

立法會
Legislative Council

LC Paper No. CB(1)862/17-18
(These minutes have been seen
by the Administration)

Ref : CB1/BC/4/17/2

Bills Committee on Financial Reporting Council (Amendment) Bill 2018

**Minutes of the first meeting on
Tuesday, 13 February 2018, at 2:15 pm
in Conference Room 2B of the Legislative Council Complex**

Members present : Hon WONG Ting-kwong, GBS, JP (Chairman)
Hon Kenneth LEUNG (Deputy Chairman)
Hon James TO Kun-sun
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Kin-por, GBS, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Dr Hon Junius HO Kwan-yiu, JP
Hon CHAN Chun-ying
Hon CHEUNG Kwok-kwan, JP
Hon LUK Chung-hung
Hon Kenneth LAU Ip-keung, BBS, MH, JP

Member absent : Hon Dennis KWOK Wing-hang

Public officers attending : Ms NG Ching-ching, Winnie, JP
Deputy Secretary for Financial Services and the
Treasury (Financial Services)³

Mr AU Ka-shing, Billy
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)⁴

Mr CHAN Fong-ming
Assistant Secretary for Financial Services and the
Treasury (Financial Services)(4)1

Ms CHEUNG Mee-bo, Mabel
Senior Assistant Law Draftsman (LP)
Department of Justice

Ms CHAN Ka-man, Carmen
Senior Government Counsel
Department of Justice

Attendance by invitation : Mr Paul F WINKELMANN
Chief Executive Officer
Financial Reporting Council

Ms Florence WONG
Senior Director (Investigation & Compliance)
Financial Reporting Council

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Miss Evelyn LEE
Assistant Legal Adviser 10

Mr Hugo CHIU
Senior Council Secretary (1)4

Mr Keith WONG
Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Ms Vivian CHAN
Clerical Assistant (1)4

Action

I Election of Chairman

Election of Chairman

Mr James TO, the member with the highest precedence among those who were present at the meeting, presided over the election of the Chairman of the Bills Committee. He invited nominations for the chairmanship of the Bills Committee.

2. Mr WONG Ting-kwong was nominated by Ms Starry LEE and the nomination was seconded by Mr Christopher CHEUNG. Mr WONG accepted the nomination. There being no other nomination, Mr James TO declared that Mr WONG Ting-kwong was elected the Chairman of the Bills Committee. Mr WONG then took the chair.

Election of Deputy Chairman

3. The Chairman invited nominations for the deputy chairmanship of the Bills Committee. Mr Kenneth LEUNG was nominated by Mr WU Chi-wai and the nomination was seconded by Ms Starry LEE. Mr LEUNG accepted the nomination. There being no other nomination, the Chairman declared that Mr Kenneth LEUNG was elected the Deputy Chairman of the Bills Committee.

II Meeting with the Administration

(LC Paper No. CB(3)287/17-18	— The Bill
File Ref: ACCT/2/1/2C	— Legislative Council Brief
LC Paper No. LS25/17-18	— Legal Service Division Report
LC Paper No. CB(1)591/17-18(01)	— Marked-up copy of the Financial Reporting Council (Amendment) Bill 2018 prepared by the Legal Service Division (Restricted to members only)
LC Paper No. CB(1)590/17-18(01)	— Background brief prepared by the Legislative Council Secretariat)

Action

Discussion

4. The Bills Committee deliberated (Index of proceedings attached at **Appendix**).

5. Ms Starry LEE declared that she was an accountant and an employee of one of the "Big Four" accounting firms.

Follow-up actions to be taken by the Administration

Financial arrangement of the Financial Reporting Council

6. Some members had expressed concern about the increase in the annual budget of the reformed Financial Reporting Council ("FRC") from the current some \$30 million to around \$90 million (at 2016 price level) upon implementation of the proposed new regulatory regime for auditors of public interest entities ("PIE auditors"). The Administration was requested to explain the reasons involved and whether the increase was due to expected increases in the remuneration of the senior staff of FRC.

