



中華人民共和國香港特別行政區
Hong Kong Special Administrative Region of the People's Republic of China



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LEGAL SERVICE DIVISION
LEGISLATIVE COUNCIL SECRETARIAT

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By Fax (2869 4195)

19 March 2018

Mr Billy AU
Principal Assistant Secretary for Financial Services &
the Treasury (Financial Services)4
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
Hong Kong

Dear Mr AU,

Financial Reporting Council (Amendment) Bill 2018

I am scrutinizing the captioned Bill ("Bill") with a view to advising Members on its legal and drafting aspects. Please find attached a schedule listing my enquiries. We should be grateful for your explanation of or clarification on the matters set out in the schedule. Please let me have the Administration's reply in Chinese and English as soon as possible.

Yours sincerely

(Evelyn LEE)

Assistant Legal Adviser

Encl.

c.c. Department of Justice (Attn: Ms Mabel CHEUNG, SALD) (Fax: 3918 4613))
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SALA 3
Clerk to the Bills Committee

Scope of regulation

1. According to paragraph 4 of the Legislative Council ("LegCo") Brief, the amendments proposed in the Bill are made in the light of the principles of securities regulation introduced by the International Organisation of Securities Commissions since 2010 and the review of Hong Kong's auditor regulatory regime completed by the International Monetary Fund ("IMF"). IMF recommended that an independent authority should be established in Hong Kong to oversee the audit profession and should have jurisdictions over all auditors that audit companies listed in Hong Kong. Under the Bill, the Financial Reporting Council ("FRC") would be the independent authority. Please explain the reason for the Bill to focus on the regulation of auditors undertaking or carrying out any public interest entity ("PIE") engagement specified in the proposed Schedule 1A to Cap. 588 and whether the scope of regulation will be expanded in the future to include other types of auditors of other listed corporations.

Composition of FRC

2. It is noted that under the proposed section 7 introduced by clause 9 of the Bill, the Chief Executive may appoint all the members of FRC. Please explain how such arrangement would meet the recommendation of IMF of establishing a fully independent authority as referred to in paragraph 4 of the LegCo Brief.

Renewal of registration

3. Under the proposed sections 20K(2), an application for renewal of registration as a PIE auditor must be made no earlier than 3 months and no later than 45 days before the day on which the current registration expires. Under the proposed section 20J(1), unless a registration application is made within the transitional period, the registration expires on 31 December of the year in which the registration takes effect. Please advise how a registered PIE auditor whose registration takes effect in less than 45 days before the current registration expires may apply for renewal. For example, in the case where a registration takes effect on 1 December of a year pursuant to a reversal made by the Public Interest Entities Auditors Review Tribunal under the proposed section 20J(1)(a)(ii).

Undertaking and carrying out PIE engagement by an overseas auditor

4. It is noted that the proposed section 20ZB prohibits an overseas auditor to undertake or carry out any PIE engagement for an overseas entity defined in clause 4 of the Bill ("overseas entity") unless a recognition

application has been made and granted. According to proposed section 20ZD, a person who, without reasonable excuse, contravenes section 20ZB commits an offence. However, the Bill does not expressly prohibit an unrecognized overseas auditor from undertaking or carrying out a PIE engagement for an entity which is not an overseas entity. Please explain the reason for the above arrangement.

5. Please also clarify whether a recognized overseas auditor may only carry out the PIE engagement(s) specified in the application for recognition under the proposed section 20ZE and approved by FRC during the validity period of the recognition so that if the overseas auditor wants to carry out any PIE engagement for another overseas entity, the auditor would have to make a fresh recognition application to FRC.

Duty for a recognized Mainland auditor to provide information to HKICPA Register

6. According to the proposed section 20ZX(1), the HKICPA Registrar must establish and maintain a register of PIE auditors which contains, insofar as recognized auditors are concerned, the details provided under the proposed section 20ZX(3) ("recognition details"). Save for the duty to notify FRC in respect of any change of certain information as required under the proposed section 20ZW, the Bill does not impose any duty on a Mainland auditor who satisfies the conditions under the proposed section 20ZT(2), or the entity which engaged the auditor, to provide the recognition details to FRC or the HKICPA Registrar. Further, such an auditor is recognized automatically as PIE auditor without the need to apply for recognition pursuant to the proposed section 20ZT. As such, please advise the means to ensure the HKICPA Registrar has an up-to-date register of PIE auditors with all the recognition details of such Mainland auditors. Please also advise what would be the consequence, if any, if the HKICPA Registrar failed to keep the recognition details up-to-date.

Purposes of an inspection of PIE auditors register

7. According to the proposed section 20ZY, a right of inspection of the HKICPA Register is only exercisable for any of the purposes provided under the proposed section 20ZY(3). The proposed section 20ZY(5) provides, among other things, that the HKICPA Registrar must, as far as practicable, make the PIE auditors register available to any person for inspection on the internet. Please advise the safeguards on PIE auditors against a person who inspects the Register through the internet and does not do so for any of the above purposes. Please also advise the consequence of breaching the proposed section 20ZY, if any, by that person.

