

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

**Summary of views of Submissions and the Government’s response**

Item	Summary of views of submissions	Government’s response
(A) Directions and objectives of the reform		
1.	<p>Supportive of the objectives and directions of the reform.</p> <p><i>[Hong Kong Institute of Certified Public Accountants (“HKICPA”), The Society of Chinese Accountants and Auditors (“SCAA”), Mid-tier Firm Alliance (“MFA”), Deloitte Touche Tohmatsu (“Deloitte”), Ernst &amp; Young (“EY”), KPMG, PricewaterhouseCoopers (“PwC”), BDO Limited (“BDO”), Crowe Horwath (HK) CPA Limited (“Crowe Horwath”), Baker Tilly Hong Kong Limited (“Baker Tilly”), Securities and Futures Commission (“SFC”), The Mandatory Provident Fund Schemes Authority, Consumer Council, Hong Kong Investment Funds Association (“HKIFA”), Asian Corporate Governance Association (“ACGA”), Universities Superannuation Scheme Investment Management Ltd (“USS”), Hong Kong Take the Lead Institute (“HKTLI”)]</i></p>	<p>We are pleased to note the views of the deputations and in the submissions.</p>
(B) Composition of the post-reform Financial Reporting Council (“FRC”)		
2.	<p>At least one-third of FRC members should have relevant and up-to-date audit skill, knowledge and experience.</p> <p><i>[HKICPA, MFA, BDO, Baker Tilly]</i></p>	<p>We note that the views of the profession on details of the future composition of the FRC are very diverse. Some deputations and submissions suggested that more practitioners with audit knowledge and experience should be</p>

<p>At least one-third of FRC members should be experienced persons from the audit profession.</p> <p><i>[SCAA]</i></p> <p>The Bill should specify that the knowledge of auditing of Hong Kong listed entities possessed by the members should be “current knowledge”.</p> <p><i>[CPA Australia]</i></p> <p>Out of the non-practitioners, there should be a high proportion of persons who have audit experience, e.g. retired audit practitioners who have passed the three-year cooling-off period.</p> <p><i>[Crowe Horwath]</i></p>	<p>appointed as FRC members, including the proposal that the proportion of practitioners in the FRC should be at least one-third of the Council members. Some deputations and submissions, on the other hand, opined that the FRC should comprise solely non-practitioners (including lay persons or audit personnel who have passed the three-year cooling-off period) so as to meet the new European Union requirements adopted in June 2016 and pave the way for Hong Kong to attain the EC equivalence status.</p> <p>Given the views of different stakeholders, we consider that the legislative proposals should strike a proper balance. As one of the major objectives of the reform is to enable Hong Kong to become eligible for membership of the International Forum of Independent Audit Regulators (“IFIAR”), and the IFIAR only requires the governing board of the independent auditor regulator to comprise a majority of non-practitioner members, we consider it a reasonable and balanced approach to propose in the Bill that the FRC should have a majority of non-practitioner members and that at least two members should possess knowledge and experience in auditing the financial reports of PIEs. Such arrangement will ensure that the FRC is independent from the profession while there is sufficient expertise for the FRC to handle relevant cases. It was also a clear consensus during the public consultation that Hong Kong should achieve IFIAR membership without further delay.</p>
<p>3. The European Commission (“EC”) equivalence status, which mandates the governing board of the auditor regulator to comprise solely non-practitioners, only brings little additional benefits and should not be the objective of the current reform.</p> <p><i>[HKICPA]</i></p> <p>The post-reform FRC should comprise solely non-practitioners in order to obtain the EC equivalence status.</p> <p><i>[SFC, ACGA, USS]</i></p> <p>The post-reform FRC should comprise solely non-practitioners while maintaining relevant knowledge and expertise in public interest entity (“PIE”) auditing.</p> <p><i>[Deloitte, EY, PwC]</i></p> <p>Having practitioners at the Council level cannot satisfy EC equivalent status.</p>	

	<p><i>[KPMG]</i></p> <p>The post-reform FRC should comprise a majority of non-accountants.</p> <p><i>[The Association of Chartered Certified Accountants (“ACCA”)]</i></p>	
4.	<p>The Chief Executive Officer of the FRC should not be a Council member.</p> <p><i>[MFA, HKICPA]</i></p>	<p>Currently, the Chief Executive Officer of the FRC, being a Council member under the Financial Reporting Council Ordinance (“FRCO”), is also responsible for the investigation duties of the FRC. Therefore, we do not consider it necessary to change the arrangement under the new regime. This practice is also in line with the arrangements of other financial regulators. Besides, the FRC will put in place administrative arrangements to ensure that the officers responsible for the investigation/inspection or disciplinary processes of a case (including the relevant executive directors) would not take part in making a disciplinary decision of the same case, i.e. the so-called “China Wall” policy.</p>
<b>(C) Scope of PIE / PIE engagements</b>		
5.	<p>The definitions of PIE and PIE engagement should be simplified.</p> <p><i>[HKICPA]</i></p>	<p><i>PIEs</i></p> <p>The concept of PIEs originated from the IFIAR requirement that its members must be regulators of PIE auditors. The IFIAR, however, has not defined the meaning of PIEs. Each jurisdiction may thus specify the entities that fall within the scope of PIEs according to their own circumstances. Generally speaking, PIEs are mainly listed corporations.</p> <p>Under the Bill, a PIE is defined as a corporation with issued shares listed in Hong Kong and a collective investment scheme with interests listed in Hong Kong.</p>