7. Some members were concerned about the proposal of imposing a levy on investors of securities transactions for funding the reformed FRC. The Administration was requested to provide information on:

- (a) the funding sources of PIE auditors oversight bodies in major member jurisdictions of the International Forum of Independent Audit Regulators ("IFIAR") (including the United States, the United Kingdom, Australia, Singapore and Canada); and
- (b) whether the jurisdictions concerned had imposed any levies on investors in their funding mechanisms.

Regulatory work of the Financial Reporting Council

8. The Administration was requested to address some members' concerns about:

- (a) how FRC could maintain consistency in the regulation of registered PIE auditors (local auditors to be registered by the Hong Kong Institute of Certified Public Accountants) and recognized PIE auditors (overseas auditors to be recognized by FRC);

Action

- (b) how FRC could ensure the proper carrying out of audit work by PIE auditors on overseas companies listed in Hong Kong; and
- (c) the regulatory powers of FRC as compared to those of PIE auditors oversight bodies of major financial markets.

Benefits and impacts of the proposed new regulatory regime for auditors of public interest entities on Hong Kong

9. The Administration was requested to provide information on the anticipated benefits for Hong Kong to become a member of IFIAR, such as increase in job opportunities for local auditors and increase in the number of entities applying for listing in Hong Kong.

10. Some members were concerned about the high compliance cost of the proposed new regulatory regime for PIE auditors of small and medium-sized accounting/audit firms in Hong Kong, and the possibility that the PIE auditors sector would be dominated by the "Big Four" accounting firms as a result. In this connection, the Administration was requested to provide information on the scale of PIE auditors taking up PIE engagements in the major member jurisdictions of IFIAR including the United States and Singapore.

(Post meeting note: The Administration's written responses were issued to members vide LC Paper No. CB(1)687/17-18(02) on 19 March 2018.)

III Any other business

Invitation of views

11. Members agreed to post a notice on the website of the Legislative Council ("LegCo") and write to the 18 District Councils ("DCs"), relevant organizations and stakeholders to invite views on the Financial Reporting Council (Amendment) Bill 2018; and to meet with deputations at the second meeting to be held in March 2018.

(Post-meeting note: With the concurrence of the Chairman, the second meeting was scheduled for 20 March 2018 at 9:00 am and members were informed of the arrangement vide LC Paper No. CB(1)603/17-18 on 15 February 2018. The notice to invite deputations' views was posted on LegCo website on 15 February 2018 and letters were sent to DCs, relevant organizations and stakeholders on 21 February 2018.)

Action

Date of next meeting

12. The Chairman said that he would work out the schedule of meetings with the Clerk and consulted members accordingly.

(Post-meeting note: Members were consulted on the tentative meeting schedule vide LC Paper No. CB(1)639/17-18 issued on 28 February 2018.)

13. There being no other business, the meeting ended at 4:02 pm.

Council Business Division 1
Legislative Council Secretariat
24 April 2018

**Proceedings of the first meeting of the Bills Committee on
Financial Reporting Council (Amendment) Bill 2018
on Tuesday, 13 February 2018, at 2:15 pm
in Conference Room 2B of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
Agenda item I — Election of Chairman			
000406 – 000550	Mr James TO Ms Starry LEE Mr Christopher CHEUNG Mr WONG Ting-kwong Mr WU Chi-wai Mr Kenneth LEUNG	Election of Chairman and Deputy Chairman	
Agenda item II — Meeting with the Administration			
000551 – 004337	Chairman Administration	Briefing by the Administration on the Financial Reporting Council (Amendment) Bill 2018 ("the Bill") <i>(Post-meeting note: The powerpoint presentation materials (LC Paper No. CB(1)599/17-18(01)) were issued to members vide Lotus Notes e-mail on 13 February 2018.)</i>	
004338 – 014839	Chairman Mrs Regina IP Mr Christopher CHEUNG Mr CHAN Kin-por Ms Starry LEE Mr WU Chi-wai Administration The Financial Reporting Council ("FRC")	<u>Composition of the reformed Financial Reporting Council and impacts of the new regulatory regime on the accounting industry</u> Mrs IP's views and concerns as follows: (a) the existing composition of the Financial Reporting Council ("FRC") did not have representatives from small and medium-sized ("SME") accounting/audit firms, and the situation was unlikely to be improved by the new composition of FRC; and (b) the proposed new regulatory regime for auditors of public interest entities ("PIE	

