

立法會
Legislative Council

LC Paper No. CB(1)1374/17-18
(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 fourth meeting on
Tuesday, 5 June 2018, at 10:45 am
in Conference Room 2 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 CHAN Kin-por, GBS, JP
Hon Charles Peter MOK, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHAN Chun-ying
Hon CHEUNG Kwok-kwan, JP
Hon Kenneth LAU Ip-keung, BBS, MH, JP

Members absent : Hon Starry LEE Wai-king, SBS, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon WU Chi-wai, MH
Hon Dennis KWOK Wing-hang
Dr Hon Junius HO Kwan-yiu, JP

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

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

Ms Sharon CHAN
Legislative Assistant (1)4

Action

I Confirmation of minutes

(LC Paper No. CB(1)862/17-18 — Minutes of the meeting on
13 February 2018)

The minutes of the meeting held on 13 February 2018 were confirmed.

Action

II Meeting with the Administration

Matters arising from the previous meeting

(LC Paper No. CB(1)771/17-18(01) — List of follow-up actions arising from the discussion at the meeting on 20 March 2018

LC Paper No. CB(1)771/17-18(02) — Administration's response to issues raised at the meeting on 20 March 2018

LC Paper No. CB(1)1062/17-18(01) — Administration's further response to issues raised at the meeting on 20 March 2018

LC Paper No. CB(1)783/17-18(01) — Letter dated 19 March 2018 from the Legal Service Division to the Administration

LC Paper No. CB(1)783/17-18(02) — Administration's response to the letter dated 19 March 2018 from the Legal Service Division)

Clause-by-clause examination of the Bill

(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

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

Follow-up actions to be taken by the Administration

Pecuniary penalty to be imposed by the Financial Reporting Council

3. The Administration was requested to respond to a member's views that it should consider reducing the proposed maximum pecuniary penalty of \$10 million provided in the Bill which the Financial Reporting Council ("FRC") might impose for misconduct of auditors of public interest entities ("PIE auditors").

Financial arrangement of the Financial Reporting Council

4. The Administration was requested to provide the detailed budget of the post-reform FRC and the underlying assumptions, including a breakdown on the staff costs by levels of the officers, and a breakdown of the fixed and recurrent costs.

Negotiation with the Mainland on access to audit working papers of recognized auditors of public interest entities

5. The Administration was requested to provide information on the progress of negotiation between FRC and the relevant Mainland regulators on a Memorandum of Understanding ("MOU") which, inter alia, allowed FRC to seek non-confidential audit working papers of recognized PIE auditors in the Mainland. The Administration was also requested to confirm if the MOU could be concluded before the proposal under the Bill would come into operation (i.e. 1 August 2019).

Composition of the Financial Reporting Council

6. As provided in the proposed section 7(1)(a) of the Financial Reporting Council Ordinance (Cap. 588) ("FRCO"), the chairperson of FRC was a non-executive director of FRC and a non-practitioner. The Administration was requested to explain the rationale for adopting a non-executive director model for the chairmanship of FRC, and provide information on the relevant studies conducted in supporting this model including the models adopted by other comparable regulators in Hong Kong and overseas.

Action

7. The Administration was requested to review the proposed section 7(4)(b)(i) and (ii) regarding the background of persons to be appointed as FRC members to remove possible overlaps between the provisions.

The function and power of the Financial Reporting Council in overseeing the Hong Kong Institute of Certified Public Accountants' performance of functions relating to registered PIE auditors

8. The proposed section 9(b) of FRCO provided FRC with a function to "oversee" the Hong Kong Institute of Certified Public Accountants' ("HKICPA") performance of certain functions relating to registered PIE auditors (e.g. registration, setting continuing professional development requirements and standards on professional ethics and auditing and assurance practices for these auditors). The proposed section 10(1A) of FRCO stipulated FRC's powers for performing the function under the proposed section 9(b), and the proposed section 10(1B) provided that HKICPA must comply with any direction given by FRC under subsection (1A)(c). According to the Administration, FRC and HKICPA would conclude an agreement on the implementation details of FRC's function and power regarding the above provisions ("the proposed agreement"). The Administration was requested to:

- (a) provide the framework and outline of the proposed agreement, and the timetable for concluding the agreement;
- (b) explain the legislative intent of the proposed section 10(1A) and confirm whether the powers stipulated in the provision were exhaustive;
- (c) review the proposed section 10(1B) to consider the need of expanding the provision to cover subsection (1A)(a) and (b); and
- (d) explain the consequences on HKICPA for its non-compliance with FRC's request or direction given under the proposed section 10(1A).