		<p>The relevant factors considered in adopting the above definition are:</p> <ul style="list-style-type: none"><li>(a) As mentioned above, the IFIAR has not defined the meaning of PIEs and each jurisdiction may adopt their own definition according to their own circumstances.</li><li>(b) In its Financial Sector Assessment Programme report released in May 2014, the International Monetary Fund (“IMF”) recommended that Hong Kong should establish a “fully independent authority with responsibility for the oversight of the audit profession and with strong enforcement power” and that such authority “should have jurisdictions over all auditors that audit companies listed in Hong Kong”. The definition of PIEs as set out in the Bill is consistent with that recommended by the IMF.</li><li>(c) A major objective of the current legislative amendment exercise is to safeguard the interests of the investing public. Defining a PIE as a listed corporation and a listed collective investment scheme is in line with this objective. The consultation paper issued by the Government for public consultation in 2014 also proposed that the scope of PIEs covering listed corporations and listed collective investment schemes should form the basis of the legislative exercise. Therefore, further consultation is required if the scope is to be expanded.</li><li>(d) The current reform will bring about significant changes to the existing regulatory regime. It will enhance investor protection on the one hand and impose additional statutory regulatory/levy obligations on the relevant stakeholders on the other hand. It would, therefore, be prudent</li></ul>
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		<p>to adopt a step-by-step approach in taking forward the reform.</p> <p><i>PIE engagements</i></p> <p>Please see the reply in Item 6 below.</p>
6.	<p>The list of PIE engagements should cover all assurance engagements under the Listing Rules (“LR”).</p> <p><i>[HKICPA, Deloitte, EY, KPMG, PwC, BDO, ACCA, USS, SCAA]</i></p> <p>Various engagements under LR fall outside the definition of PIE engagements, and the most significant one is the assurance engagement in relation to interim accounts of listed companies.</p> <p><i>[SFC]</i></p> <p>Proposed coverage of PIE engagement serves the public interest. Supportive of inclusion of any other engagements that are considered to be of public interest.</p> <p><i>[ACCA]</i></p> <p>Strong objection to expanding the scope of PIE engagements.</p> <p><i>[MFA]</i></p>	<p>Schedule 1A to the Bill provides that “PIE engagements” include:</p> <ul style="list-style-type: none"> <li>(a) an annual auditor’s report of a PIE;</li> <li>(b) a specified report in a listing document of a PIE; and</li> <li>(c) an accountant’s report compiled for a reverse takeover or a very substantial acquisition under the Listing Rules.</li> </ul> <p>We note there are views that the scope of PIE engagements should be expanded to cover all assurance engagements required to be undertaken by auditors under the LR. The objectives of the current reform are to facilitate Hong Kong to join IFIAR and enhance investor protection, without bringing unnecessary changes to the existing regulatory regime. The PIE engagements specified in the Bill are the most significant ones and the proposed scope has received widespread support during the public consultation.</p> <p>In addition, there are many types of assurance engagements that are required to be undertaken by auditors under the LR, ranging from auditor’s report on interim financial statements to circulars relating to major transactions, etc. We understand that auditors undertaking such engagements for listed corporations may not be the PIE auditors under the proposed regime. Thus, if the scope of PIE engagements is expanded, other auditors, including small</p>

		and medium-sized audit firms, will be included in the new regulatory regime. To take forward such an important change, we will have to further consult the affected parties to ensure a consensus is reached. Our view is that upon accumulating sufficient operating experience of the new regime, we may review the scope of PIE engagements if necessary. Hence, we consider that the scope set out in the existing Bill is appropriate.
<b>(D) Funding mechanism of the post-reform FRC</b>		
7.	Supportive of or having no further issue with imposing levies on securities investors, PIEs and PIE auditors. <i>[ACCA, Hong Kong Institute of Chartered Secretaries, USS]</i>	We are pleased to note the views in the submissions.
8.	The \$90M budget should be better justified. <i>[HKICPA, MFA]</i>	<i>FRC's Operating Expenses</i> The Government estimates that the annual operating expenses of the post-reform FRC is around \$90 million at 2016 price level.
9.	PIE auditors should not be one of the funding parties. <i>[BDO, Crowe Horwath]</i> Investors should be the sole funding source. <i>[HKICPA]</i> PIE and PIE auditors should be the sole funding sources. If not, the ratio of funding from the three funding parties should be equal. <i>[HKIFA]</i> The Government should be responsible for at least 25% of the funding. <i>[SCAA]</i> The Government should be the sole funding source. <i>[MFA]</i> The Government should share part of the FRC's funding.	We consider that the estimated operating expenses are justified for the following reasons: (a) At present, the FRC is primarily responsible for conducting independent investigations into possible auditing irregularities of listed entity auditors. Under the new regime, the FRC's functions will be substantially expanded. Its scope of work will increase by more than three-fold to cover recurring inspections, enforcement of disciplinary matters, recognition of overseas auditors, oversight of the HKICPA's regulatory functions in respect of PIE auditors, enhanced co-operation and interface with relevant international bodies and overseas audit regulators, etc.

