged cases relating to listed companies could fill the existing gap in the terms of investigation powers.

10. Dr Eric LI added that the Administration could investigate and take legal actions against members of the HKSA with the powers given under other legislation such as the SFO and the Companies Ordinance. Cases involving breaches of professional standard or misconduct would also be referred to the HKSA for disciplinary actions. The Investigation Committee appointed by the HKSA would not investigate alleged criminal offences but would await until the court had given its judgement and the case had been referred to the HKSA. The HKSA had the legal obligation to take necessary disciplinary actions against its member if he/she was convicted of a criminal offence. HKSA members who felt aggrieved by the decision of the Disciplinary Committee could appeal to the court but other statutory bodies such as the SFC could not challenge or change the decision.

11. Referring to recent incidents involving falsified financial reports of listed companies in overseas jurisdictions, Mr CHAN Kam-lam sought information on the percentage of criminal cases among the total number of misconduct/breaches cases handled by the HKSA in the past years. In reply, Mr David SUN said that the HKSA did not have the requested information at present as decisions had yet to be made by the Investigation Committee on cases involving serious misconduct. He further explained that given the complexity of the cases under investigation, the HKSA would not be able to comment at this stage whether the alleged misconduct or breaches would be substantiated or the reasons behind the increase in number of such cases in recent years.

*Process of the proposed legislative amendments*

12. Mr James TIEN doubted the need for the HKSA to initiate the legislative amendments under a Private Member's Bill and felt that these could be incorporated in the amendments to be introduced by the Administration later on. In response, Mr David SUN and Dr Eric LI advised that the HKSA intended to expedite the legislation process of its proposed measures so that it could respond quickly to international developments and public expectations of the accounting profession. As the proposal of IIB had to be further considered after the public consultation in July/August, the HKSA planned to put in place the proposed improvement measures as soon as possible by introducing the Private Member's Bill into the LegCo.

13. Mr SIN Chung-kai expressed support for the legislative proposals of the HKSA in principle and commended the HKSA for its initiatives in working out measures to improve the effectiveness and transparency of its self-regulatory regime. He however considered that the process had taken too long and there was still no concrete timetable for the implementation of the IIB. Pointing out that the Democratic Party supported the proposal of establishing an IIB, Mr SIN sought HKSA's view on the source of funding for the operation of the proposed IIB.

14. In response, Mr David SUN said that the HKSA had proposed that the IIB should be established with separate funding outside the HKSA, which might be arranged through market-financing or government subsidies.

15. Regarding government subsidies, PSFS advised members that it was a traditional practice for professional bodies in Hong Kong to be self-regulated with the regulatory activities funded by the market. The Administration would remain open-minded in taking forward the IIB proposal during the public consultation while at the same time mindful of the aforesaid traditional practice in considering any proposal for government subsidies for the operation of the IIB.

16. Mr SIN Chung-kai opined that while he appreciated the need to consult the public on the legislative proposals, he cautioned further delay in addressing the deficiencies in the present regime. Ms Emily LAU pointed out that the regulatory regime of the accounting profession should be open, effective, transparent and able to inspire the confidence of the investing public. Ms LAU urged the Administration to expedite the legislative process for the establishment of the IIB though she was aware that the investigation and disciplinary mechanisms for misconduct and breaches involving the accounting profession might not be effective enough to deter dishonourable acts even after the establishment of the IIB.

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**Extract from the minutes of meeting  
of the Panel on Financial Affairs on 2 April 2004**



**V. Regulation of the accounting profession**

(LC Paper No. CB(1)1393/03-04(05) — Paper provided by the Administration

LC Paper No. CB(1)2487/02-03 — Consultation Paper on the proposals to enhance the oversight of the public interest activities of auditors and to establish a Financial Reporting Review Panel

LC Paper No. CB(1)1393/03-04(06) — Extract of the minutes (Item I) of the special meeting of the Panel on 13 June 2003)

