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By email (elee@legco.gov.hk)

30 August 2021

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 2021

I refer to your letter dated 11 August 2021 and email dated 27 August 2021 seeking clarification on the captioned Bill. The Administration's responses are set out in **Annex** for your information.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Billy AU', with a stylized flourish at the end.

(Billy AU)

for Secretary for Financial Services and the Treasury

c.c.
Clerk to Bills Committee
Department of Justice

(Attn: Ms Connie SZETO)
(Attn: Ms Sandy HUNG
Ms YM LAI
Mr Gary LI)

**Bills Committee on Financial Reporting Council (Amendment) Bill 2021
("the Bill")**

**The Administration's responses to questions raised in the Assistant Legal
Adviser's letter dated 11 August 2021 and email dated 27 August 2021**

**Regulatory reform for the accounting profession (Paragraph 1 of the list of
questions)**

Under the reform, the following powers which are currently vested with the Hong Kong Institute of Certified Public Accountants ("HKICPA") are proposed to be transferred to the Accounting and Financial Reporting Council ("AFRC")¹ –

- (i) Issue of practising certificates and registration
The AFRC will become the authority for the issue of practising certificates to qualified certified public accountants ("CPA") and registration of CPA firms, corporate practices and public interest entities ("PIE")² auditors. It will be empowered to, inter alia, process applications for practising certificates and registration, make decisions on whether to grant or refuse the applications and handle renewal applications.

- (ii) Inspection
The AFRC will be empowered to carry out inspections on practice units³ for the purpose of determining whether the practice units have observed, maintained or applied the statement of professional ethics or standard of accounting, auditing or assurance practices issued or specified by the HKICPA; and take follow-up actions in relation to the relevant practice units and related CPAs.

- (iii) Investigation and discipline
The AFRC will be empowered to carry out investigations into whether a practice unit or CPA has committed a professional irregularity and take follow-up actions, including imposing sanctions on the relevant

¹ The Financial Reporting Council is proposed to be renamed as AFRC under the Bill.

² A PIE refers to a corporation with issued shares or stocks listed in Hong Kong or a collective investment scheme with interests listed in Hong Kong.

³ According to clause 5(9) of the Bill, a practice unit is (a) a CPA (Practising) who practises accountancy on the accountant's own account under the accountant's own name; (b) a CPA firm; or (c) a corporate practice.

practice unit or CPA. These powers are currently exercised under the Professional Accountants Ordinance (Cap. 50) (“PAO”) through the HKICPA’s mechanisms of investigation committees and disciplinary committees.

2. Meanwhile, the HKICPA will continue to perform the functions related to CPA registration including the administration of qualification programme and conduct of examinations for ascertaining whether a person is qualified for registration, and the arrangements of mutual or reciprocal recognition of professional accountants with accounting bodies of overseas jurisdictions; as well as functions related to professional development including the setting of standards on professional ethics, and accounting, auditing and assurance, setting of continuing professional development (“CPD”) requirements, and provision of CPD training. The HKICPA’s performance of the aforementioned functions will be subject to the independent oversight by the AFRC.

3. In drawing up the reform proposal, we note that the international trend on accounting profession regulation is to vest the regulatory powers with a regulatory body independent from the trade to ensure impartiality. Major overseas jurisdictions have already given expanded power to their respective independent regulators which oversee the accounting profession to ensure that professional accounting services are duly regulated. Practice units and related CPAs in Australia and Singapore are subject to inspection, investigation and discipline by the respective local independent regulators namely the Securities and Investments Commission of Australia and the Accounting and Corporate Regulatory Authority of Singapore. In the United Kingdom, the independent regulator, namely Financial Reporting Council, is the ultimate authority that recognises accounting professional bodies and has regulated practice units and CPAs through the oversight on recognised professional bodies. A reform is underway in the United Kingdom to establish a new regulatory body to enhance independent regulation on the accounting profession. In the United States, the State Boards of Accountancy, which are independent regulators of the accounting profession, are also empowered to register CPAs and regulate the profession including conducting disciplinary proceedings.