	<p><i>[HKTLI]</i> The ratio of contributions from the three funding parties should be better justified.</p> <p><i>[Consumer Council]</i> The funding should come from the general Government revenue.</p> <p><i>[CPA Australia]</i> The amount of funding from securities investors, PIEs, PIE auditors and the Government should be in the ratio of 40:25:15:20 respectively.</p> <p><i>[Baker Tilly]</i></p>	<p>(b) The levy contribution from PIE auditors will account for 25% of the operating expenses of the post-reform FRC under the new regime, and this proportion of funding from the audit profession is the same as that for the existing FRC<sup>1</sup>. With the estimated annual operating expenses of the post-reform FRC at around \$90 million (at 2016 price level), the contribution by PIE auditors will be around \$22.5 million. This amount, according to our understanding, is comparable to the total amount borne by the audit profession for the current operations of the FRC and the HKICPA in respect of the regulation of PIE auditors<sup>2</sup>.</p>
10.	<p>The FRC should be adequately funded for discharging its regulatory functions. Have doubt on whether \$90 million is sufficient.</p> <p><i>[ACGA]</i></p>	<p>(c) Under the new regime, the regulatory functions of inspection and disciplinary proceedings will be transferred from the HKICPA to the FRC. The FRC will take the opportunity to improve and strengthen the mechanisms and procedures through which it discharges these new statutory functions. For inspection of PIE auditors, the FRC will put in place a system which is benchmarked against the international standard and practice in this area. As regards disciplinary proceedings, currently the HKICPA discharges this function primarily through Disciplinary Panels, and members of these Panels serve on a pro bono basis. Such a practice has been criticised by the IMF as not conducive to the</p>

<sup>1</sup> At present, the FRC is funded through contributions made by four parties, viz. the HKICPA, the SFC, the Hong Kong Exchanges and Clearing Limited and the Companies Registry Trading Fund, on an equal basis under a multi-party Memorandum of Understanding (“MoU”) entered into by the four parties at five-yearly intervals.

<sup>2</sup> The HKICPA charged the audit profession \$7.3 million for making contribution to the FRC in 2016. In addition, the annual costs currently incurred by the HKICPA in conducting recurring inspections and carrying out disciplinary functions in respect of PIE auditors (which will be transferred to the post-reform FRC) amounted to some \$12-13 million. Therefore, the total costs borne by the audit profession for the current operations of the FRC and the HKICPA in respect of the regulation of PIE auditors are comparable to the contribution made by PIE auditors under the new regime.

		<p>development of expertise and precedents. The post-reform FRC, on the other hand, will be supported by a team of full-time and salaried executives in dealing with disciplinary proceedings. The above-mentioned improvements will incur additional costs as compared to the existing regime, but are worthy initiatives as they will serve to strengthen our auditor regulatory regime which will in turn further enhance investor protection.</p> <p>As for the breakdown of the annual operating expenses of the post-reform FRC, please refer to our paper submitted to the Bills Committee on 16 March 2018 (LC Paper No. CB(1)687/17-18(02)).</p> <p><i>Levy for the operation of the FRC</i></p> <p>Since its establishment, the FRC has been funded through an ad hoc agreement amongst four parties, i.e. the HKICPA, the SFC, the Hong Kong Exchanges and Clearing Limited and the Companies Registry Trading Fund. These four parties negotiate and sign a multi-party MoU on the funding arrangement at five-yearly intervals. In devising the funding mechanism for the post-reform FRC which will become a full-fledged regulator in respect of PIE auditors, our key considerations are stability of funding support for the FRC, the “user pay” principle and the principle that the FRC as an independent auditor oversight body should be operationally and financially independent of the Government. Accordingly, during the public consultation in 2014, we proposed that the post-reform FRC should be funded through three new levies to be imposed upon securities transactions, PIEs and PIE</p>
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		<p>auditors respectively on a roughly equal basis. This funding proposal was retained in the consultation conclusions released in 2015.</p> <p>Upon release of the consultation conclusions, we have continued to engage the audit profession as we take forward the legislative amendment exercise. During this engagement process, we have duly noted the concern that the reform would bring about significant changes to the audit profession, and have taken on board a number of views and suggestions from the profession in formulating our detailed legislative proposals. For the funding mechanism, having considered the concern from the audit profession about the financial implications of the new regime on them, especially on the small and medium-sized audit firms, we have proposed that the contributions from securities transactions, PIEs and PIE auditors should be in the ratio of 50:25:25 respectively. Taken as a whole, we consider this funding mechanism balanced and reasonable.</p> <p><i>Role of the Government</i></p> <p>We have received suggestions that the Government should be one of the funding sources of the FRC under the new regime. On this, we maintain the view that the Government should not be a recurrent funding source for the operation of the post-reform FRC. This is consistent with the aforementioned principle that the FRC as an independent auditor regulator should be financially and operationally independent from the Government, and is also in line with the practices in other comparable overseas jurisdictions. At the same time, the Government is fully aware of the need</p>
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		for the post-reform FRC to be provided with adequate funding in order to prepare for the smooth transition to the new regime and to discharge its full range of statutory functions. We will carefully consider the views and suggestions received before finalising the funding mechanism.
11.	<p>The FRC’s budget should be transparent and carefully monitored.  <i>[ACCA, Baker Tilly]</i></p> <p>Expressing worries whether the level of levy will increase every year.  <i>[MFA]</i></p> <p>A mechanism should be established for regular review and scrutiny of the funding mechanism and FRC’s budget to ensure that the FRC achieves its objectives and uses its funds efficiently and wisely. The Financial Secretary (“FS”) should be empowered to review the level of levies at any time.  <i>[PwC]</i></p> <p>Welcome the Government to provide seed money but expressing concern how the Government could monitor the use of the fund by the FRC.  <i>[HKICPA]</i></p> <p>There should be regular reporting to the public to ensure prudent use of funding from stakeholders.  <i>[Consumer Council]</i></p>	<p>As regards the stakeholders’ concern about the future monitoring of the use of funding for the FRC, the Bill has put in place a number of checks and balances to monitor the FRC’s funding so as to protect the levy-paying stakeholders:</p> <p>(a) the amounts or rates of the levies are specified in the Bill. Any future adjustments to such amounts or rates will have to go through negative vetting by the Legislative Council (“LegCo”) before implementation. This arrangement should address the stakeholders’ concern that a rise in the FRC’s expenses will automatically lead to an increase in levies; in other words, the amounts or rates of the levies will not be changed arbitrarily;</p> <p>(b) the FRC’s annual budget will be submitted to the FS for approval to ensure the proper use of funds;</p> <p>(c) the FRC’s annual financial statements must be audited by the Director of Audit;</p> <p>(d) the FRC’s annual financial statements and year-end report must be laid on the table of LegCo; and</p> <p>(e) where the reserves of the FRC are more than twice of its annual operating expenses, the FRC must consult the FS with a view to reducing the rates/amounts of the levies.</p>
12.	The levy on an individual auditor should be calculated according to	On the basis of determining the levy on auditors, since the establishment of

