

9 March 2018

Clerk to Bills Committee on  
Financial Reporting Council (Amendment) Bill 2018  
Legislative Council Secretariat  
Legislative Council Complex  
1 Legislative Council Road  
Central, Hong Kong

Dear Sirs

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

EY welcomes the Government's introduction of the Financial Reporting Council (Amendment) Bill 2018 ("Amendment Bill") into the Legislative Council, which will enhance the independence of the regulatory regime for auditors of listed entities. We appreciate the efforts of the Government, the Financial Reporting Council ("FRC"), the Hong Kong Institute of Certified Public Accountants and various stakeholders over the past years for making valuable contributions to the auditor regulatory reform in Hong Kong.

EY supports an enhanced regulatory regime for auditors of listed entities which will further boost the public confidence when investing in public companies and provide better investor protection, and at the same time will strengthen the status of Hong Kong as an international financial centre. We believe that such enhancement will also enable the regulatory regime to gain a wider recognition internationally.

In response to the provisions formulated in the Amendment Bill, we are pleased to take this opportunity to express our views:

**1. Powers of FRC**

Schedule 1A has been added to the Amendment Bill. It defines the type of engagements that are under the powers of the FRC when regulating auditors of listed entities. Those engagements include the preparation of an auditor's report in relation to annual financial statements or annual accounts, and preparation of a report in other specified situations. However, there are also other assurance services that auditors may provide to listed entities. We believe that these assurance engagements should be under the powers of the FRC as well. To do so will enhance the operational efficiency and avoid the potential duplication of efforts of oversight. We therefore suggest that the definition of Public Interest Entity (PIE) engagements be widened to include any assurance engagement that is provided by a registered PIE auditor in relation to the preparation of a specified report as required by the Listing Rules.

## **2. Composition of FRC**

The Amendment Bill sets out the composition of the FRC in its system of governance. It includes a specific provision that the number of non-practitioners in the Council must exceed the number of practitioners. In this regard, we are mindful that some people may hold a view that if practitioners in the profession participate in the overall management and decision making functions within the Council, it may give rise to a real or apparent conflict of interest.

To further improve the effectiveness of its system of governance, we suggest that the composition of the Council should consist only of members who are “non-practitioners” (as defined in Clause 4 of the Amendment Bill) and that an adequate portion of appointed non-practitioners should possess relevant professional accounting qualifications, and have solid knowledge and extensive experience in the auditing of listed entities prior to the three-year cooling-off period as currently set out in the Amendment Bill. We consider “an adequate portion” should be no less than one third.

## **3. Criminal offences**

We do not believe that imposing criminal offences against a person who fails to comply with the requirements during a regulatory inspection of listed entity auditors is appropriate, given the distinct nature of an inspection when compared to an investigation, for which criminal offences are provided in the Financial Reporting Council Bill.

An inspection is a routine process carried out by regulators to evaluate the effectiveness of a firm’s quality control system and the extent of compliance by engagement teams with the firm’s quality control policies and procedures. The primary objective of an inspection is to maintain the audit quality in the profession. In contrast, an investigation is carried out by regulators when a suspected auditing/reporting irregularity is identified, and it comes with an element of sanctions for any wrong-doing, which act as a deterrent.

We strongly believe that providing for criminal offences in relation to a failure to comply with requirements during an inspection is inappropriate and would only exert unnecessary pressure on auditors of listed entities. A non-compliance incident in relation to an inspection can be properly dealt with under the existing disciplinary mechanism. Criminal offences are, in our view, excessive and disproportionate.

## **4. Further guidance**

Following the introduction of the Amendment Bill, we believe that further detailed guidance and explanatory notes to be developed by the FRC will be essential to supplement the success of the enhanced regulatory regime. The key areas that will require clarification and elaboration include the independence of governance in the FRC, how the FRC exercises its oversight and delegation powers, the funding requirements and management of the funding, and detailed application of the sanction and disciplinary mechanisms.

We believe that a transparent and practical approach to address the above areas in the forthcoming guidelines will benefit both the FRC and the auditing profession.

If you would like to discuss our comments further, please do not hesitate to contact Alden Leung at [alden.leung@hk.ey.com](mailto:alden.leung@hk.ey.com)

Yours faithfully

