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

Explanatory notes to Member's Committee Stage Amendments from Hon. Kenneth Leung

The proposed committee stage amendments to sections 37D(3)(b)(iv)(A) and 37E(3)(b)(iii)(A) of the Bill provide alternative levels of maximum pecuniary penalty for misconduct by PIE auditors or registered responsible persons. The current maximum pecuniary penalty is set at the greater of \$10,000,000 or 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

The three alternative amendments seek to lower the level to respectively, \$1,000,000, \$5,000,000 or \$8,000,000 or 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

The amendment is necessary for the following reasons.

1. The penalty level is substantially higher than that imposed by regulators in other developed economy

Canada (Canadian Public Accountability Board) and **Australia** (Australian Securities and Investments Commission) do not issue fines but only exercise certain administrative penalties.

Singapore (Accounting and Corporate Regulatory



Authority) imposes a maximum fine of SGD10,000 (approximately \$600,000) for both an auditor and an audit firm. Singapore is the jurisdiction Hong Kong should make comparison with.

United Kingdom (United Kingdom Financial Reporting Council) does not place a limit on financial penalty. This is the model jurisdiction which FSTB believes Hong Kong should follow. However, since 2008, the auditors in the UK have been allowed under the Companies Act to place a cap through the execution of a liability limitation agreement with an audit client to limit the amount of compensation payable under any civil claim arising out of an audit. Hong Kong does not have such a cap arrangement, and auditors are subject to a much higher pecuniary exposure. The observation is, it is not relevant to refer to the United Kingdom when setting the level of penalty even if the FRC may model after some aspects of the UK FRC.

2. The purpose of the penalty is to serve as a warning and not to drive small and medium PIE auditors out of business

The average cash flow of a small/ medium PIE audit is around \$1,000,000 to \$2,000,000. It is thus more reasonable to restrict the level maximum penalty to a multiple of the profits from a poorly executed PIE audit engagement rather spilling the penalty effect to affect the continuous survival of an audit practice.



3. No justification to align the level of penalty with other regulated businesses

Auditing is a unique professional services which requires, amongst other things, knowledge, skills, judgment and common sense. The inherent risks auditors are facing are different from other types of regulated businesses; likewise, the nature of the type of misconduct commonly alleged against an auditor (for example, failure to take necessary auditing procedures) is also different from other types of regulated business. The one-size-fit-all level of penalty lacks a conceptual framework.
