

香港特別行政區政府
財經事務及庫務局
財經事務科

香港金鐘道六十六號
金鐘道政府合署十五樓



FINANCIAL SERVICES BRANCH
FINANCIAL SERVICES AND
THE TREASURY BUREAU
GOVERNMENT OF THE HONG KONG
SPECIAL ADMINISTRATIVE REGION

15TH FLOOR
QUEENSWAY GOVERNMENT OFFICES
66 QUEENSWAY
HONG KONG

電話 TEL.: 2528 9016
圖文傳真 FAX.: 2869 4195
本函檔號 OUR REF: ACCT/2/1/2C (2018)
來函檔號 YOUR REF: LS/B/1/17-18

By fax and email (elee@legco.gov.hk)

9 April 2018

Legal Service Division
(Attn.: Ms Evelyn LEE)
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Ms Lee,

Financial Reporting Council (Amendment) Bill 2018

I refer to your letter dated 19 March 2018 seeking clarification on the captioned Bill. The Administration's responses are set out in Annex for your information.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Billy AU', written over a faint circular stamp.

(Billy AU)

for Secretary for Financial Services and the Treasury

c.c.

Clerk to Bills Committee
Financial Reporting Council
Department of Justice

(Attn: Ms Connie SZETO)
(Attn: Ms Florence WONG)
(Attn: Ms Beverly YAN
Ms Mabel CHEUNG)
Ms Carmen CHAN)

Bills Committee on Financial Reporting Council (Amendment) Bill 2018 (“the Bill”)

**The Administration’s responses to questions raised in the
Assistant Legal Adviser’s letter dated 19 March 2018**

Scope of regulation (Paragraph 1 of the list of questions)

Under the Bill, auditors undertaking or carrying out public interest entity (“PIE”) engagements specified in the proposed new Schedule 1A of the Financial Reporting Council Ordinance (Cap. 588) (“FRCO”) will fall within the new regulatory regime. We consider this proposed scope of regulation appropriate, as it will meet the objectives of the current reform to enhance investor protection and enable Hong Kong’s regulator to be eligible for joining the International Forum of Independent Audit Regulators. At the same time, we acknowledge that the reform will entail substantial changes to the existing regulatory system, and hence it would be prudent for us to adopt a step-by-step approach. Upon passage of the Bill and taking into account the actual operating experience of the new regime, we will keep in view possible areas for refinement including the suggestion in the list of questions as to whether the scope of regulation should be expanded to cover other types of auditors.

Composition of the Financial Reporting Council (“FRC”) (Paragraph 2 of the list of questions)

2. Paragraph 4 of the Legislative Council (“LegCo”) Brief quoted the recommendation of the International Monetary Fund that Hong Kong should establish a “fully independent authority with responsibility for the oversight of the audit profession”. This means the auditor oversight body should be independent of the *audit profession*. Pursuant to the proposed section 7 of the FRCO, members of the FRC are to be appointed by the Chief Executive, a majority of whom should be non-practitioners to ensure the FRC’s independence from the audit profession.

Renewal of registration (Paragraph 3 of the list of questions)

3. The purpose of the proposed new section 20K(2) of the FRCO is to provide the decision authority, i.e. the Hong Kong Institute of Certified Public Accountants (“HKICPA”), with sufficient time to process the relevant applications. There are similar provisions in the

legislation of other financial regulatory regimes¹. We believe that the HKICPA and the Public Interest Entities Auditors Review Tribunal will take into account the relevant provisions of the FRCO before deciding the date on which the registration is to take effect.

Undertaking and carrying PIE engagement by an overseas auditor (Paragraphs 4 and 5 of the list of questions)

4. It is not necessary to provide in the Bill that an unrecognised overseas auditor cannot undertake or carry out a PIE engagement for an entity which is not an overseas entity. Under the new regime, only registered PIE auditors and recognised PIE auditors are allowed to undertake PIE engagements. A recognised PIE auditor can only become the auditor of a specified overseas entity which submits the recognition application pursuant to the proposed new section 20ZE of the FRCO. On the other hand, a registered PIE auditor can become the auditor of both local and overseas entities. However, since a registered PIE auditor must be a practice unit² pursuant to the proposed new section 20G(1) of the FRCO, it cannot be an overseas auditor. Therefore, it is not possible for an unrecognised overseas auditor to undertake or carry out a PIE engagement for an entity which is not an overseas entity under the new regime.