(Post meeting note: The Administration's written response was issued to members vide LC Paper No. CB(1)1190/17-18(02) on 27 June 2018.)

Action

III Any other business

Date of next meeting

9. The Chairman reminded members that the next meeting would be held on 3 July 2018 at 2:30 pm.
10. There being no other business, the meeting ended at 12:27 pm.

Council Business Division 1
Legislative Council Secretariat
5 September 2018

**Proceedings of the fourth meeting of
the Bills Committee on Financial Reporting Council (Amendment) Bill 2018
on Tuesday, 5 June 2018, at 10:45 am
in Conference Room 2 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
Agenda item I — Confirmation of minutes			
000812 – 001000	Chairman	Confirmation of minutes [LC Paper No. CB(1)862/17-18]	
Agenda item II — Meeting with the Administration			
001001 – 001208	Chairman Administration	Briefing by the Administration on its further response to issues raised at the meeting on 20 March 2018 [LC Paper No. CB(1)1062/17-18(01)]	
001209 – 003634	Chairman Deputy Chairman Administration Assistant Legal Adviser 10 ("ALA10")	<p><u>Pecuniary penalty to be imposed by the Financial Reporting Council</u></p> <p>The Deputy Chairman's views as follows:</p> <p>(a) the auditing industry (particularly the small and medium-sized firms) remained concerned about the proposed 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) the Financial Reporting Council ("FRC") might impose on misconduct of auditors of public interest entities ("PIE auditors"). The Administration should carefully examine the structure of Hong Kong's capital market and the need of the auditing industry, and reconsider reducing the said proposed pecuniary penalty level;</p> <p>(b) whether the Administration's major consideration in determining the level of proposed maximum pecuniary penalty on PIE auditors was to align such level with that in other regulatory regimes in Hong Kong; and</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(c) the relevant regulatory regimes in Canada and Australia did not impose fines on PIE auditors, while the maximum pecuniary penalty for misconduct of PIE auditors in Singapore was lower than that proposed in the Financial Reporting Council (Amendment) Bill 2018 ("the Bill"). Although the maximum level of pecuniary penalty in the United Kingdom was higher, the structure of its capital market might not be directly comparable to that of Hong Kong.</p> <p>The Administration responded as follows:</p> <p>(a) the maximum pecuniary penalty for misconduct of auditors under the existing Professional Accountants Ordinance (Cap. 50)("PAO") was \$500,000. There had long been views in the community that the penalty level was not sufficient to ensure a proportionate disciplinary sanction for misconduct, thus undermining the effectiveness of disciplinary sanction;</p> <p>(b) the International Monetary Fund in its last review of Hong Kong's securities market under the Financial Sector Assessment Programme pointed out that the range of sanctions of Hong Kong's auditor regulatory regime was very limited, and recommended that the future independent auditor oversight body should have strong enforcement power;</p> <p>(c) during the 2014 public consultation, different views on the proposed level of pecuniary penalty were received from stakeholders;</p> <p>(d) the Administration had assured the auditing industry that the purpose of the pecuniary penalty was not to put a firm or individual in financial jeopardy. FRC was statutorily required to issue guidelines indicating the manner in which it would exercise its power to order a PIE auditor or responsible person to pay a pecuniary penalty; and</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(e) the Administration considered the proposed maximum pecuniary penalty appropriate having regard to the practices of other comparable jurisdictions and relevant financial regulatory regimes in Hong Kong.</p> <p>At the Deputy Chairman's request, the Administration was required to reconsider reducing the proposed maximum pecuniary penalty of \$10 million provided in the Bill which FRC might impose for misconduct of PIE auditors.</p> <p><u>Negotiation with the Mainland on access to audit working papers of recognized auditors of public interest entities</u></p> <p>At the Deputy Chairman's request, the Administration was required to provide information on the progress of negotiation between FRC and the relevant Mainland regulators on a Memorandum of Understanding ("MOU") which, inter alia, allowed FRC to seek non-confidential audit working papers of recognized PIE auditors in the Mainland. The Administration was also required to confirm if the MOU could be concluded before the proposal under the Bill would come into operation (i.e. 1 August 2019). The Deputy Chairman further stressed that the Administration should support FRC's negotiation with the Mainland.</p> <p>The Administration advised that:</p> <p>(a) the negotiation between FRC and the Ministry of Finance ("MoF") on the MOU was progressing smoothly. FRC and MoF agreed that the MOU would cover FRC's regulatory functions under the new regime, namely, inspection, investigation and discipline; and</p> <p>(b) it was FRC's target to conclude the MOU around the same time as the commencement of the new regulatory regime.