	<p>the audit fees received or the market capitalisation of its listed clients. <i>[Crowe Horwath]</i></p> <p>The basis of determining the levy on auditors by number of listed clients is not fair to mid-tier firms. <i>[Baker Tilly]</i></p> <p>The duties of determining the amount and collection of the levies on auditors should be given to the HKICPA, subject to the oversight by the FRC. <i>[Crowe Horwath]</i></p>	<p>the FRC, the HKICPA has been using the flat fee per listed entity client approach to collect fees from relevant auditors as annual contributions to the FRC. The HKICPA's decision to collect fees by this simple and straightforward approach was made after due consultation with members and consideration of other calculation basis. Over the past few years, we have consulted the HKICPA on a number of occasions to see if the audit profession has reached a consensus on an alternative fee collection method. The HKICPA however responded that the profession has yet to forge a consensus on this matter. We therefore maintain that unless the audit profession achieves an early consensus on the review of the calculation basis, the flat fee per PIE client approach will continue to be used in determining the levy on individual auditors. The HKICPA is aware of the Government's stance in this regard.</p>
(E) Inspection and Investigation		
13.	<p>Supportive of the proposed powers for the FRC to follow up on inspection reports. <i>[ACCA]</i></p>	<p>We are pleased to note the views in the submissions.</p>
14.	<p>Objection to the imposition of criminal offence for non-compliance with inspection requirements. <i>[HKICPA, Deloitte, EY, KPMG, PwC, BDO, Baker Tilly, SCAA]</i></p>	<p>On the FRC's inspection function, some respondents opined that the provision in the Bill stipulating that a PIE auditor may commit an offence for non-compliance with the FRC's inspection requirements should be removed. We consider this legislative proposal justified. To maintain a robust regulatory regime, it is important to ensure that the regulators can discharge their functions effectively. In addition to case investigation, recurring inspection is also a key regulatory activity. If criminal liability is not imposed on non-compliance with the inspection requirements, it will severely</p>

		<p>undermine the effectiveness of the regulatory regime and the confidence of investors in the overall financial regulation of the capital market in Hong Kong. In fact, failing to comply with the FRC’s investigation requirements is already an offence under the existing FRCO. The proposal is also in line with other financial regulatory regimes in Hong Kong, under which non-compliance with the regulators’ inspection requirements is an offence. Meanwhile, the Bill has made it clear that the court will take into account whether the auditor has reasonable excuse for failing to comply with the FRC’s inspection requirements before making a decision on the case.</p>
15.	<p>Objection to the power of entering into business premises for inspection. <i>[MFA]</i></p>	<p>Given the nature of an inspection, there is a practical need to enter into an auditor’s business premises, which is also an inseparable part of the inspection process. During an inspection, the inspector has to observe the operation, work process and quality control work of the audit firm and collect the necessary information from the management and staff at all levels. Under the current regime, inspection duties are undertaken by the HKICPA in accordance with the Professional Accountants Ordinance (“PAO”) and the HKICPA will also enter the business premises of the auditor concerned for inspection.</p> <p>We consider that the statutory power to enter premises as set out in the provision is reasonable and proportionate with appropriate checks and balances. In exercising the power to enter premises, the FRC has to fulfil certain requirements. The power as well as checks and balances provided for under the Bill are on par with those made for other financial regulators in Hong Kong. The FRC will devise guidelines and codes on how it exercises</p>

