

**立法會**  
**Legislative Council**

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**Bills Committee on Financial Reporting Council (Amendment) Bill 2018**

**Background brief**

**Purpose**

This paper provides background information on the Financial Reporting Council (Amendment) Bill 2018 ("the Bill"), and summarizes the views and concerns expressed by members when related issues were discussed by the Panel on Financial Affairs ("FA Panel") since the Fifth Legislative Council ("LegCo").

**Background**

Existing regulatory regime for auditors and the role of the Financial Reporting Council

2. At present, Hong Kong's regulatory regime for auditors is administered by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is a statutory professional body established under the Professional Accountants Ordinance (Cap. 50) ("PAO"). HKICPA is empowered under PAO to, inter alia, set admission and registration criteria and continuing professional development ("CPD") requirements for its members; set accounting, auditing and professional ethical standards; and conduct investigations and exercise disciplinary powers where warranted.

3. In light of the public demand for strengthening the regulation of the accountancy profession in Hong Kong, LegCo enacted the Financial Reporting Council Ordinance (Cap. 588) ("FRCO") in July 2006 to establish the Financial

Reporting Council<sup>1</sup> ("FRC") as an independent investigatory body of auditing and reporting irregularities in relation to listed entities. FRC became fully operational in July 2007. While FRC may initiate investigations or enquiries upon receipt of complaints or on its own initiative, it is not empowered to discipline or prosecute. All other regulatory powers with respect to the audit profession continue to be vested with HKICPA under PAO. FRC will refer relevant cases to other parties for follow-up as necessary.<sup>2</sup>

#### Consultation on proposals to improve the regulatory regime for auditors of listed entities

4. According to the Government, it has become international standard and practice that regulatory regimes for auditors of public interest entities<sup>3</sup> ("PIE auditors") should be independent of the audit profession and be subject to independent oversight by bodies acting in the public interest. Against this international trend, Hong Kong's present regulatory regime is considered by many as a self-regulatory regime. This has rendered Hong Kong not eligible to be represented on the International Forum of Independent Audit Regulators,<sup>4</sup> thus hindering cooperation between Hong Kong and other jurisdictions in the regulation of auditors. In its report of the Financial Sector Assessment Programme conducted for Hong Kong in 2014, the International Monetary Fund recommended, inter alia, that Hong Kong should establish a fully independent regulatory authority with strong enforcement power for PIE

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<sup>1</sup> The key functions of Financial Reporting Council ("FRC") are to: (a) conduct independent investigations into possible auditing and reporting irregularities related to listed entities; (b) enquire into possible non-compliances with financial reporting requirements on the part of listed entities; and (c) require listed entities to remove any non-compliance identified.

<sup>2</sup> Any auditing or reporting irregularities identified by FRC will be referred to the Hong Kong Institute of Certified Public Accountants, while any non-compliances relevant to the Listing Rules will be referred to the Securities and Futures Commission or the Stock Exchange of Hong Kong Limited for necessary action.

<sup>3</sup> Public interest entities include listed companies and listed collective investment scheme.

<sup>4</sup> The International Forum of Independent Audit Regulators ("IFIAR") is an international organization for independent regulators of auditors established in September 2006. Its membership is restricted to regulators that are both independent of the audit profession and engaged in audit regulatory functions in the public interest. At present, IFIAR comprises independent auditor regulators from 50 jurisdictions. It has become an increasingly influential organization, which convenes to discuss issues relating to international audit quality and regulatory and market developments having an impact on auditing.

auditors.

5. To address the above, the Government has proposed to reform the existing regulatory regime for PIE auditors to enhance independence of the regime. The Government conducted a public consultation on the reform proposals from June to September 2014, and released the consultation outcome in June 2015. Under the reform proposals, FRC will take up the role of an independent auditor oversight body to conduct inspection and investigation as well as exercise disciplinary powers with regard to PIE auditors; and oversee HKICPA's functions of registration and setting CDP requirements and standards on professional ethics, auditing and assurance in respect of PIE auditors. A summary of the respective statutory roles and functions of FRC and HKICPA under the proposed regulatory regime is in **Appendix I**. According to the Government, an overwhelming majority of the respondents to the consultation were supportive of the objective and direction of the reform.

### **The Financial Reporting Council (Amendment) Bill 2018**

6. To take forward the reform proposals, the Government published in the Gazette the Bill on 19 January 2018 which received its First Reading at the LegCo meeting of 24 January 2018.