</p>	<p>The Administration to take action as per paragraph 3 of the minutes</p> <p>The Administration to take action as per paragraph 5 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p data-bbox="624 271 1230 338"><u>Financial arrangement of the Financial Reporting Council</u></p> <p data-bbox="624 376 1230 629">At the request of the Chairman and the Deputy Chairman, the Administration was required to provide the detailed budget of the post-reform FRC and the underlying assumptions, including a breakdown on the staff costs by levels of the officers, and a breakdown of the fixed and recurrent costs.</p> <p data-bbox="624 674 1230 1032">In response to the Deputy Chairman's enquiry, the Administration confirmed that the Bill only sought to enable Hong Kong to join the International Forum of Independent Audit Regulators by fulfilling the latter's requirements, and there was no plan to change the proposed composition of the post-reform FRC to enable Hong Kong to obtain the regulatory equivalence status of the European Commission.</p> <p data-bbox="624 1077 1230 1368">The Deputy Chairman enquired whether the Administration could, under the premise that PIE auditors would contribute 25% of the funding of the post-reform FRC, adopt an open attitude towards the industry's suggestion regarding the basis of determining the proposed levy on individual PIE auditors. The Administration replied in the affirmative.</p> <p data-bbox="624 1413 1230 1839">The Chairman remarked that the Legal Adviser to the Bills Committee ("ALA10") had raised certain legal and drafting issues relating to the Bill to the Administration vide a letter dated 19 March 2018, and the Administration had provided written responses to the letter (i.e. LC Paper Nos. CB(1)783/17-18(01) and (02) circulated to members on 11 April 2018). He said that ALA10 could raise her concerns when the Bills Committee discussed the relevant clauses of the Bill.</p>	<p data-bbox="1249 376 1492 517">The Administration to take action as per paragraph 4 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
Clause-by-clause examination of the Bill			
003635 – 004014	Chairman Deputy Chairman Administration	<p>Financial Reporting Council (Amendment) Bill 2018</p> <p>Part 1</p> <p>Preliminary</p> <p><u>Clause 1 – Short title and commencement</u></p> <p><u>Clause 2 – Enactments amended</u></p> <p>The Deputy Chairman enquired why the Administration had proposed 1 August 2019 as the commencement date in the Bill. The Administration responded as follows:</p> <p>(a) the registration cycle of the new regime would align with that of the Hong Kong Institute of Certified Public Accountants ("HKICPA") (i.e. 1 January to 31 December of each calendar year); and</p> <p>(b) the proposed commencement date would allow a few months' transitional period to carry out various transitional matters before the first registration cycle commenced on 1 January 2020.</p>	
004015 – 005355	Chairman Administration Deputy Chairman	<p>Part 2</p> <p>Amendments to Financial Reporting Council Ordinance (Cap. 588)</p> <p><u>Clause 3 – Long title amended</u></p> <p><u>Clause 4 – Section 2 amended (interpretation)</u></p> <p><u>Clause 5 – Section 3 amended (listed entity)</u></p> <p><u>Clause 6 – Section 3A added</u></p> <p><i>3A. Meaning of various types of auditors and engagements</i></p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Deputy Chairman's enquiries as follows:</p> <ul style="list-style-type: none"> (a) the party which could take up the role of a quality control system responsible person ("QCSR") under the new regulatory regime, and whether the duties of QCSR could be delegated to a partner of a PIE auditor; (b) whether front-line staff members of a PIE auditor would be subject to disciplinary sanctions under the new regulatory regime; and (c) whether a front-line staff member of a PIE auditor would be registered as its responsible person. <p>The Administration responded as follows:</p> <ul style="list-style-type: none"> (a) the proposed new section 20H(2)(c) of the Financial Reporting Council Ordinance (Cap. 588) ("FRCO") set out the requirements for the QCSR of a registered PIE auditor; (b) under the new regulatory regime, a practice unit applying to HKICPA to be a registered PIE auditor had to provide in its application the names of the three categories of responsible persons (i.e. engagement partners, engagement quality control reviewers and QCSR). Only the practice unit per se and the three categories of responsible persons would be subject to the disciplinary sanctions of FRC; (c) the three categories of responsible persons were not new concepts to the industry, and HKICPA had already issued relevant guidelines for such persons. The new regulatory regime sought to introduce a registration system for such persons; and (d) HKICPA would process applications for registered PIE auditors prudently. It was not envisaged that a front-line staff 	

