



羅兵咸永道

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

9 March 2018

Our Ref: LWHF/EG2

Dear Sirs

### **Comments on the Financial Reporting Council (Amendment) Bill 2018 (the “Bill”)**

We thank you for giving PwC the opportunity to comment further on the Bill.

We are pleased to note that a number of the comments in our submissions to the Financial Services and the Treasury Bureau in September 2014 were considered and incorporated into the Bill.

We wish to highlight again at the outset that PwC are fully supportive of the Bill and are of the view that an independent regulation of the auditing profession relating to PIE engagements is of significant benefits to the public.

We would like to take this opportunity to raise a few key matters which we believe ought to be properly addressed in the new law such that this significant regulatory reform will bring about the objectives of transparency, clarity and fairness.

#### **1. Expanding FRC oversight to cover all PIE assurance engagements**

- 1.1. “PIE engagements” are currently defined under the current Bill to include only (i) preparation of auditor’s reports on the financial statements of a PIE, (ii) preparation of accountants’ reports for inclusion in listing documents, or (iii) preparation of accountants’ reports for inclusion in circulars for the purpose of reverse takeovers or very substantial acquisitions (the new Schedule 1A).
- 1.2. There are other types of assurance engagements performed and externally reported by an auditor for PIEs in accordance with the Listing Rules. These other engagements should also be regulated by the FRC and ought to be covered in the Bill in order to avoid any regulatory overlaps between the FRC and other regulators (such as the HKICPA) and potential duplication of costs.

#### **2. Changing composition of the Council to include solely non-practitioners**

- 2.1. The current Bill requires that the number of non-practitioners must exceed the number of practitioners in the Council (the new section 7). We suggest that all of the members in the Council should be non-practitioners in order to ensure that the FRC is fully independent from the industry and is not influenced by any regulated firms. Having said that, it is important to ensure that a sufficient number of Council members possess the relevant accounting and audit knowledge, experience and expertise to effectively regulate the profession. This can be achieved by including, for example, former practitioners in the Council.

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### **3. Removing sanctions against quality control system responsible person**

- 3.1. The current Bill provides that the “quality control system responsible person” nominated by the firm may, in his individual capacity, potentially be subject to sanctions for audit deficiencies in a particular PIE engagement (given the current broad wording of the new section 37B).
- 3.2. We accept that the firm’s management and leadership team should assume ultimate responsibility for the firms’ system of quality control (as required by HKSQC 1). However, we consider that the current Bill places excessive burden on those persons who are appointed by the firm to oversee the firm’s quality control system.
- 3.3. Any sanctions imposed on the firm by the FRC will already reflect any failures in the quality control system, which will prompt the firm to undertake any appropriate corrective measures to rectify systemic issues.
- 3.4. We are not aware of any similar powers available to overseas audit regulators to sanction quality control leaders, which may support our position that sanctioning those persons is unnecessary and may create undesirable and unintended consequences.

### **4. Timely provision of Implementation Guidelines (and Sanctions guidelines)**

- 4.1. We respectfully suggest that the Implementation Guidelines (including those for sanctions), which set out how the FRC will implement the Bill and conduct its operation, should be made available at this stage when the Bills Committee is considering the Bill. One of the key objectives of this regulatory reform is to bring about transparency in the process. It follows, therefore, that the Implementation Guidelines (including those for sanctions) should be made available for comments at this stage.
- 4.2. The sanctions guidelines (which may be published in the Gazette) are particularly important as the new section 37H specifically provides that the issuing of those guidelines is a pre-condition to imposing pecuniary penalty. The public, especially the stakeholders, should be given the opportunity to comment on them before the law is passed, such that any issues with respect to those guidelines can be identified and, if necessary, rectified before the law comes into force.

### **5. Ensuring relevant expertise for handling investigations and disciplinary cases**

- 5.1. It was highlighted in the consultation papers that the FRC should seek relevant expert opinion on accounting and auditing standards (which can be very complex for laymen) at different stages of the investigation and disciplinary process. However, the Bill does not provide for a clear mechanism requiring the FRC to do so. This needs to be addressed.

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- 5.2. We further suggest that the FRC should seek assistance from a panel of experts (consisting of more than one, ideally three persons) rather than from one individual expert as there may be significant risks of bias, especially when professional judgment is involved and the accounting and auditing standards may be open to different interpretations.
- 5.3. Having a transparent system for the investigation and disciplinary process (including detailing how external assistance will be obtained by the FRC) is so fundamental that it should appropriately be included in the Bill, instead of in the implementation guidelines.

#### **6. Removing criminal sanctions for failing to comply with inspection requests**

- 6.1. The current Bill appears to treat inspections the same as investigations. The purpose of inspections is generally to review the audit policies and practices of audit firms with a view to improving them in order to ensure good standard across the industry. Audit firms will be required to take any necessary corrective measures as recommended by the inspector.
- 6.2. In contrast, investigations under the new section 23, are very different in nature and require certain thresholds to be met (for instance, the FRC needs to have reasonable cause to believe that there was misconduct). In light of public interests, failing or refusing to comply with an investigation notice should be seen as much more serious than failing to comply with a request for inspection. As such, it is inappropriate to set the same level of penalties for both. In any event, imposing criminal sanctions (including imprisonment) for failing to comply with a request for inspection is in our view inappropriate. There are other measures available (such as by referring the matter to the investigation team for consideration) to ensure compliance with an inspection request.

#### **7. Limiting the sanctions available following inspections**

- 7.1. The current Bill allows the FRC to initiate an investigation or even impose sanctions against the auditor following issuance of an inspection report (the new section 27H). We think this is inappropriate and suggest that sanctions (and disciplinary actions) should only be imposed if a firm fails to carry out any corrective measures as required by the FRC (or the inspector) within a reasonable time.
- 7.2. As noted above, we fear that the current Bill does not make a clear distinction between inspections and investigations, which by nature are very different. It is unclear how inspections will be used. Given that the Bill appears to allow inspections to be carried out at any time (under the new section 21B), there is a real concern that it may be used effectively as a form of investigation, making the provisions for investigation (as well as the threshold requirement for commencing an investigation) redundant.

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## 8. Monitoring funding and budget

- 8.1. We suggest that the funding mechanism and the FRC's budget be subject to regular review and scrutiny. Under the current Bill, the Financial Secretary will only be asked to review the level of levies if the reserves of the FRC exceed two times of its estimated operating expenses (the new section 50D), and such mechanism may be inadequate. The level of reserves may not necessarily indicate how expenses are spent and whether they are excessive (for instance, excessive headcount). In the interest of transparency and public accountability, a mechanism should be established to ensure that the FRC achieves its objectives and uses its funds efficiently and wisely.
- 8.2. We recommend that the annual budget of the FRC be subject to review by (for example) the Financial Secretary annually, and that the Financial Secretary be given the power to review the level of levies at any time.

We should be grateful if our comments above would be taken into consideration by the Bills Committee.

Yours faithfully

A handwritten signature in black ink, appearing to be 'P. C. ...' followed by a stylized flourish.

LWHF:CCSY