7. The Bill seeks to amend FRCO to:

- (a) enhance the independence of the regulatory regime for PIE auditors;
- (b) regulate PIE auditors through registration, recognition, inspection, investigation and disciplinary sanction;
- (c) provide for a review and appeal mechanism regarding decisions made against PIE auditors;
- (d) provide for the new composition and functions of FRC;
- (e) provide for levies payable to FRC; and
- (f) provide for transitional and related matters.

8. The main provisions of the Bill are explained in paragraph 29 of the LegCo Brief (File Ref.: ACCT/2/1/2C issued on 18 January 2018) and

paragraphs 4 to 11 of the Legal Service Division Report on the Bill (LC Paper No. LS25/17-18). The Bill, if passed, will come into operation on 1 August 2019. The major provisions in the Bill are as follows:

- (a) Clauses 4, 5 and 6 provide for the definitions of some key terms, including responsible person, PIE, non-PIE, PIE auditor, non-PIE auditor, PIE engagement and non-PIE engagement;
- (b) Clause 9 amends FRCO to provide for the composition of FRC under the new regime. The existing provisions of FRCO requiring FRC to include three members to be nominated by HKICPA, the Securities and Futures Commission ("SFC") and the Hong Kong Exchanges and Clearing Company limited ("HKEX") and also an ex-officio member representing the Financial Secretary are repealed. FRC is to be comprised of non-executive and executive directors who are to be appointed by the Chief Executive;
- (c) Clauses 11 and 12 amend FRCO to provide for the new functions and powers of FRC under the new regime, including overseeing the performance by HKICPA of the functions in relation to PIE auditors;
- (d) Clause 23 introduces new provisions in FRCO to provide for the registration and recognition of local auditors and overseas auditors (including Mainland auditors) respectively as PIE auditors under the new regime;
- (e) Clause 48 introduces new provisions in FRCO to provide for (i) the powers of FRC in imposing disciplinary sanctions against PIE auditors and their responsible persons; and (ii) the set-up of an independent review and appeal mechanism (i.e. the Public Interest Entities Auditors Review Tribunal ("PIEART")) regarding registration, recognition and disciplinary decisions under the new regime. Clause 82 introduces a new Schedule 4A to provide for the composition and operation of PIEART; and
- (f) Clause 62 introduces new provisions in FRCO to stipulate that new levies will be imposed on securities transactions, PIEs and PIE auditors. The levies are to provide funding for FRC. Clause 85 introduces a new Schedule 7 to prescribe the rates of the three levies.

## **Major views and concerns expressed by Members**

9. The Government briefed FA Panel on the reform proposals and the conclusions of the public consultation at the meetings on 7 July 2014 and 6 July 2015 respectively. Issues relating to the independent audit oversight reform were also discussed at meetings of FA Panel on 3 May 2013, 5 May 2014, 4 May 2015, 23 May 2016 and 5 June 2017 during the annual briefings on FRC's work. The major concerns and views expressed by Panel members at the above meetings are summarized in the ensuing paragraphs.

### The proposed regulatory regime and new powers of the Financial Reporting Council

10. Some members expressed concerns that the proposed expansion of FRC's regulatory remit might lead to over-concentration of powers in FRC, and entrusting HKICPA with the role of the Registrar of PIE auditors might result in a cumbersome regulatory structure. To ensure fairness and due process in the exercise of FRC's powers, members urged that FRC should separate its investigation and disciplinary mechanisms, and suggested that the Government should consider setting up a separate disciplinary committee within FRC or an independent tribunal for hearing and deciding on disciplinary cases in respect of PIE auditors. On the registration of PIE auditors, members relayed the concern of some practitioners that they might be disadvantaged by the reform due to potential increase in compliance cost and possible tightening of the eligibility criteria for registration. Some members also proposed that FRC should take up the registration function for PIE auditors.

11. The Government explained that the reform proposals would meet the prevailing international standard that auditor regulatory regime should be independent of the audit profession and address concern about the effectiveness of the existing disciplinary mechanism of HKICPA. Entrusting FRC with the role of an independent audit oversight body in lieu of setting up a new statutory body would also address the concern that the regulatory framework could become cumbersome after the reform.