Briefing by the Administration

23. The Chairman pointed out that when the Panel was consulted on 13 June 2003 on a proposed Member's Bill sponsored by Dr Eric LI to enhance the self-regulatory regime of the accounting profession, members were informed that the Administration would consult the public on a related proposal of the Hong Kong Society of Accountants (HKSA), i.e. the proposal to set up an Independent Investigation Board (IIB) to consider complaints of alleged accounting, auditing and/or ethics irregularities committed by professional auditors involving listed companies. The Administration then issued a consultation paper on 19 September 2003. The public consultation also included a proposal to establish a Financial Reporting Review Panel (FRRP), which was initiated in the Standing Committee on Company Law Reform's Phase I Corporate Governance Review in 2001. The FRRP's ambit was to enquire into apparent departures from the law and accounting standards in the annual accounts of companies. The public consultation exercise ended on 31 October 2003.

24. At the Chairman's invitation, SFST briefed members on the results of the public consultation and sought members' views on the preliminary proposals on the way forward. He highlighted the following points:

- (a) The results of the public consultation indicated that there was overwhelming support for the establishment of IIB to deal with investigation of irregularities of the auditing profession relating to listed companies. Investigation of accounting anomalies relating to non-listed companies would continue to be undertaken by HKSA, as would decisions on discipline.
- (b) Most respondents agreed with the proposal to establish FRRP to enquire into apparent departures from the law, accounting standards and listing rules in the annual accounts of companies and to seek remedial action. FRRP's work should cover the financial statements of all listed companies.
- (c) On the institutional arrangements of IIB and FRRP, the Administration proposed to establish an independent governing board to oversee both bodies so that there would be one independent entity overseeing auditors and financial statements preparers. The new governing board should comprise not more than ten members. They would be from the Financial Services and the Treasury Bureau and the Companies Registry (CR), persons nominated by SFC and HKEx, and persons appointed by the Government to represent public interest.
- (d) As regards funding for the new governing board, the Administration proposed that the cost be shared among SFC, HKEx, the accounting profession and the Government. The Government's contribution would be borne by the Companies Registry Trading Fund (CRTF).
- (e) The Administration would continue discussion with the relevant parties on the details regarding the structure, functions and funding of the new governing board and the preparatory work on the legislative amendments for implementing the proposal. The Administration planned to submit the legislative proposals to LegCo in the next session.

## Discussion

### *Functions and powers of IIB*

25. Responding to Mr Kenneth TING's enquiry about the functions and powers of IIB, SFST advised that as IIB aimed at enhancing oversight of the public interest activities of the auditing profession, it would concentrate on investigation of alleged accounting, auditing and/or ethics irregularities related to listed companies. As a start, IIB would act only on referrals from other regulators and on complaints. As regards investigations into alleged misconduct in respect of non-listed companies, they would continue to be carried out by the Investigation Committees of HKSA. SFST stressed that IIB would not be given disciplinary powers, which remained

vested with HKSA. Upon completion of an investigation, IIB would refer the case to the relevant law enforcement agency if it appeared to involve criminal offence. If the case related only to a violation of the professional code of the auditors concerned, IIB would report the outcome of the investigation to HKSA for taking disciplinary actions as appropriate.

26. Mr Albert HO enquired about the mechanism for instigating an investigation under IIB, and the differences between such an investigation and the investigation instigated by FS under section 143 of the Companies Ordinance (CO) (Cap. 32). He also opined that the relevant legislative proposal should prescribe the regime for instigating investigations under IIB.

27. In reply, SFST said that it would be the responsibility of the new governing board to decide whether there were justifications for IIB to undertake an investigation having regard to the case concerned. Since members of the governing board would comprise professionals, prominent figures representing public interest and possibly people nominated by SFC and HKEx, the Administration had confidence in the professionalism and capability of the board in making the decision. As regards investigations under section 143 of CO, SFST explained that the investigations were instigated by FS and covered a wide range of activities of a company that had given rise to serious public concerns and affected public interests. On the mechanism for instigating investigations under IIB, DS/FST(FS) supplemented that reference would be made to the existing system adopted by HKSA for investigating its members.

28. Given that the new governing board would have a lean structure and a small budget, Mr Albert HO expressed concern that it would be difficult for the board to handle a large corporate scandal. In response, PS/FST(FS) said that the governing board might consider hiring external expertise to assist in its investigation of a large corporate scandal.