Conformity with Article 142 of the Basic Law (“BL”) (Paragraphs 2 - 5 and 6(b) of the list of questions)

4. Regarding the question on whether, and if so how, the reform proposals as a whole, as well as the proposed new section 20AAL(4) in specific, are in conformity with BL 142(3), we are of the view that while BL 142(3) recognizes the professions and the professional organizations recognized prior to the establishment of the Hong Kong

Special Administrative Region and their professional functions, it does not rule out the need of the Government in introducing changes to the relevant regulatory system to meet changing developments. In the context of this proposed accounting regulatory reform, the AFRC will be empowered to be the authority to register CPA firms, corporate practices and PIE auditors and issue practising certificates to CPAs (as proposed under various provisions of the Bill) and thus have the discretion to dispense with certain requirements for the issue and renewal of practising certificates (as proposed under the new section 20AAL(4)). The HKICPA will continue to register CPAs and discharge a number of related functions including administering the professional examination, setting the examination papers as well as the passing criteria. The proposals will bring Hong Kong's regulatory system more in line with the latest global best practice, and at the same time continue to recognize the role and professional functions of the professional body. The reform proposals as a whole, as well as the proposed new section 20AAL(4) in specific, are therefore compatible with BL 142(3).

5. In order to facilitate the AFRC's regulatory work under the reformed new regime in relation to a variety of areas in accounting, audit and assurance and with reference to the arrangements for other financial regulators⁴, we propose to establish a statutory Advisory Committee consisting of practitioners, service users and other stakeholders of the accounting profession. When being consulted by the Financial Secretary on the appointment of members to the Advisory Committee, the AFRC would consider factors including but not limited to the background and experience of members to ensure diversity of expertise of the Advisory Committee relevant to the prevailing regulatory work focus of the AFRC. In order to allow flexibility for appointment of members from different background to cater for the regulatory focus and operational needs of the AFRC which will evolve in the future, we consider it reasonable that the composition of the Advisory Committee or the specific matters to be taken into account by the AFRC when being consulted on the appointment are not specified in the Bill.

Issue and renewal of practising certificate (Paragraphs 6(a), 7 and 8 of the list of questions)

6. In the transfer of power for issue of practising certificates to qualified CPAs from the HKICPA to the AFRC, while the AFRC, as an independent regulator, will be vested with the power to make decisions on applications, the HKICPA, as a professional accounting body and the authority of CPA registration, will be in a suitable position to help set the requirements related to experience and professional knowledge. In the

⁴ For instance, an Advisory Committee for the Securities and Futures Commission ("SFC") has been set up under section 7 of the Securities and Futures Ordinance (Cap. 571) ("SFO") to advise the SFC on matters of policy regarding any of its regulatory objectives and functions.

light of the AFRC's role as the ultimate authority for issue of practising certificates, the discretion to dispense with the relevant requirements, which is currently vested with the HKICPA Council (under section 29A(4) of the PAO) will be transferred to the AFRC for exercise as it sees fit.

7. In addition to the aforementioned requirements related to experience and professional knowledge of an applicant for practising certificate, section 30(2) of the PAO currently stipulates the requirement for the applicant to have the intention to practise as a CPA (Practising). Section 30(6) of the PAO further provides power for the HKICPA Council to cancel a practising certificate if the CPA fails to commence practice within six months from the date of issue of the practising certificate. Such requirement on intention to practise is proposed to be transferred to the Financial Reporting Council Ordinance (Cap. 588) ("FRCO") and the power to cancel practising certificate due to failure to practise within the same specified period to be vested with the AFRC. In practice, an applicant for practising certificate is currently required to provide the address of registered office in which he/she intends to practise and a copy of Business Registration Certificate is required to be produced to the HKICPA within six months from the date of issue of the practising certificate as evidence of his/her commencement of business. The AFRC will make reference to the current practice of the HKICPA when formulating its mechanism for ascertaining an applicant's intention and actual commencement of practice.