		the inspection power.
16.	<p>The criteria for elevating a case from inspection to disciplinary proceedings and the interface of the two functions should be explained or clarified.</p> <p><i>[HKICPA]</i></p> <p>In normal circumstances, inspection should be dealt with through remediation plans, without the need for recourse to disciplinary action.</p> <p><i>[Deloitte]</i></p> <p>For issues arising from an inspection, the appropriate regulatory response should depend on severity of the issues, facts and circumstances.</p> <p><i>[KPMG]</i></p> <p>Sanctions should only be imposed if a firm fails to carry out corrective measures required after inspection, and distinction between inspection and investigation is not clear.</p> <p><i>[PwC]</i></p>	<p>Some deputations and submissions suggested that there should be clear provisions or guidelines on how the FRC makes the decision to initiate investigation or disciplinary proceedings based on inspection findings, so as to prevent the FRC from abusing its inspection function and subjecting the auditor concerned to unnecessary investigation or disciplinary sanction. In fact, issues identified during the inspection process are not mandatorily required to be referred to the investigation or disciplinary department under the new regulatory regime. The inspection department may take action having regard to the nature and severity of the issues. In some cases, corrective action may be more appropriate than disciplinary sanction. Before initiating investigation or disciplinary proceedings based on the inspection findings, the relevant department must have reasonable grounds to believe that the auditor has committed a misconduct. The relevant provision in the Bill serves to ensure that the auditor will not be subject to unnecessary investigation or disciplinary sanction.</p> <p>Moreover, after becoming a member of IFIAR, the FRC will share with other international regulators important information on the regulatory environment, operating experience and market changes, etc. to ensure that the performance of its inspection function aligns with the latest international standard and practice. During the FRC's inspection process, persons independent of the FRC and with experience in PIE auditing will also advise on the proposed follow-up actions in respect of the inspection. Finally, to ensure clarity and transparency in its operation, the FRC will formulate guidelines setting out the</p>

		thresholds and circumstances under which misconduct identified during inspection should be referred to the disciplinary department for follow-up.
(F) Discipline		
17.	<p>Segregation of functions and responsibilities should be expressed in the Bill or operational structure of the FRC. The “China wall” for decision making should be expressed in the Bill or dealt with by a policy commitment.</p> <p><i>[HKICPA]</i></p> <p>There should be separation of powers for inspection and investigation and decision making of enforcement.</p> <p><i>[ACCA, CPA Australia, SCAA]</i></p> <p>Objection to concentration of powers of inspection, investigation and disciplinary sanctions in the FRC.</p> <p><i>[MFA]</i></p> <p>Disciplinary mechanism needs to be sufficiently independent of the inspection and investigation process.</p> <p><i>[KPMG]</i></p>	<p>We completely agree with the views from some deputations and submissions that the FRC should segregate executives responsible for inspection, investigation, disciplinary proceedings and disciplinary sanction. Following the release of the consultation conclusions in June 2015, we have been discussing with the FRC and the HKICPA the specific details of the new regime in response to the concerns of the audit profession. To address the audit profession’s concerns over the FRC’s disciplinary powers, we will put in place a series of administrative arrangements, including that the executives who have participated in the investigation/ inspection or disciplinary processes of a case would not take part in making a disciplinary decision of the case (i.e. the so-called China Wall policy).</p>
18.	<p>Maximum cap of \$10M for pecuniary penalty does not appear to be excessive.</p> <p><i>[ACCA]</i></p> <p>Expressing concern that the monetary sanction of up to \$10M or three times of profit gained/ loss avoided is too high.</p> <p><i>[HKICPA, MFA, Crowe Horwath]</i></p> <p>Penalties for audit failure should be proportionate to the audit failure and should be consistently applied.</p>	<p>Currently, the maximum disciplinary pecuniary penalty provided in the PAO is \$500,000. There have long been views in the community that the penalty level is not sufficient to ensure a proportionate disciplinary sanction for misconduct, thus undermining the effectiveness of disciplinary sanction. The IMF also criticised the situation as it considered that the sanctions available to the HKICPA were very limited and recommended that the independent auditor oversight body should be given strong enforcement power. Hence, the cap on pecuniary penalty should reflect the severity of the non-compliance and our</p>