Time Marker	Speaker	Subject(s)	Action Required
		<p>auditors") would increase the compliance cost of the industry and might drive SME accounting firms out of the market.</p> <p>Declaration of interest by Ms LEE</p> <p>Ms LEE's concern that the high compliance cost of the proposed new regulatory regime for PIE auditors on SME accounting/audit firms in Hong Kong might result in the PIE auditors sector being dominated by the "Big Four" accounting firms. The Administration was requested to provide information on the scale of PIE auditors taking up PIE engagements in the major member jurisdictions of the International Forum of Independent Audit Regulators ("IFIAR") including the United States and Singapore.</p> <p>The Government responded as follows:</p> <p>(a) members of the reformed FRC would comprise both non-practitioners and practitioners with the former as the majority. The term "non-practitioners" would replace the term "lay persons" in the existing Financial Reporting Council Ordinance. The definition of "non-practitioner" means an individual who was not, or had not at any time within the previous three years been, a certified public account (practicing), or a partner, director, agent or employee of a practice unit. The proposed new composition of FRC would strike a proper balance between ensuring FRC's independence from the audit profession and allowing for sufficient professional expertise; and</p> <p>(b) the Chief Executive would appoint suitable and experienced persons as members of FRC. There would be no restriction on the background of persons to be appointed.</p>	<p>The Administration to take action as per paragraph 10 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p><u>Hong Kong's participation in the International Forum of Independent Audit Regulators</u></p> <p>Ms LEE's enquiries as follows:</p> <ul style="list-style-type: none"> (a) how Hong Kong could benefit from its participation in IFIAR; (b) how IFIAR developed international standards for auditors oversight bodies; and (c) whether Hong Kong could be eligible for joining IFIAR by just changing the existing composition of FRC. <p>Mr WU's views and enquiries as follows:</p> <ul style="list-style-type: none"> (a) the Administration should provide information on the anticipated benefits for Hong Kong to become a member of IFIAR, such as increase in job opportunities for local auditors and increase in the number of entities applying for listing in Hong Kong; and (b) the consequences that Hong Kong would face if it did not implement the proposed new regulatory regime for PIE auditors. <p>Mrs IP's enquiries as follows:</p> <ul style="list-style-type: none"> (a) whether the Mainland was a member of IFIAR; and (b) how Hong Kong would be represented in IFIAR, and what were the key performance indicators on Hong Kong's participation in IFIAR. <p>The Government and FRC responded as follows:</p> <ul style="list-style-type: none"> (a) IFIAR had become an increasingly influential multinational organization in auditor regulation. Its discussion covered emerging regulatory issues, 	<p>The Administration to take action as per paragraph 9 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>challenges facing the audit profession and strategic approaches to sustainable audit quality around the globe;</p> <p>(b) Hong Kong would have no influence in IFIAR's discussion unless it was admitted as its members. Besides, certain jurisdictions including Singapore only allowed PIE auditors in member jurisdictions of IFIAR to operate business in their jurisdictions;</p> <p>(c) Hong Kong's participation in IFIAR would demonstrate the independence and robustness of Hong Kong's regulatory regime with regard to PIE auditors and thus further enhance the confidence of companies and investors in Hong Kong's capital market;</p> <p>(d) Hong Kong could not join IFIAR unless it set up a full-fledged oversight body for PIE auditors independent of the audit profession and the Government. Hong Kong could not meet IFIAR's admission criteria by changing the existing composition of FRC only;</p> <p>(e) the Mainland was not a member of IFIAR; and</p> <p>(f) it was envisaged that the Chief Executive Officer of FRC would attend the meetings of IFIAR.