12. On the concern about over-concentration of powers in FRC, the Government pointed out that there was no international requirement in auditor regulation to vest the disciplinary power in a body independent of the independent auditor regulator. Given that FRC was independent of the audit profession, it would not be unfair to PIE auditors if FRC was empowered to exercise inspection, investigation and disciplinary powers under the new

regime. There would be checks and balances to ensure fairness and due process when FRC discharged its functions, including deploying separate teams of staff members to undertake the investigation and disciplinary work respectively, and requiring FRC to give reasons for its disciplinary decisions and provide the parties concerned with the opportunity of being heard before imposition of disciplinary sanctions. There would also be an independent appeal mechanism to hear appeals from PIE auditors and the provision for further appeal to the Court of Appeal. The Government would consider whether, and if so how, any person independent of FRC should be given any formal role in the disciplinary process under the auspices of FRC when working out the details of the bill. The Government would continue liaising with relevant stakeholders in devising the disciplinary mechanism under the new regime. The Government had also, at members' request, provided information on the regulatory regime for auditors in other relevant jurisdictions.<sup>5</sup>

13. As regards the registration of PIE auditors, the Government responded that it would be appropriate for HKICPA, which had established infrastructure and accumulated experience in discharging registration functions, to assume the role of the Registrar of PIE auditors while being subject to independent oversight by FRC. To enhance transparency and facilitate public inspection, there would be a new statutory requirement for HKICPA to establish and maintain a register of PIE auditors. If a disciplinary decision made by FRC involved removal of a regulated person from the register, HKICPA would need to enforce the disciplinary decision by following stipulated procedures. The Government also clarified that the proposed reform would not bring any material change to the existing qualification and experience requirements for registration as PIE auditors.

#### Pecuniary penalty

14. Members expressed diverse views on the proposed pecuniary penalty on PIE auditors for breaching the requirements under the new regulatory regime. While some members noted the concern raised by small and medium-sized audit firms about the proposed maximum penalty of \$10 million would pose threat to their viability, some members were worried that the proposal requiring FRC to consider before imposing the fine whether the fine would put the firm or individual concerned in financial jeopardy might weaken

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<sup>5</sup> The information paper was issued to members vide LC Paper No. CB(1)1913/13-14(02) on 8 August 2014.

the deterrent effect of the penalty. Some members enquired if the Government would consider introducing a tiered penalty system.

15. The Government pointed out that in the auditor regulatory regimes of major overseas jurisdictions including the United Kingdom, there was no statutory limit on the amount of pecuniary penalty to be imposed. It explained that \$10 million was the proposed maximum penalty level and the proposal had already taken into account the views of different stakeholders. To ensure that the pecuniary penalty would be imposed in a fair and reasonable manner, FRC would be statutorily required to issue guidelines setting out the factors it would consider when determining the level of pecuniary penalty. Such factors would include fairness, proportionality of the penalty to the nature and seriousness of the irregularity concerned, amount of profits accrued or loss avoided as a result of the irregularity, the audit fees received, other circumstances of the subject auditors, such as size and financial resources of the firm or individual, and whether the penalty would have the likely effect of putting an auditing firm or a PIE auditor concerned in financial jeopardy.

#### Scope of the reform

16. Some members enquired about the rationale for limiting the scope of the reform to PIE auditors instead of the entire audit profession. The Government advised that since the proposed reform would entail substantial changes to the existing regulatory regime, it would be prudent for the Government to adopt a step-by-step approach in proceeding with the reform having regard to, among other factors, the implications of the reform on the profession and its impact on FRC's manpower requirement.

#### Financial arrangement for the post-reform Financial Reporting Council

17. Noting that under the existing funding arrangement, FRC was jointly funded by the Companies Registry Trading Fund, HKEX, HKICPA and SFC, some members asked whether the four parties would increase their respective shares of funding if FRC required more resources for undertaking its work.

18. The Government advised that based on the Memorandum of Understanding signed among FRC and the four funding parties in 2014, the four parties would contribute on an "equal share" basis with a 5% annual increment up to 2019. The budget of FRC was subject to approval by the Secretary for Financial Services and the Treasury.

## **Council questions**

19. At the LegCo meeting of 27 February 2013, Hon Kenneth LEUNG raised a written question which conveyed the concerns of some practising accountants about their audit work being subject to a dual regulatory regime involving FRC and HKICPA, and the increase in the administration cost as a result. At the LegCo meeting of 17 January 2018, Hon Kenneth LEUNG raised an oral question on whether the Government would request FRC, upon its becoming an independent oversight body of PIE auditors, to discuss with the Mainland authorities for establishing a mechanism to facilitate FRC to obtain papers concerning the auditing of accounts of Mainland enterprises and to set out the relevant procedure for handling audit papers involving state secrets and sensitive information. Details of the questions and the Government's replies are given in the hyperlinks in **Appendix II**.