29. While expressing support for the establishment of IIB, Mr NG Leung-sing considered that the relevant legislative proposals should cover the mechanisms for ensuring transparency of investigations and accountability of members of the new governing board as well as for avoiding prolonged investigation on cases.

#### *Funding for IIB and FRRP*

30. While expressing support for the establishment of IIB and FRRP, Mr Kenneth TING considered that as the accounting profession and the listed companies would be the major parties to be benefited from the proposal, they should be responsible for the costs involved. Moreover, he had reservation over the proposal of funding the Government's share from CRTF. Given that both listed and non-listed companies had contributed to CRTF but IIB only dealt with cases relating to listed companies, Mr TING considered it unfair to require non-listed companies to share the costs. He also enquired about the funding arrangements of similar oversight bodies in overseas jurisdictions.

31. In response, SFST stressed that the enhancement of market quality would ultimately benefit the accounting profession, market participants and reinforce Hong Kong's position as an international financial centre. As such, it would be appropriate for the accounting profession, SFC, HKEx and the Government to share the costs of IIB and FRRP. Moreover, by adopting the cost-sharing approach, the Administration believed that it would facilitate the discussion and the reaching of consensus among the relevant parties so as to expedite the formation of IIB and FRRP. SFST also re-iterated that in order to minimize cost, the new governing board would consist of not more than ten members and its executive arm would employ about ten staff. With such a structure, the estimated annual operating cost would be about \$8 million to \$10 million. The initial proposal was that the cost would be shared equally among the four parties concerned. It was unlikely that the small amount would impose a financial burden on any parties.

32. As regards Government's contribution to the costs, SFST pointed out that to be in line with the "users pay" principle, the Administration considered it inappropriate to fund its share from the general revenue. As the income of CRTF came from the business sector, it was appropriate to utilize the fund for financing the operation of IIB and FRRP. DS/FST(FS) supplemented that the major source of income of CRTF was fees paid by both listed and non-listed companies incorporated in Hong Kong. She added that among the total of 17 investigations on accounting irregularities conducted by HKSA in the past six years, 14 cases were related to listed companies while the remaining three were related to non-listed companies. The Registrar of Companies also supplemented that while there was no policy governing the utilization of CRTF for regulating listed and non-listed companies, as listed companies involved more public interest concerns, the CR had to pay more attention to listed companies when enforcing the provisions of CO. To this extent, it was true that the non-listed companies were already subsidizing the listed companies.

33. On the funding arrangements of oversight bodies for the accounting profession in overseas jurisdictions, DS/FST(FS) said that while detailed arrangements varied among jurisdictions, the costs were generally shared by several parties including the accounting profession, business sector and government. For instance, in the UK, while the annual running costs of the Financial Reporting Council were equally shared among the accounting profession, business sector and the government, the costs of investigating and prosecuting public interest disciplinary cases were borne by the professional accounting bodies. In the United States, the issuers and the accounting profession paid for the costs of the Public Company Accounting Oversight Board. In Canada, the funding for the oversight body was paid by public accounting firms, while in Australia, the funding was in practice predominantly provided by the government.

34. Mr James TIEN expressed the views of the LegCo Members of the Liberal Party that IIB and FRRP should be funded by SFC, HKEx, listed companies and the accounting profession. Noting that the vast majority of cases investigated by

HKSA had involved listed companies rather than non-listed companies, and that enhancement of market quality would ultimately benefit listed companies, Mr TIEN considered it appropriate to require listed companies to share the costs of IIB and FRRP. If the Government was required to share the costs, its contribution should be borne by fees collected from listed companies in CRTF.

35. Mr Jasper TSANG asked whether SFC and HKEx would consider imposing levies on listed companies to recover their contributions to the costs. In response, SFST said that it was a matter for SFC and HKEx to decide. While SFC would consider paying its share from its income, HKEx had not yet made a decision on the matter. Given the small amount to be contributed by each party, it was not envisaged that HKEx would recover the costs from a special levy on listed companies.