</p> <p><u>Funding mechanism of the Financial Reporting Council</u></p> <p>Mr CHEUNG expressed support for the Bill in principle but conveyed the opposition of the securities industry on the proposed levy on investors of securities transactions which might adversely affect competitiveness of the Hong Kong market. He pointed out that instead of investors, listed entities and PIE auditors were "users" of the new regulatory regime. They together with the Government should bear the cost of the new</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>regulatory regime. He also requested the Administration to provide information on:</p> <p>(a) the funding sources of PIE auditors oversight bodies in major member jurisdictions of IFIAR (including the United States, the United Kingdom, Australia, Singapore and Canada); and</p> <p>(b) whether the jurisdictions concerned had imposed any levies on investors in their funding mechanisms.</p> <p>Mr CHAN's views that:</p> <p>(a) the proposed levy of \$12,310 per year per PIE client on a PIE auditor was too high for SME accounting/audit firms; and</p> <p>(b) whether the Government would consider making reference to the practice of the Insurance Authority ("IA") to impose FRC's levies in phases.</p> <p>Mrs IP, Ms LEE and Mr WU echoed the concern about the high proposed levy for PIE auditors. Mrs IP and Ms LEE further suggested that the Government should consider subsidizing the levy to be payable by SME accounting/audit firms. Mr WU asked whether the Government would consider retaining the existing funding mechanism of FRC, and meeting the shortfall in FRC's expenditure by government subsidies.</p> <p>The Chairman's view that the Government should consider providing resources for the reformed FRC. He pointed out that the Government had provided seed money for establishing regulators like IA and the Mandatory Provident Fund Schemes Authority.</p>	<p>The Administration to take action as per paragraph 7 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Government responded as follows:</p> <p>(a) the Bill sought to strengthen the independence of the existing regulatory regime for PIE auditors so as to enhance investor protection. Investors could benefit from improvement in the integrity and accuracy of financial reports of listed entities. Hence, it would not be unreasonable to impose a levy on investors of securities transactions for funding the future FRC;</p> <p>(b) currently, the Hong Kong Institute of Certified Public Accountants ("HKICPA") contributed one-fourth of the expenditure of the annual budget of FRC. HKICPA collected around \$4,000 per year per listed client from each auditor for meeting its funding contribution to FRC;</p> <p>(c) it had become the international standard and practice that PIE auditor oversight bodies should be financially and operationally independent of the Government; and</p> <p>(d) the Government was fully aware of the need for the post-reform FRC to be provided with adequate funding in order to prepare for the transition to the new regime and to discharge its full range of statutory functions. The Government would consider the views of members and various stakeholders regarding the proposed funding mechanism for FRC.</p> <p><u>Proposed level of pecuniary penalty by the Financial Reporting Council</u></p> <p>Mrs IP's and Ms LEE's concern about the high level of pecuniary penalty (capped at \$10 million, or three times the amount of the profit gained or loss avoided as a result of the misconduct whichever was the greater) for PIE auditors' misconduct was too high</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>and could be a burden for SME accounting/audit firms.</p> <p>The Government responded that the Bill included provisions requiring FRC to issue guidelines on how to exercise its power in imposing pecuniary penalty, and FRC must have regard to such guidelines when deciding whether to impose such pecuniary penalty and the amount of pecuniary penalty to be imposed. The guidelines would set out the factors to be considered by FRC when determining the level of pecuniary penalty, including that the penalty should not have the likely effect of putting a firm or an individual in financial jeopardy. FRC was formulating the guidelines and the Government understood that FRC and the industry had reached certain consensuses on the factors to be included in the guidelines.