	<p><i>[KPMG]</i></p> <p>The FRC is encouraged to make use of both financial and non-financial penalties where appropriate.</p> <p><i>[ACCA]</i></p>	<p>proposal has taken into full consideration the views of various stakeholders. It should be noted that some overseas jurisdictions (such as the UK) do not have a cap on the amount of pecuniary penalty they can impose.</p>
19.	<p>The statutory requirement for the FRC to issue guidelines on imposition of pecuniary penalty is welcomed.</p> <p><i>[ACCA]</i></p> <p>The sanctioning guidelines should be made available before the passage of the legislation.</p> <p><i>[HKICPA]</i></p> <p>Looking forward to seeing details of FRC’s sanctioning guidelines and internal processes over inspection and disciplinary matters.</p> <p><i>[KPMG]</i></p> <p>Timely provision of implementation guidelines and sanctioning guidelines is necessary.</p> <p><i>[PwC]</i></p> <p>A comprehensive and transparent set of guidelines on pecuniary penalty should be developed and made available.</p> <p><i>[CPA Australia, Crowe Horwath]</i></p> <p>The sanctioning guidelines should be made available for the Bills Committee’s consideration.</p> <p><i>[Baker Tilly]</i></p>	<p>The Bill provides that the FRC must issue guidelines on the imposition of pecuniary penalty to indicate the manner in which it exercises its power to order a PIE auditor to pay a pecuniary penalty, and must have regard to the issued guidelines when exercising such power. The FRC is committed to issuing the guidelines as soon as practicable after the Bill is enacted and certainly prior to the proposed commencement of the new regime on 1 August 2019. In gist, the FRC must have regard to the principles of fairness and proportionality when determining the pecuniary penalty to be imposed in individual cases. The FRC will devise details of the guidelines in due course and engage relevant stakeholders throughout the process. In view of the Bills Committee’s concern regarding the guidelines, the FRC’s response which set out the principles it would adhere to when devising the guidelines was submitted to the Bills Committee on 6 April 2018 (LC Paper No. CB(1)771/17-18(02)).</p>
20.	<p>Need a policy commitment on qualification, role and scope of independent reviewers (i.e. case advisers).</p> <p><i>[HKICPA]</i></p>	<p>On the qualification and role of case advisers in the disciplinary process, as stated in the Legislative Council Brief, the FRC will establish a panel of case advisers who are legal experts and independent of the FRC. In contentious</p>

		<p>cases (i.e. where the recommended sanction of the disciplinary department for consideration of the FRC is not accepted by the PIE auditor or responsible person concerned), the FRC will invite a case adviser to study all relevant documents and information and give his views on whether the principles of due process and natural justice have been observed in the disciplinary process, as well as on the merits of the case including whether the recommended sanction is appropriate. The case adviser may also suggest modifications to the level of recommended sanction if he considers it appropriate to do so, and where necessary, request further information from the disciplinary department or PIE auditor or responsible person concerned and seek further opinion from the audit expert before finalising his views to the FRC. To ensure transparency, the PIE auditor or the responsible person concerned will be informed of the views of the case adviser and will have a further opportunity to make representations before the FRC makes a decision on the case.</p>
21.	<p>Need guidance and clarification on the definition of misconduct. [HKICPA]</p>	<p>The proposed new section 20K(2) has defined the meaning of “misconduct”. The scope of misconduct provided for under the Bill is basically the same as that of “relevant irregularity” under section 4 of the existing FRCO. For instance, failing or neglecting to observe a professional standard, an irregularity under the existing FRCO, will also be a misconduct under the new regime.</p>
(G) Registration of PIE auditors		
22.	<p>Arrangement should be in place to ensure smooth transition of existing registered auditors to the new registration framework. [CPA Australia] Clear guidelines should be developed and made available on the</p>	<p>The Bill has clearly provided for a transitional arrangement. For an auditor appointed to undertake a PIE engagement before the commencement of the new regime, if the engagement is still on-going on the commencement date of the new regime, the auditor may notify the HKICPA or the FRC (as the case</p>



	<p>eligibility criteria for the registration of new PIE auditors.  <i>[CPA Australia]</i></p>	<p>may be) of his/her intention to continue to carry out the engagement after the implementation of the new regime. On sending such notification, the auditor will be taken to be a PIE auditor during the transitional period. The names of those who are taken to be registered or recognised PIE auditors will be put onto the PIE auditors register, and the auditors concerned will be subject to the inspection, investigation and disciplinary mechanisms under the new regime. During the transitional period, these auditors may file applications for registration or recognition as PIE auditors under the new regime. We believe that the HKICPA and the FRC will provide clear guidelines to the auditors concerned on the transitional arrangement and the eligibility criteria and procedures for the registration or recognition of PIE auditors.</p>
<p>(H) Regulation of overseas auditors</p>		
<p>23.</p>	<p>The FRC should have direct regulatory powers over all PIE auditors including overseas PIE auditors.  <i>[HKICPA, ACCA]</i></p> <p>The FRC should not cede powers to overseas regulators.  <i>[HKICPA]</i></p> <p>There should be a level playing field of equally robust regulation of local and overseas PIE auditors. Expressing concern on how the FRC will conduct inspection, investigation and sanctioning on overseas auditors.  <i>[HKICPA]</i></p> <p>The FRC appears to lack powers in regulating overseas PIE auditors, hence not fair to local PIE auditors.  <i>[MFA]</i></p>	<p>Under the new regime, the regulatory powers of the FRC for inspection, investigation and disciplinary sanction over local PIE auditors will be equally applicable to overseas PIE auditors. The range of sanctions available to the FRC in case of disciplinary actions against overseas PIE auditors will also be the same as that for local PIE auditors. The new regime will also enable the FRC to seek co-operation and assistance from overseas regulators when necessary in performing its regulatory functions in respect of recognised PIE auditors.</p> <p>It is also worth noting that the relevant legislative proposal serves to close a gap in the current regulatory regime, as these overseas auditors are at present not subject to regulation by an auditor regulatory body.</p>