Reasonable excuse and use of self-incriminating evidence

8. The proposed section 21F provides, among other things, that a person commits an offence if the person, without reasonable excuse, fails to comply with a specified requirement¹ made by an inspector. The Bill does not make provision for the use of self-incriminating evidence obtained under such requirements. However, the proposed section 30 provides for the use of self-incriminating evidence obtained by an investigator under the proposed section 25. Please explain the reason for the above differences in treatment in respect of self-incriminatory evidence.

9. The proposed section 12(7) provides, among other things, that if certain conditions are satisfied, FRC must not give (a) any explanation, further particulars or answers to questions obtained from a requirement under the proposed section 25 (which concerns investigation), (b) information or explanation which is obtained from a requirement under section 43(1) (which concerns an enquiry) or (c) the evidence of such requirements, to a specified authority in a jurisdiction outside Hong Kong for use in criminal proceedings against the person. There is no similar prohibition on FRC in respect of any answer given pursuant to the proposed section 21C under an inspection. Please explain the reason for the difference in treatment.

Qualification of an inspector and an investigator

10. According to the proposed section 21A, an inspector appointed must be a certified public accountant. However, there is no such requirement for an investigator appointed under the proposed section 22A. Please explain the reason for the differences in qualification required to be an inspector and an investigator.

Investigation report

11. It appears that under the proposed section 31A(3) and 31(4), FRC may publish or otherwise disclose an investigation report (or any part of it) in which persons may be named. The proposed section 52 provides, among other things, for the protection of the identity of a relevant person who is defined in section 52(6) to include an informer who has given information to the FRC with respect to an investigation. In the case where an investigation report which discloses the name of a relevant person is published before the relevant proceedings takes place, it may be difficult for the tribunal or court concerned to protect the identity of such person under the proposed section 52. Please clarify whether the name or identity of a relevant person should also be

¹ Specified requirement is defined in the proposed section 21F(10) to be requirements imposed under the proposed sections 21C(2), 21D(1) or 21D(2).

protected in an investigation report. If the answer is in the affirmative, please explain how.

Guidelines in respect of pecuniary penalty are not subsidiary legislation

12. The Bill seeks to add sections 37D(3)(b)(iv) and 37E(3)(b)(iii) to the Financial Reporting Council Ordinance (Cap. 588) to provide, among other things, for FRC's power to impose pecuniary penalty up to \$10,000,000 or three times of the profit gained or loss avoided as a result of the misconduct. The proposed section 37H(1)(a) provides, among other things, that FRC must not impose such penalty unless it has published guidelines (which are not subsidiary legislation) to indicate the way in which it exercises the above power and has had regard to such guidelines. As the proposed section 37D(3)(b)(iv) and section 37E(3)(b)(iii) empower FRC to impose a substantial amount of pecuniary penalty, please explain why such indication should not be provided in the form of legislation.

Disclosure of sanctions

13. The proposed sections 37E and 37I provide, among other things, that FRC may impose more than one type of sanctions on a PIE auditor or a registered responsible person. The proposed section 37K(4)(a) provides, among other things, that FRC must not make any disclosure in relation to the sanctions against a person to the public under the proposed section 37K(2) if the disclosure relates to a private reprimand. Please clarify, for example, whether a pecuniary penalty imposed on any such auditor or person may be disclosed under the proposed section 37K(4) if FRC imposes such penalty and makes a private reprimand on the same misconduct committed by the auditor or person concerned.

Immunity only afforded to auditors under section 55

14. In gist, under the proposed amendments to section 55(1) introduced by clause 67 of the Bill, immunity is provided to a PIE auditor or non-PIE auditor who communicates in good faith to the FRC any information or opinion on a practice irregularity or relevant non-compliance provided under the Bill. However, such immunity is not provided to other persons (such as a responsible person defined in the amended section 2 of Cap. 588 who communicates such information or opinion to FRC). Please explain the reason for the above arrangement.

Purpose of levies

15. At present, section 6A of Schedule 1 of the Resolution of the Legislative Council Establishing Companies Registry Trading Fund ("CRTF") expressly provides that CRTF supports the performance of FRC's function by,

among other things, making contribution in cash or in kind to sponsor the performance by FRC of any of its functions. According to paragraph 25 of the LegCo Brief, FRC would be funded by the three levies introduced by the Bill. Therefore, clause 90 of the Bill seeks to repeal section 6A of the above Schedule. Section 4(2) of the proposed Schedule 2 to Cap. 588 provides, among other things, the remuneration, allowances and expenses of an FRC member are to be paid out of the funds of the FRC. However, neither Cap. 588 nor the Bill contains the meaning of "funds". Further, it is noted that in other ordinances (such as section 16 of Schedule 3 to the Property Management Services Ordinance (Cap. 626) and section 28A of the Construction Workers Registration Ordinance (Cap. 583)), there are express provisions providing for the source of funds or use of the levies received. Please consider whether similar express provisions should be introduced for FRC.