5. A recognised PIE auditor can undertake or carry out any PIE engagements as specified in the proposed new Schedule 1A of the FRCO for an overseas entity which submitted the application pursuant to the proposed new section 20ZE of the FRCO. Nevertheless, that recognised PIE auditor cannot undertake or carry out any PIE engagement for another overseas entity unless that other overseas entity makes a separate application pursuant to the proposed new section 20ZE.

Duty for a recognised Mainland auditor to provide information to the HKICPA Registrar (Paragraph 6 of the list of questions)

6. For recognised Mainland auditors mentioned in the question, the relevant recognition details (i.e. full name and business address of the auditor) have been made

¹ The same 45-day restriction also appears in section 64ZV(3) of the Insurance Ordinance (Cap.41) (as added by Insurance Companies (Amendment) Ordinance 2015) for renewal of licences for insurance agencies, insurance agents, technical representatives and insurance broker companies.

² A practice unit is defined in the Bill as having the same meaning given by section 2(1) of the Professional Accountants Ordinance (Cap. 50) (“PAO”): (a) a certified public accountant (practising) practising accountancy on his own account pursuant to the PAO; (b) a firm of certified public accountants (practising) practising accountancy pursuant to the PAO; and (c) a corporate practice which is a company registered under section 28E of the PAO.

available through the relevant reciprocal arrangement which has already been in place between the Mainland and Hong Kong and to which the FRC and the HKICPA are parties. Therefore, the PIE auditor register will contain the relevant information of the Mainland auditors. To ensure that the register of PIE auditors is properly maintained, the FRC may, if satisfied that it is in the public interest to do so, give written directions to the HKICPA under the proposed section 10(1A) of the FRCO for the maintenance of the register.

Purposes of an inspection of PIE auditor register (Paragraph 7 of the list of questions)

7. The proposed new section 20ZY(3) of the FRCO only relates to the proposed new sections 20ZY(1) and (2) but is not applicable to the proposed new section 20ZY(5). Therefore, the concern on a person who inspects the register on the Internet under section 20ZY(5) and does not do so for any purposes under section 20ZY(3) would not arise. If a person would like to inspect the register under sections 20ZY(1) and (2) for any purposes other than section 20ZY(3), his right under sections 20ZY(1) and (2) will not be exercisable. Please also refer to sections 99(4) and (7) of the Securities and Futures Ordinance (Cap. 571) (“SFO”) and sections 64O(4) and (6) of the Insurance Ordinance (Cap.41) (as added by Insurance Companies (Amendment) Ordinance 2015) for similar provisions.

Reasonable excuse and use of self-incriminating evidence (Paragraph 8 and 9 of the list of questions)

8. Inspection and investigation serve different purposes. The former is a routine check by the regulator. As stated in the proposed new section 21B, the purpose of an inspection is for “ascertaining whether the auditor has complied with or is likely to be able to comply with a provision of this Ordinance or a professional standard”. It is unlikely that self-incriminating evidence will be involved. This explains the absence of a provision similar to section 30 of the FRCO for an inspection.

9. On the other hand, section 30 has been provided for the purpose of an investigation as a statutory safeguard for the right against self-incrimination of the person being investigated. As can be seen from the proposed new section 23, an investigation cannot be initiated unless the FRC has reasonable cause to believe that certain misconduct has been committed or that certain provision in the FRCO has been contravened. Where there is already a suspected misconduct or contravention of the FRCO, the investigator might require the person being investigated to produce information which might tend to incriminate

him³. Section 30 ensures that even though the person being investigated is compelled to provide information which might incriminate himself, in general such information cannot be used against him in subsequent criminal proceedings and that the investigator is required to inform the person being investigated of such limitation before requiring him to produce the information.

10. As regards the question on section 12(7) of the FRCO, the same explanation as stated in paragraphs 8 and 9 above applies. Section 12(1) provides that the FRC may refer to, or seek assistance from, specified authorities concerning *cases* or *complaints* relating to PIE auditors, registered responsible persons or PIE engagements which are usually related to investigations and enquiries. Sections 31(9) and 43(3) of the FRCO provide that a person is not excused from complying with a requirement imposed on him during an investigation and enquiry respectively on the ground that to do so might tend to incriminate him. As there is no similar provision for inspection, it follows that section 12(7) of the FRCO does not need to cover inspection for the use of self-incriminating evidence.

Qualification of an inspector and an investigator (Paragraph 10 of the list of questions)

11. The qualification requirements of an inspector and investigator are modelled on the existing arrangements having regard to the different requirements of skills for inspection and investigation. Under section 32B(1)(d) of the PAO, a reviewer (i.e. inspector under the new regulatory regime) of the HKICPA must be a certified public accountant. On the other hand, there is no such requirement for an investigator under the existing FRCO.