</p> <p><u>Regulatory power and work of the Financial Reporting Council</u></p> <p>Mrs IP's enquiry as how FRC could address the industry's concern about possible over-concentration of powers in the reformed FRC as FRC would be empowered to exercise inspection, investigation and disciplinary powers under the new regulatory regime.</p> <p>Mr WU's view that the Administration should provide information on:</p> <p>(a) how FRC could maintain consistency in the regulation of registered PIE auditors (local auditors to be registered by HKICPA) and recognized PIE auditors (overseas auditors to be recognized by FRC); and</p> <p>(b) how FRC could ensure the proper carrying out of audit work by PIE auditors on overseas companies listed in Hong Kong.</p>	<p>The Administration to take action as per paragraph 8(a) and 8(b) of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>Ms LEE's views and enquiries as follows:</p> <p>(a) the Administration should provide information on the regulatory powers of FRC as compared to those of PIE auditors oversight bodies in major financial markets; and</p> <p>(b) how FRC would conduct its investigations and inspections.</p> <p>The Government responded as follows:</p> <p>(a) under the proposed new regulatory regime for PIE auditors, an overseas corporation or overseas collective investment scheme listed in Hong Kong or seeking to be listed in Hong Kong might, same as at present, seek the approval of the Hong Kong Exchanges and Clearing Limited or the Securities and Futures Commission (as the case might be) to engage an overseas auditor to undertake its PIE engagements. With such approval, the company could apply to FRC for recognizing the overseas auditor as a recognized PIE auditor. A regulatory cooperation agreement between FRC and the corresponding overseas regulator must be in place before FRC could recognize the overseas auditor concerned. FRC's regulation of registered PIE auditors would be consistent with that on recognized PIE auditors; and</p> <p>(b) FRC would initiate investigation on suspected or identified auditing/reporting irregularities on its own initiative or upon receipt of complaints. FRC would also conduct inspections (including onsite inspections) on auditors in respect of their PIE engagements. FRC's inspections would be similar to the practice reviews currently conducted by HKICPA. FRC would issue guidelines on how it would</p>	<p>The Administration to take action as per paragraph 8(c) of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>exercise its inspection and investigatory powers.</p> <p><u>Annual budget of the Financial Reporting Council</u></p> <p>Mrs IP, Mr CHEUNG and Mr WU expressed concern about the increase in the annual budget of the reformed FRC from the current some \$30 million to around \$90 million (at 2016 price level) upon implementation of the proposed new regulatory regime for PIE auditors. The Administration was requested to explain the reasons involved and whether the increase was due to expected increases in the remuneration of the senior staff of FRC.</p> <p>The Government responded that the annual budget of the reformed FRC would increase as it had to take up more functions under the new regime. It undertook to provide the information as requested.</p> <p>In response to the Chairman's enquiry, the Government advised that the proposed levies would be paid into the account of FRC while the pecuniary penalty would be transferred to the general revenue of the Government.</p> <p><u>Definition of "public interest entity"</u></p> <p>Mr CHAN's view that the Administration should consider whether it was necessary to refine the definition of "public interest entity" to ensure that the term appropriately covered both entities and collective investment schemes listed in Hong Kong only. He considered that the existing description in the powerpoint material (p.8) that PIEs to include "corporations with issued shares <u>or</u> stocks listed in Hong Kong ..." misleading which could cover "corporations with issued shares but not listed".</p>	<p>The Administration to take action as per paragraph 6 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		The Government took note of Mr CHAN's views and confirmed that the definition of "public interest entity" in the Bill would not cover corporations with issued shares that were not listed.	
Agenda item III — Any other business			
014840 – 015121	Chairman Clerk	Invitation of views and date of next meeting	

Council Business Division 1
Legislative Council Secretariat
24 April 2018