Speaking note of the representative of Baker Tilly Hong Kong Limited

20 March 2018

Our Ref.: FRC (Amend-Bill) 2018/dc/u18

By hand

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,

Comments on the Financial Reporting Council (Amendment) Bill 2018 (the "Bill")

I thank you for giving me as an individual (choosing not to be published with names) practicing CPA in mid-tier firm the opportunity to comment further on the Bill.

I agree Hong Kong shall join the IFIAR to allow us to have greater transparency and influence on the international development of auditor's regulation and obtain a higher reputation of the auditor's report issued by Hong Kong-based audit firms in other IFIAR member countries.

However, there are specific comments I would like to take this opportunities to raise some key matters which I believe ought to be properly addressed in the new rules or amendments so that this significant regulatory reform will bring about a positive direction instead of adverse and severe operational impacts to the existing mid-tier practising firms in Hong Kong.

Additional comments on the Financial Reporting Council (Amendment) Bill 2018

1. **Changing composition of FRC**

   Under the Amendment Bill, there must be at least 2 persons out of the 7 executive or non-executive directors who should possess knowledge of, and experience in, Public Interest Entity ("PIE") engagements. I believe the appropriate proportion would be one-third rather than minimum of 2. I strongly believe it is imperative to have adequate members of the Council who have proper training and latest practical audit experiences so that they can contribute their audit knowledge to the Council's work and commitment to the audit cases in reaching a fair and sound decisions.

2. **Removing the sanctions against quality control system responsible person**

   Under current Bill, the engagement quality reviewer nominated by the firm, in his individual capacity, will be potentially subject to sanctions for audit deficiencies in a particular PIE engagement. I agree that the firm's management and leadership team will be the ultimate responsible parties to the firm's system of quality control as per HKSQC 1 requirements. Nevertheless, I consider that the current Bill puts excessive responsibilities on these persons who are appointed by the firm to oversee the firm's quality control system because he/she is not actively working and directly supervise on each audit case within the firm.

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3. **Criminal liability for failure to comply with inspection requirement**

   I disagree with the Amendment of Bill in respect of the proposed criminal liability under S.21F and imprisonment of up to one year for failure to comply with a specific inspection requirement as it is too heavy. In view of the penalty level, I believe that suspension or removal of the license (either temporarily or permanent depending on seriousness of situation) from the registration list of ALEs will be sufficient and appropriate enough. It is because there should be opportunities available for the industrial players to improve their quality standards for ALEs in future if they are not repeated breakers of the rules.

4. **Funding proportion of FRC**

   The Amendment Bill has proposed a funding basis by 3 parties whereas 50% is through levies on securities transactions, 25% is by each of PIE and ALEs respectively. From my point of view, ALEs to bear the proportion of 25% is still too high as the audit fee per listed clients charged by mid-tier firms are not very high in general and vary from one case to the other. I believe government funding should also be considered such that the proportion of sharing be as: Government (20%); Levies on securities transactions (40%); PIE (25%) and ALEs (15%).

   In addition, the audit fee per each listed client by each of ALEs and their cost structure is not necessarily the same and not very comparable between Big-Four and mid-tier firms with former the much higher in audit fees. This is not a fair basis of simply using numbers of listed clients to justify the equal sharing of each ALEs within this 25% portion. I expect there should be more detailed guidelines for the justification of a fair basis of sharing by ALEs before the proposal is submitted to the Legislative Council for 2nd reading.

   Moreover, the closely monitoring function of the government (by Financial Secretary) over the spending and initial cost level for the FRC's budget of HKD99m when new FRC is about to start in the first year of 2019 is very important in order to avoid unnecessary overrun costs to happen which may damage the future of our industry.

5. **Provision of implementation guidelines and sanction guidelines (up to maximum of HKD10m)**

   I believe a suggestion to have a more detailed implementation guidelines which set out how FRC will carry out the Bill and conduct its operation, particularly in the transitional period and thereafter the effective date in respect of how to determine the penalty level of each case against the possibility of bankruptcy of CPA practice, be available at this stage before the Bills Committee is considering and approving the Bill. This purpose is to enhance its transparency to industrial players and allow them to comment beforehand to minimise unnecessarily misunderstanding.

Should you have any questions, please feel free to contact me at [redacted]

Yours faithfully,

Choi Kwong Yu - Audit Director

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