Investigation report (Paragraph 11 of the list of questions)

12. The identity of a relevant person who is identified in section 52(6) of the FRCO is protected in that the FRC's investigation report does not and will not name those relevant persons. The investigation report will refer only to those parties under investigation who are not a relevant person under section 52(6).

³ Section 31(9) of the FRCO provides that a person is not excused from complying with a requirement imposed on him during an investigation only on the ground that to do so might tend to incriminate him. This is also consistent with the other financial regulatory regimes, where the self-incriminating provision similar to section 31(9) of the FRCO would only be applicable in the case of investigation but not inspection. Please refer to section 184(4) of the SFO and section 41G(6) of the Insurance Ordinance (Cap.41) (as added by Insurance Companies (Amendment) Ordinance 2015).

Guidelines in respect of pecuniary penalty are not subsidiary legislation (Paragraph 12 of the list of questions)

13. The proposed new sections 37A and 37B provide what constitute misconduct by PIE auditors and registered responsible persons respectively, and the proposed new sections 37D and 37E provide for the sanctions for misconduct. The guidelines to be issued under the proposed new section 37H are to give an indication of how the FRC will exercise its power to impose pecuniary penalties under the proposed new sections 37D(3)(b)(iv) and 37E(3)(b)(iii). They are not intended to provide further rules or regulations for PIE auditors or registered responsible persons. These guidelines are required to be updated swiftly from time-to-time to take into account the fast-changing regulatory environment. In addition, the proposed new section 37H(2) of the FRCO is consistent with section 199(3) of the SFO and section 83(2) of the of the Insurance Ordinance (Cap.41) (as added by Insurance Companies (Amendment) Ordinance 2015), which also cover guidelines of pecuniary penalty as a result of a misconduct committed by the regulatees.

Disclosure of sanctions (Paragraph 13 of the list of questions)

14. If, in an unlikely event, the FRC makes a private reprimand and imposes a pecuniary penalty against an auditor at the same time as in the example suggested in the question, only the pecuniary penalty imposed on the auditor will be disclosed. While the example in the question may be theoretically feasible, at a practical level, we trust that if the FRC imposes a private reprimand which is a lenient form of sanction, it is very unlikely that the FRC will also impose a pecuniary penalty. Otherwise, the disclosure requirement for a pecuniary penalty will defeat the purpose of a private reprimand.

Immunity only afforded to auditors under section 55 (Paragraph 14 of the list of questions)

15. Section 55 of the FRCO is intended to address the concern of an auditor of a listed entity which intends to whistle-blow to the regulator of any suspected misconduct in relation to the entity but is worried that the entity might bring legal action against it for breach of the confidentiality provision in the engagement contract between the entity and the auditor, and/or its duty to maintain confidentiality under tort and/or defamation. Given the scope of section 55, it is unlikely that a responsible person will choose to whistle-blow in his personal capacity. The communication would be made in the name of the practice unit so that the practice unit can enjoy the immunity. At a practical level, we trust that if the responsible person wishes to whistle-blow but believes or knows that the practice unit is reluctant to do

so, he would choose to inform either anonymously or on the basis that his name should not be disclosed, thereby enjoying the protection given to an informer under section 52 of the FRCO.

Purpose of levies (Paragraph 15 of the list of questions)

16. The existing FRC is not funded by the Companies Registry Trading Fund (“CRTF”) alone. It is funded through an ad hoc agreement of four parties, viz. the HKICPA, the Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and the CRTF which negotiate and sign a multi-party Memorandum of Understanding at 5-yearly intervals. The current FRCO does not contain any provision explicitly stating what the funds of the FRC are, but there are provisions regarding its income, expenditure and accounts to ensure the transparency of its finances.

17. The arrangements regarding the transparency and accountability of the finances of the FRC will continue to be adopted under the new regime. Moreover, it is clear from Part 4A that the levies collected under that Part are intended to be funds of the FRC. For example, the proposed new sections 50A, 50B and 50C provide that the levies collected under those sections are to be paid into a bank account specified by the FRC. The proposed new section 50F provides that the FRC may recover the amount of any levy payable under Part 4A as a civil debt due to it. The proposed new section 50D provides that the FRC may recommend reduction of levies with reference to its reserves. Taking into account the entire arrangement under the FRCO, there is no ambiguity that the levies under Part 4A constitute funds of the FRC.

Financial Services and the Treasury Bureau

9 April 2018