Time Marker	Speaker	Subject(s)	Action Required
		member of a PIE auditor would be registered as its responsible person.	
005356 – 005614	Chairman Administration Deputy Chairman	<p><u>Clause 7 – Section 4 amended (relevant irregularity)</u></p> <p>In response to the Deputy Chairman's enquiry, the Administration confirmed that the practice irregularities stipulated in the proposed amended section 4(5)(a) to (g) of FRCO were consistent with those set out in HKICPA's existing guideline.</p>	
005615 – 011024	Chairman Mr James TO Administration Deputy Chairman Mr CHEUNG Kwok-kwan	<p><u>Clause 8 – Section 6 amended (establishment of Financial Reporting Council)</u></p> <p><u>Clause 9 – Section 7 substituted</u></p> <p><i>Composition of FRC</i></p> <p>Mr TO's views as follows:</p> <p>(a) the Administration should explain the rationale for requiring the chairperson of FRC to be a non-executive director of FRC as provided in the proposed section 7(1)(a) of FRCO; and</p> <p>(b) whether the Administration had conducted studies or made reference to the practices of other jurisdictions in formulating the requirement in (a) above.</p> <p>The Deputy Chairman concurred that the Administration should explain its considerations in formulating the requirement.</p> <p>Mr CHEUNG asked whether the imposed requirement was to prevent the staff of FRC from becoming FRC's chairperson.</p> <p>The Administration responded as follows:</p> <p>(a) the senior staff members of FRC could become executive directors of FRC; and</p> <p>(b) the Administration had considered different arrangements for the chairperson</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>of FRC, and made reference to local and overseas experience. As the Bill sought to enhance the independence and credibility of the regulatory regime for PIE auditors, it was appropriate that the chairperson of FRC should be a non-executive director of FRC.</p> <p>At the request of Mr TO and the Deputy Chairman, the Administration was required to explain the rationale for adopting a non-executive director model for the chairmanship of FRC, and provide information on the relevant studies conducted in supporting this model including the models adopted by other comparable regulators in Hong Kong and overseas.</p> <p>At the request of Mr TO, the Administration was required to review the proposed section 7(4)(b)(i) and (ii) of FRCO regarding the background of persons to be appointed as FRC members to remove possible overlaps between the provisions. The Administration advised that similar drafting was present in the existing section 7(1)(c)(iv) of FRCO.</p>	<p>The Administration to take action as per paragraph 6 of the minutes</p> <p>The Administration to take action as per paragraph 7 of the minutes</p>
011025 – 012741	Chairman Administration Deputy Chairman Mr James TO	<p><u>Clause 10 – Section 8 repealed (Chief Executive Officer)</u></p> <p><u>Clause 11 – Section 9 amended (functions of Council)</u></p> <p><u>Clause 12 – Section 10 amended (powers of Council)</u></p> <p>The Administration remarked that it would propose an amendment to clause 11 to delete the word "accounting" ("會計") in the proposed amended section 9(b)(iv) of FRCO which was a clerical error.</p> <p>The Deputy Chairman raised the following views and enquiries in the proposed amended section 9(b)(iv) of FRCO regarding FRC's oversight of HKICPA's performance in setting standards on professional ethics, and accounting, auditing and assurance practices, for registered PIE auditors:</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(a) FRC's oversight function should not cover standards and practices set by HKICPA for non-PIE auditors; and</p> <p>(b) how FRC would discharge its oversight function if the standards and practices concerned covered both PIE and non-PIE auditors.</p> <p>The Administration responded as follows:</p> <p>(a) HKICPA's performance in setting standards and practices would be subject to the oversight of FRC as long as the standards and practices covered PIE auditors; and</p> <p>(b) FRC would adopt a light-handed oversight approach, and would not intervene in the day-to-day operation of HKICPA.