	<p>There should be clearer guidelines and fair treatment on the regulation of PIE auditors irrespective of whether they are from Hong Kong or overseas.</p> <p><i>[CPA Australia]</i></p>	
24.	<p>The FRC should have regulatory powers over Mainland auditors recognised under the new regime.</p> <p><i>[HKICPA]</i></p> <p>The FRC should have full access to audit working papers kept in the Mainland.</p> <p><i>[HKICPA]</i></p>	<p>Following the convergence of the Mainland and Hong Kong accounting and auditing standards in 2007, the two sides entered into a co-operation agreement in 2009. Mainland-incorporated companies listed or seeking to be listed in Hong Kong may engage any one of the specified Mainland audit firms, which have been assessed as meeting specific conditions for auditing their financial statements using Mainland auditing standards. Implemented in Hong Kong since 2010, the co-operation agreement can help increase market efficiency and reduce compliance costs.</p> <p>The provision in the Bill concerning the recognition of relevant Mainland audit firms aims to provide continuity to the co-operation agreement without the need for material changes to the existing qualification requirements for PIE auditors. As stated in Item 23 above, under the new regime, the regulatory powers of the FRC for inspection, investigation and disciplinary sanction over local PIE auditors will be equally applicable to Mainland PIE auditors. The range of sanctions available to the FRC in case of disciplinary actions against local PIE auditors will also be applicable to Mainland PIE auditors. Under the new regime, the FRC will, in performing its regulatory functions in respect of Mainland PIE auditors, seek the assistance of relevant Mainland regulator where necessary pursuant to the prevailing co-operation agreement.</p>

		As regards obtaining or reviewing the PIE auditors' audit working papers kept in the Mainland, the FRC is discussing with the relevant Mainland regulator the signing of a co-operation agreement. The co-operation agreement will cover the FRC's future functions under the new regulatory regime, including the use of relevant audit working papers for the FRC's disciplinary hearings. The parties concerned will continue the discussion to facilitate the early signing of the co-operation agreement.
25.	It is not clear how FRC will assess an overseas auditor's resources and capability in processing recognition application. <i>[HKICPA, ACCA]</i>	The FRC will devise detailed guidelines on the recognition and regulation of overseas PIE auditors, including how to assess whether an overseas auditor has adequate resources and capability to be a PIE auditor.
(I) Oversight of the HKICPA's regulatory functions in respect of PIE auditors		
26.	Supportive of the provisions on the FRC's powers on issuing written direction to the HKICPA. <i>[ACCA]</i> The issue of direction from the FRC to the HKICPA should only be exercised where the HKICPA has not already rectified the non-compliance in question. <i>[ACCA]</i>	We are pleased to note the views in the submissions.
27.	The FRC's power to issue direction to the HKICPA should be dealt with more formally and publicly. <i>[HKICPA]</i>	The specific operational details of how the FRC would issue directions to the HKICPA, including the detailed arrangements and procedures for issuing directions, will be set out in a MoU between the FRC and the HKICPA.
(J) Review and Appeal		
28.	The Review Tribunal should consist of up to five members and	The Bill prescribes that the chairperson of the Tribunal must possess relevant

	<p>amongst them, two should possess PIE audit knowledge.  <i>[HKICPA]</i>          Specific and current listed company audit expertise is required on the Tribunal.  <i>[CPA Australia]</i></p>	<p>legal qualifications. The Government will appoint suitable members to the Tribunal panel, so as to ensure the Tribunal's independence from the FRC. The Bill contains provisions to ensure that the Tribunal has the power to summon any person (including an audit expert) to appear before it or to produce reports where necessary.</p> <p>In addition, the new regime also ensures that the FRC may, at various stages of the case, seek an audit expert's advice as appropriate on the application of relevant audit standards, related practices of the audit profession or experiences in previous cases of a similar nature. The advice given will be kept in the case file and made available to the Tribunal for reference in handling the case. The operation of the Tribunal is similar to that of the Judiciary. The chairperson and members of the Tribunal panel appointed by the Government will make independent, fair and impartial decisions on the review applications. It should be noted that tribunals with similar composition and modus operandi (such as the Securities and Futures Appeals Tribunal) have worked well for years in other financial regulatory regimes.</p>
29.	<p>Objection to the proposal that the sanctions may be effective before the determination of the Review Tribunal is made.  <i>[MFA]</i></p>	<p>This is a misunderstanding. The disciplinary decision of the FRC will be automatically stayed if an application for a review of the decision has been lodged. Therefore, auditors need not worry that sanctions will be implemented before an appeal is lodged.</p>
30.	<p>The hearing of the Review Tribunal should be private instead of public.  <i>[CPA Australia]</i></p>	<p>The Tribunal is a body independent of the FRC. Unless otherwise determined by the Tribunal, all its sittings shall be held in public. Taken as a whole, the new regime will better protect the anonymity of an auditor undergoing disciplinary proceedings than the existing PAO regime under</p>