## **Latest development**

20. At the House Committee meeting on 26 January 2018, Members agreed to form a Bills Committee to study the Bill.

## **Relevant papers**

21. A list of relevant papers is in the **Appendix II**.

Council Business Division 1  
Legislative Council Secretariat  
12 February 2018



**Summary of the respective statutory roles and functions of  
the Financial Reporting Council ("FRC") and  
the Hong Kong Institute of Certified Public Accountants ("HKICPA")  
under the proposed regulatory regime for listed entity auditors**

	<b>HKICPA</b>	<b>FRC</b>
<b>Registration</b>	<p><i>Mechanism for registering listed entity auditors</i></p> <p>(1) Maintaining a register of listed entity auditors and making it available for public inspection.</p> <p>(2) Receiving applications for registration/renewing registration as a listed entity auditor, and approving/rejecting such applications in accordance with the statutory registration criteria.</p> <p>(3) Removing a listed entity auditor from the register under specified circumstances (e.g. if the auditor is subject to a registration removal order under FRC's disciplinary proceedings (see (18))).</p> <p>(4) Submitting periodic reports to FRC on the exercise/performance of the above powers/functions (see (5)(a)) and complying with FRC's written directions in relation to the exercise/performance of any of the above powers and functions (see (5)(c)).</p>	<p>(5) Exercising oversight powers over HKICPA in relation to the registration of listed entity auditors through the following arrangements –</p> <p>(a) receiving periodic reports from HKICPA on the exercise/performance of its powers/functions;</p> <p>(b) conducting quality review on HKICPA in respect of its exercise/performance of such powers/functions;</p> <p>(c) upon being satisfied that it is in the public interest to do so, giving HKICPA written directions in relation to its exercise/performance of such powers/functions; and</p> <p>(d) requiring information from HKICPA for the purpose of exercising its oversight powers over HKICPA.<sup>1</sup></p>

<sup>1</sup> Item (d) was added in the consultation conclusions on the proposals to improve the regulatory regime for listed entity auditors.

	<b>HKICPA</b>	<b>FRC</b>
	<p><i>(Note: Appeals to HKICPA's registration decisions will be heard by an independent appeal mechanism.)</i></p> <p><u><i>Mechanism for recognising overseas auditors of specific overseas entities listed in Hong Kong</i></u></p> <p>(6) Maintaining a list of overseas auditors recognised by FRC for entering into audit engagements with specific overseas entities listed in Hong Kong under (8), and updating the list having regard to recognition decisions made by FRC.</p> <p>(7) Making available for public inspection the list of overseas auditors who are recognised by FRC under (8).</p>	<p>(8) Receiving applications for recognising/renewing the recognition of an overseas auditor of a specific overseas entity listed in Hong Kong, and approving/rejecting such applications in accordance with statutory requirements.</p>
<b>Setting of continuing professional development ("CPD") requirements</b>	<p>(9) Setting CPD requirements for the purpose of renewal of registration of listed entity auditors.</p> <p>(10) Subjecting to FRC's oversight powers as in (5) when exercising/performing the power/function in (9).</p>	<p>(11) Exercising oversight powers over the HKICPA in relation to the setting of CPD requirements through the arrangements as set out in (5).</p>
<b>Setting of standards on professional ethics, auditing and assurance</b>	<p>(12) Issuing or specifying statements of professional ethics required to be observed, maintained or applied by any registered listed entity auditor.</p> <p>(13) Issuing or specifying standards of auditing and assurance required to be observed, maintained or applied by any registered listed entity auditor.</p>	<p>(15) Exercising oversight powers over HKICPA in relation to the setting of standards on professional ethics, auditing and assurance through the arrangements as set out in (5).</p>

	<b>HKICPA</b>	<b>FRC</b>
	(14) Subjecting to FRC's oversight powers as in (5) when exercising/performing the powers/functions in (12) and (13).	
<b>Inspection</b>	N/A	(16) Performing/exercising the functions and powers in relation to the inspection of listed entity auditors in respect of their listed entity audit engagements.
<b>Investigation</b>	N/A <sup>2</sup>	(17) Conducting an investigation into an auditing/reporting irregularity in relation to a listed entity and carrying out follow-up action as it thinks fit.
<b>Disciplinary</b>	N/A	(18) Making decisions on disciplinary cases and exercising disciplinary powers in respect of auditing/reporting irregularities of listed entity auditors subject to fair hearing and due process.  <i>(Note: Appeals to FRC's disciplinary decisions will be heard by an independent appeal mechanism)</i>

(Source: pages 4 to 6 of the Administration's consultation paper entitled "Proposals to Improve the Regulatory Regime for Listed Entity Auditors" at: [http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult\\_rpirrlea\\_e.pdf](http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_rpirrlea_e.pdf) and paragraph 8 of the consultation conclusions at: [http://www.fstb.gov.hk/fsb/ppr/consult/doc/conclu\\_rpirrlea\\_e.pdf](http://www.fstb.gov.hk/fsb/ppr/consult/doc/conclu_rpirrlea_e.pdf))

<sup>2</sup> At present, all suspected auditing and reporting irregularities in relation to listed entities identified by the Hong Kong Institute of Certified Public Accountants are referred to Financial Reporting Council for independent investigation.

