

立法會

Legislative Council

LC Paper No. CB(1)1209/18-19

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Paper for the House Committee meeting on 28 June 2019

Report of the Subcommittee on Financial Reporting Council (Amendment) Ordinance 2019 (Commencement) Notice

Purpose

This paper reports on the deliberations of the Subcommittee on Financial Reporting Council (Amendment) Ordinance 2019 (Commencement) Notice (L.N. 80) ("the Notice") made under the Financial Reporting Council (Amendment) Ordinance 2019 ("the Subcommittee").

Background

The Financial Reporting Council (Amendment) Ordinance 2019

2. The Financial Reporting Council (Amendment) Bill 2018 was passed by the Legislative Council ("the LegCo") on 30 January 2019 and published in the Gazette on 15 February 2019 as the Financial Reporting Council (Amendment) Ordinance 2019 ("FRCAO"), i.e. Ord. No. 3 of 2019. FRCAO amends the Financial Reporting Council Ordinance (Cap. 588) to, among others, enhance the independence of the regulatory regime for auditors of listed entities ("ALEs"); regulate ALEs through registration, recognition, inspection, investigation and disciplinary sanction; provide for a review and appeal mechanism regarding decisions made against ALEs; provide for the new composition and functions of the Financial Reporting Council ("FRC"); and provide for levies payable to FRC.

3. In accordance with section 1(2) of FRCAO, FRCAO will come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury ("SFST") by notice published in the Gazette.

The Notice

4. By the Notice, SFST appoints 1 October 2019 as the day on which FRCAO, except sections 62 and 85 (concerning payment and calculation of levies payable to FRC by specified parties), comes into operation. SFST also appoints 1 January 2022 as the day on which sections 62 and 85 of FRCAO come into operation.

5. According to paragraph 5 of the Administration's paper provided to the Subcommittee (LC Paper No. CB(1)1140/18-19(01)), the Financial Secretary announced in the 2019-2020 Budget¹ that he had decided to increase the amount of seed capital for FRC to \$400 million to help migrate to the new regime, and exempt the levies² payable to FRC for the first two years upon the implementation of the new regime.

The Subcommittee

6. At the House Committee meeting held on 24 May 2019, Members agreed to form a subcommittee to study the Notice. Under the Chairmanship of Hon WONG Ting-kwong, the Subcommittee has held one meeting with the Administration to examine the Notice. The membership list of the Subcommittee is in the **Appendix**.

7. To enable the Subcommittee to report to the House Committee and to allow sufficient time for giving notice of motion to amend the Notice, the Subcommittee agreed that the Chairman should move a motion to extend the scrutiny period of the Notice to the Council meeting of 10 July 2019. However, the motion could not be dealt with at the Council meeting of 19 June 2019 before the adjournment of the meeting. As such, the period for amending the Notice expired at the Council meeting of 19 June 2019.

¹ Please refer to paragraph 44 of the Speech by the Financial Secretary for moving the Second Reading of the Appropriation Bill 2019.

² FRC under the new regime will be funded by introducing three new levies on securities transactions, public interest entities ("PIEs") and PIE auditors respectively.

Deliberations of the Subcommittee

8. Subcommittee members have raised no objection to the Notice. In the course of deliberations, members have taken the opportunity to examine FRC's proposed guidelines on imposing sanctions,³ the use of auditing standards and reference cases in FRC's enforcement work, etc.

Guidelines on pecuniary penalty in sanctions

9. Under FRCAO, FRC may impose financial or non-financial sanctions on auditors of public interest entities ("PIE auditors") or registered responsible persons of a registered PIE auditor for misconduct committed by them. However, FRC must not impose a pecuniary penalty on a PIE auditor or a registered responsible person⁴ unless it has published, in the Gazette and in any other manner it considers appropriate, guidelines to indicate the way in which it exercises the power to impose the penalty and it has had regard to the guidelines so published in imposing such penalty.

10. Subcommittee members note that upon the request of the Bills Committee previously formed to study the Financial Reporting Council (Amendment) Bill 2018, the Administration had provided to the Bills Committee a set of principles that FRC will adhere to in exercising the power to impose a pecuniary penalty and in determining the level of penalty. Members note that these principles include the seriousness of the misconduct committed, whether the penalty is proportionate to the misconduct, whether the penalty may be an effective deterrent to future misconduct, financial resources of the practice unit or individual concerned, and whether the amount of pecuniary penalty would have the likely effect of putting the practice unit or an individual in financial jeopardy.⁵ The Administration has advised the Subcommittee that the

³ Please refer to Annex A and Annex B to LC Paper No. CB(1)1140/18-19(01) provided by the Administration to the Subcommittee for details.