36. Mr Kenneth TING opined that the costs for IIB and FRRP should be paid by accountants or listed companies who had been found responsible for the accounting irregularities. Mr NG Leung-sing shared the view and suggested that the Administration should explore the feasibility of imposing fines on the parties involved to recover the investigation costs. Mr Albert HO however considered that since the establishment of IIB and FRRP would enhance investors' confidence and market stability, it might not be appropriate to apply the "users pay" principle in recovering the costs.

37. PS/FST(FS) said that the "abusers pay" principle applied in theory in the recovery of investigation costs, as ultimately the costs would be recoverable from the parties who were found responsible for the irregularities.

38. Mr SIN Chung-kai expressed support for the establishment of IIB and FRRP and agreed that the operating costs be shared among the four parties proposed by the Administration. He also urged that the Administration should expedite discussion with the relevant parties for reaching a consensus so that Hong Kong could keep pace with international developments as early as possible.

39. SFST took note of members' views on the institutional and funding arrangements of IIB and FRRP. He assured members that there would be opportunity for them to discuss the details when the relevant legislative proposals were introduced into LegCo.

*Proposal of expanding the membership of HKSA's Council*

40. Mr Albert HO noted from Annex A to the paper provided by the Administration that there was a proposal under the Professional Accountants (Amendment) Bill 2004 (the Bill) that the Government might appoint four lay members to HKSA's Council. Pointing out that currently there was no appointment of lay members to the governing councils of self-regulatory professional bodies, such as the Law Society of Hong Kong and the Hong Kong Medical Association, Mr HO was concerned that the proposal would depart from the

general principle of self-regulation of professional bodies and might have impact on the structure of other professional bodies.

41. In reply, SFST advised that under the existing Professional Accountants Ordinance (Cap. 50), the Chief Executive (CE) might appoint two members from the academia (i.e. non-accountants) to HKSA's Council. To open up the Council, it was proposed under the Bill that CE might appoint four non-accountant members to the Council. In this connection, SFST pointed out that public confidence in the accounting profession had been affected by the corporate scandals in the United States in recent years. Given the public concern about the credibility of financial reporting and accounting practices of corporations, a number of jurisdictions had introduced reforms in their regulatory framework governing the accounting profession. In line with international developments, HKSA had put forward a series of proposals to reform its regulatory regime under the Bill. The Administration recognized that given the significant impact of the work of the accounting profession on the financial services market and the general public as a whole, there was a need to enhance the public oversight of the profession and the transparency of HKSA's Council. The proposal of increasing the number of lay members of HKSA's Council would serve these purposes and hence was supported by the Administration.

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**Proposals to enhance the oversight of public interest activities of auditors  
and establish a Financial Reporting Council**

**List of relevant papers**  
(Position as at 2 March 2005)

Paper/Report	LC Paper No.
The Hong Kong Society of Accountants' paper on "Proposed amendments to the Professional Accountants Ordinance and the Professional Accountants By-laws"	CB(1)1908/02-03(01) <i>(discussed at the FA Panel meeting on 13 June 2003)</i>
Administration's paper on "The Hong Kong Society of Accountants' Private Member's Bill on proposed amendments to the Professional Accountants Ordinance and the Professional Accountants By-laws"	CB(1)1908/02-03(02) <i>(discussed at the FA Panel meeting on 13 June 2003)</i>
Minutes of the FA Panel meeting on 13 June 2003	CB(1)2543/02-03
Consultation paper on the proposals to: <ul style="list-style-type: none"> <li>(a) Enhance the oversight of the public interest activities of auditors; and</li> <li>(b) Establish a Financial Reporting Review Panel</li> </ul>	CB(1)2487/02-03 <i>(discussed at the FA Panel meeting on 2 April 2004)</i>
Administration's paper on "Regulation of the auditing profession and preparers of financial statements"	CB(1)1393/03-04(05) <i>(discussed at the FA Panel meeting on 2 April 2004)</i>
Minutes of the FA Panel meeting on 2 April 2004	CB(1)2084/03-04
Report of the Bills Committee on Professional Accountants (Amendment) Bill 2004	CB(1)2159/03-04