</p> <p>The proposed section 9(b) of FRCO provided FRC with a function to "oversee" HKICPA's performance of certain functions relating to registered PIE auditors (e.g. registration, setting continuing professional development requirements and standards on professional ethics and auditing and assurance practices for these auditors). The proposed section 10(1A) of FRCO stipulated FRC's powers for performing the function under the proposed section 9(b), and the proposed section 10(1B) provided that HKICPA must comply with any direction given by FRC under subsection (1A)(c). In response to the Deputy Chairman's enquiry, the Administration advised that FRC and HKICPA would conclude an agreement on the implementation details of FRC's function and power regarding the above provisions ("the proposed agreement").</p> <p>At the request of the Deputy Chairman, the Administration was required to provide the framework and outline of the proposed agreement, and the timetable for concluding the agreement.</p>	<p>The Administration to take action as per paragraph 8(a) of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>In response to Mr TO's enquiry, the Administration advised that the powers stipulated in the proposed new section 10(1A) of FRCO were intended to be all the specific powers that might be exercised by FRC for overseeing HKICPA's performance of functions in respect of PIE auditors as stipulated in the proposed section 9(b).</p>	
<p>012742 – 014538</p>	<p>Chairman ALA10 Mr James TO Administration Deputy Chairman</p>	<p>Mr TO questioned the need for the proposed agreement.</p> <p>The Chairman remarked that HKICPA was not a regulatee of FRC. FRC should collaborate with HKICPA in implementing the new regulatory regime for PIE auditors.</p> <p>The Deputy Chairman remarked that both FRC and HKICPA were statutory regulators. Under the new regulatory regime, some of HKICPA's existing regulatory powers were transferred to FRC. It was therefore necessary to specify the arrangements in the proposed agreement.</p> <p>Noting the Administration's response that there would be no overlapping powers between FRC and HKICPA, Mr TO raised the following views and enquiries:</p> <p>(a) he considered it unnecessary to put in place the proposed agreement;</p> <p>(b) the legal effect of the proposed amended section 10(1) and the proposed new section 10(1A) of FRCO should be carefully examined;</p> <p>(c) the Administration should confirm whether the powers stipulated in the proposed new section 10(1A) of FRCO were exhaustive; and</p> <p>(d) the Administration should ascertain with HKICPA that there would be no overlapping powers between the two parties in the proposed new section 10(1A) of FRCO and the relevant sections of PAO.</p>	<p>The Administration to take action as per paragraph 8(b) of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>ALA10's views as follows:</p> <p>(a) the proposed new section 10(1B) of FRCO stipulated that "The HKICPA must comply with any direction given (by FRC) under subsection (1A)(c)." The Administration should explain the consequences on HKICPA for its non-compliance with FRC's request or direction given under the proposed new section 10(1A) of FRCO; and</p> <p>(b) the Administration should explain the legislative intent of the proposed new section 10(1A) of FRCO.</p> <p>At Mr TO's request, the Administration was required to review the proposed new section 10(1B) of FRCO to consider the need of expanding the provision to cover subsection (1A)(a) and (b).</p>	<p>The Administration to take action as per paragraph 8(d) of the minutes</p> <p>The Administration to take action as per paragraph 8(b) of the minutes</p> <p>The Administration to take action as per paragraph 8(c) of the minutes</p>
Agenda item III — Any other business			
014539 – 014617	Chairman Mr James TO Deputy Chairman	Date of next meeting	