⁴ Under the new sections 37D(3)(b)(iv) and 37E(3)(b)(iii) of Cap. 588, FRC may order a person who is or was an auditor of a PIE ("PIE auditor") or a registered responsible person of a registered PIE auditor and has committed a misconduct to pay a pecuniary penalty. The maximum pecuniary penalty is the greater of \$10 million, or three times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

⁵ See Annex B to LC Paper No. CB(1)771/17-18(02) issued on 6 April 2018.

current proposed sanctions guidelines presented to the Subcommittee⁶ have already included all of those principles.

Inspections, auditing standards and precedent cases

11. Mr Kenneth LEUNG has sought details on FRC's enforcement work, namely, how FRC will deal with irregularities/misconduct uncovered in the course of its inspections of PIE auditors; how FRC will determine whether an act amounts to a misconduct in cases where FRC's interpretation of the auditing/accounting standards on which the act is based differs from the relevant auditor's interpretation of professional auditing/accounting standards which are equally acceptable in the audit industry; and, when imposing sanctions, whether and to what extent FRC will make reference to, or be bound by, the decisions in the cases handled by FRC or the Hong Kong Institute of Certified Public Accountants ("HKICPA") in the past.

12. The Administration has advised that FRC's inspections over PIE auditors are primarily intended to monitor auditors' compliance with professional standards. Where improvements are required to safeguard or enhance audit quality, FRC will seek to agree an action plan with each firm inspected to achieve the improvements required. In situations where a breach of ethics is clearly identified, FRC will consider imposing disciplinary sanctions against a PIE auditor and/or a registered responsible person of a PIE auditor in accordance with FRCAO. During FRC's inspection process, FRC is able to seek advice from persons independent of FRC and with experience in PIE auditing. To ensure clarity and transparency in FRC's operation, FRC would consider whether to formulate guidelines setting out the thresholds and circumstances under which misconduct identified during inspection and/or investigation should be referred to the disciplinary department for follow-up.

13. As regards the differences in interpreting auditing/accounting standards, the Administration has advised that FRC is keenly aware that such differences do exist, and FRC will consult Honorary Advisors during an investigation and members of the Expert Panel during the disciplinary process on any technical accounting/auditing issue and will ensure that the current practice (including any diversity of practice) of the profession will be considered. Sanctions are determined on the basis of the finding of misconduct identified which is in turn based on the facts and circumstances of each particular case. In assessing the seriousness of the

⁶ Annex A and Annex B to LC Paper No. CB(1)1140/18-19(01).

misconduct, FRC will look into the failings that the misconduct has involved. FRC will also make reference to past decisions of its own and HKICPA where appropriate. FRC has 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.

Other issues

14. Considering that board directors and financial controllers of listed companies have an important duty to ensure the integrity and accuracy of the financial statements or reports of listed companies, Mr Kenneth LEUNG has enquired about the role of FRC, if any, in ensuring or promoting the fulfilment/performance of the duty by these executives of listed companies by way of, for example, educational programmes for them.

15. The Administration has advised that one of FRC's main functions is to investigate or enquire into, in response to a complaint or otherwise, "relevant irregularities" and "relevant non-compliances" in relation to listed entities. Any non-compliances relevant to the Listing Rules will be referred to the Securities and Futures Commission ("SFC") or the Hong Kong Exchanges and Clearing Limited ("HKEX") for necessary action. To this end, there are regular liaison meetings between FRC and SFC and HKEX which enable FRC to make such referrals to the latter two regulatory bodies where appropriate.

Recommendation

16. The Subcommittee has completed scrutiny of the Notice. Neither the Subcommittee nor the Administration will propose amendments to the Notice.

Advice sought

17. Members are invited to note the deliberations of the Subcommittee as set out above.

**Subcommittee on Financial Reporting Council (Amendment)
Ordinance 2019 (Commencement) Notice**

Membership list

Chairman	Hon WONG Ting-kwong, GBS, JP
Members	Hon CHAN Kin-por, GBS, JP
	Hon Charles Peter MOK, JP
	Hon Kenneth LEUNG
	Hon Christopher CHEUNG Wah-fung, SBS, JP
	Hon Holden CHOW Ho-ding
	Hon CHAN Chun-ying, JP
	Hon AU Nok-hin
	(Total : 8 members)
Clerk	Mr Derek LO
Legal Adviser	Miss Evelyn LEE