		which the identity of an auditor subject to disciplinary proceedings will be disclosed when a disciplinary committee is established.
<i>(K) Other views received</i>		
31.	The Bill is just a legally phrased narrative, and it is necessary to provide an overall illustration of whole system. <i>[HKICPA]</i>	The Bill is not a suitable instrument to deal with the operational details. We have briefed the HKICPA on various occasions on the new regime's operation and have responded to the specific questions raised by the HKICPA. The FRC will devise appropriate guidelines and procedures to set out the operational details.
32.	There should be an additional consequential amendment to the PAO to enable the delegation of HKICPA Council's power and duty regarding registration of PIE auditors to be covered under the FRCO. <i>[HKICPA]</i>	We have had several rounds of discussion with the HKICPA on the draft provisions and have made appropriate amendments to the provisions having regard to its views. It was only through the HKICPA's written submission in this exercise that we came to be aware of its proposed consequential amendment to the PAO. Having noted the views therein, we will further examine the HKICPA's proposal.
33.	The wording in the relevant provisions describing Mainland auditors' functions under the Convergence Scheme (i.e. section 20ZT) should be suitably amended as the audit of such Mainland entities cannot be carried out in the China Accounting Standards for Business Enterprises. <i>[HKICPA]</i>	Under the current arrangement, qualified Mainland auditors may also compile the financial statements for the initial public offering of a Mainland corporation. It is therefore appropriate for the proposed new section 20ZT to cover the China Accounting Standards for Business Enterprises.
34.	Principle of co-operation between FRC and HKICPA in handover of responsibilities and operations should be included in the provisions of transitional arrangements in the Bill. <i>[HKICPA]</i>	We consider that the Bill is not a suitable instrument to provide the operational details. Specific operational details of the handover will be provided in a MoU between the FRC and the HKICPA.

35.	<p>The fit and proper requirement for registration as a PIE auditor is not reasonable.</p> <p><i>[MFA]</i></p>	<p>Under the existing regulatory regime, the HKICPA has already put in place the fit and proper requirement for registration. We do not intend to change the current eligibility and experience requirements for the registration mechanism under the proposed new regime. In other words, the fit and proper requirement for registration as a PIE auditor under the new regime will also use as a benchmark whether a person is a fit and proper person to be a certified public accountant.</p>
36.	<p>The requirement imposed on the quality control system responsible person of a PIE auditor is not reasonable.</p> <p><i>[MFA, PwC, Baker Tilly, Crowe Horwath]</i></p>	<p>At present, the Hong Kong Standard on Quality Control 1 (“HKSQC 1”) of the HKICPA already requires that there must be a responsible person within a practice unit to establish and maintain a quality control system. The legislative proposal is modelled on HKSQC 1. To ensure a proper and effective regulatory regime for PIE auditors, we consider it necessary for the relevant legislation to expressly provide for the registration of responsible persons and the disciplinary sanction for responsible persons in case of failure to perform the statutory duties.</p> <p>In the light of the profession’s views during the public consultation, we have tightened up the definition of “responsible person” in the Bill such that only persons who are responsible for the PIE auditor’s quality control system of relevant audit engagements will be required to be registered under the new regime.</p>
37.	<p>Publication of implementation guidelines would provide transparency as to the processes which FRC is obliged to follow.</p> <p><i>[Deloitte]</i></p> <p>Detailed guidance and explanatory notes to be developed by FRC</p>	<p>The FRC will devise relevant guidelines on its regulatory functions under the new regime timely.</p>

	<p>will be essential.</p> <p><i>[EY]</i></p>	
38.	<p>There should be clear mechanism for FRC to seek expert opinion on accounting and auditing standards at different stages.</p> <p><i>[PwC]</i></p> <p>Important to ensure relevant expert opinions in the form of a panel of experts (instead of one expert) for handling investigation and disciplinary cases.</p> <p><i>[PwC]</i></p>	<p>In drafting an inspection/investigation report, examining the representations of a regulated person and drafting a report with proposed actions, the inspection/investigation department of the FRC will seek the opinion of an independent person. This arrangement is similar to the FRC's current practice of consulting members of the Honorary Advisory Panel on its investigation work. At present, a majority of the Honorary Advisory Panel members are from the accounting profession with rich experience in auditing, while the remaining members are from other sectors with considerable knowledge of listed entities in Hong Kong. The current arrangement under which the FRC performs its investigation function is well-established and accepted by stakeholders. Therefore, we do not consider it necessary to overhaul the existing arrangement and establish a panel of several members to give opinions. As regards disciplinary proceedings, when the application of auditing standards is an important consideration in determining whether a regulated person is guilty of a misconduct, the FRC will seek the professional opinion of a member of the expert panel. We consider that it is not justified to require at least two panel members (instead of one) to give opinions on the same disciplinary case.</p>
39.	<p>Hong Kong will need in future to establish an independent entity for setting accounting and auditing standards. An overseas example is the UK FRC.</p> <p><i>[ACGA]</i></p> <p>Encouraging Hong Kong to strengthen independence between</p>	<p>Under the new regime, the HKICPA will continue to perform the statutory functions of setting professional ethics, auditing and assurance standards for PIE auditors under the independent oversight of the FRC. We consider this an appropriate arrangement. Since the reform will bring about significant changes to the existing regulatory regime, it would be prudent to adopt a</p>

	endorsement and review of auditing and accounting standards. <i>[USS]</i>	step-by-step approach in taking forward the reform.
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**Financial Services and the Treasury Bureau**

**28 June 2018**