## Appendix II

### List of relevant papers

Date	Event	Papers/Minutes of meeting
27 February 2013	Hon Kenneth LEUNG raised a written question regarding regulation of accounting firms	<a href="#"><u>Hansard</u></a>
3 May 2013	The Panel on Financial Affairs ("FA Panel") discussed the work of the Financial Report Council ("FRC") since April 2012	<a href="#"><u>Powerpoint presentation materials at the meeting</u></a> (LC Paper No. CB(1)976/12-13(02))  <a href="#"><u>FRC's paper</u></a> (LC Paper No. CB(1)929/12-13(07))  <a href="#"><u>Minutes</u></a> (LC Paper No. CB(1)1789/12-13)
10 October 2013	FRC published a report on independent audit oversight	<a href="#"><u>Press release</u></a>  <a href="#"><u>Report by FRC</u></a>
5 May 2014	FA Panel discussed the work of FRC since April 2013	<a href="#"><u>Powerpoint presentation materials at the meeting</u></a> (LC Paper No. CB(1)1375/13-14(03))  <a href="#"><u>FRC's paper</u></a> (LC Paper No. CB(1)1309/13-14(07))  <a href="#"><u>Minutes</u></a> (LC Paper No. CB(1)1942/13-14)
7 July 2014	FA Panel discussed the proposals to improve the regulatory regime for listed entity auditors	<a href="#"><u>Powerpoint presentation materials at the meeting</u></a> (LC Paper No. CB(1)1762/13-14(01))  <a href="#"><u>Administration's paper</u></a> (LC Paper No. CB(1)1668/13-14(01))  <a href="#"><u>Minutes</u></a> (LC Paper No. CB(1)1998/13-14)

Date	Event	Papers/Minutes of meeting
		<a href="#">Administration's follow-up paper</a> (LC Paper No. CB(1)1913/13-14(02))
4 May 2015	FA Panel discussed the work of FRC since April 2014	<a href="#">Powerpoint presentation materials at the meeting</a> (LC Paper No. CB(1)833/14-15(02))  <a href="#">FRC's paper</a> (LC Paper No. CB(1)780/14-15(03))  <a href="#">Minutes</a> (LC Paper No. CB(1)1070/14-15)
6 July 2015	FA Panel discussed the consultation conclusions on the proposals to improve the regulatory regime for listed entity auditors	<a href="#">Powerpoint presentation materials at the meeting</a> (LC Paper No. CB(1)1069/14-15(04))  <a href="#">Administration's paper</a> (LC Paper No. CB(1)1034/14-15(08))  <a href="#">Minutes</a> (LC Paper No. CB(1)1258/14-15)
23 May 2016	FA Panel discussed the work of FRC since April 2015	<a href="#">Powerpoint presentation materials at the meeting</a> (LC Paper No. CB(1)955/15-16(01))  <a href="#">Administration's paper</a> (LC Paper No. CB(1)918/15-16(03))  <a href="#">Minutes</a> (LC Paper No. CB(1)1142/15-16)
5 June 2017	FA Panel discussed the work of FRC since April 2016	<a href="#">Powerpoint presentation materials at the meeting</a> (LC Paper No. CB(1)1078/16-17(02))  <a href="#">Administration's paper</a> (LC Paper No. CB(1)1030/16-17(04))  <a href="#">Minutes</a> (LC Paper No. CB(1)1356/16-17)

<b>Date</b>	<b>Event</b>	<b>Papers/Minutes of meeting</b>
17 January 2018	Hon Kenneth LEUNG raised an oral question on "Compliance with the laws and regulations of different jurisdictions by Hong Kong accounting firms"	<a href="#">Hansard (floor)</a> (pages 42 – 49)
24 January 2018	The Financial Reporting Council (Amendment) Bill 2018 was introduced into the Legislative Council	<a href="#">The Bill</a>  <a href="#">Legislative Council Brief</a> (File Ref: ACCT/2/1/2C)  <a href="#">Legal Service Division Report</a> (LC Paper No. LS25/17-18)