8. In transferring the power of renewal of practising certificates from the HKICPA to the AFRC, we propose to adopt the existing deadline (i.e. 15 December of the year in which the current practising certificate expires) for submission of renewal applications for practising certificate. In addition, to align with the existing renewal mechanism for registration of PIE auditors as provided in the FRCO which has been operating smoothly and to provide certainty to the renewal cycles, the deadline will be absolute and the AFRC will not be conferred with the discretion to allow an application to be made after the deadline. In any case, in view that the expiry date of practising certificates is on 31 December, the existing power of the HKICPA Council to allow renewal applications to be made after the deadline does not practically provide substantial leeway for applicants making renewal applications after 15 December. We consider it more appropriate for the AFRC to provide sufficient guidance and assistance to holders of practising certificates for making renewal applications by the said deadline.

Cancellation or suspension of practising certificate (Paragraph 9 of the list of questions)

9. The grounds for revocation or suspension of registration of PIE auditors and

registered responsible persons of PIE auditors who have been found by a court to be mentally incapacitated as currently provided under the FRCO was introduced in the Financial Reporting Council (Amendment) Bill 2018 with consideration of the high public interest involved in PIE engagements and thus the need to provide safeguard specifically for the PIEs and the investing public. The PAO currently does not provide powers for the HKICPA Council to revoke or suspend the registration of a CPA or cancel the practising certificate of a CPA(P) on the said grounds. Therefore, such power will not be vested with the AFRC after the reform either.

Matters which may be considered as professional misconduct (Paragraph 10 of the list of questions)

10. There is currently no definition of “professional misconduct” in the PAO in respect of regulation of practice units and CPAs, as well as in the FRCO in respect of regulation of PIE auditors, and thus the term will not be defined in the Bill to avoid the chances of inadvertently limiting the existing scope of the misconduct. The AFRC will take into account the practical experience and endorsed precedents of the HKICPA in its regulatory functions as well as engage with the profession when devising guidelines for exercise of its investigation and disciplinary powers in relation to professional misconduct for practice units and CPAs.

Guidelines to be issued by AFRC (Paragraph 11 of the list of questions)

11. The AFRC will start formulating guidelines for the exercise of its sanctioning powers to impose pecuniary penalties after the passage of the Bill for subsequent implementation upon commencement of the reformed regime. The AFRC will engage stakeholders including but not limited to accounting professionals and practices during the process before finalisation and gazettal. With reference to the similar guidelines published for PIE auditors in 2019, the guidelines to be promulgated for practice units and CPAs are expected to cover, inter alia, factors to be considered when determining whether a pecuniary penalty is appropriate, and factors to be considered when determining the amount of a pecuniary penalty. In the light of the positive experience of the formulation of the guidelines for PIE auditors in 2019, we consider it not necessary to specify the matters to be covered in the guidelines to allow flexibility for adjustments in response to stakeholders’ views and operational needs of the AFRC.

Avoidance of conflict of interests (Paragraph 12 of the list of questions)

12. The existing section 53 of the FRCO puts in place a system to ensure that members or employees of Financial Reporting Council, or any person performing a

function under the FRCO, are not involved in any conflict of interests. In view that the Council is at present empowered to take regulatory actions in relation to PIE auditors only, an exhaustive list of circumstances constituting conflict of interests (i.e. mainly interests in relation to listed entities) is specified in section 53 with reference to section 379 of the SFO.

13. Under the proposed reform, the scope of AFRC's regulatory work will expand significantly to cover all types of accounting and audit engagements carried out by practice units and CPAs. In the light of the much wider types of potential interests which a person may have in all these engagements, we consider it appropriate to adopt the Insurance Authority's system as stipulated in section 5 of Schedule 1B to the Insurance Ordinance (Cap. 41) where the governing board may determine, inter alia, the class or description of interests required to be disclosed. We note that criminal offence for non-compliance is not appropriate for such a system as an exhaustive list of circumstances constituting conflict of interests is not provided. To ensure effective implementation of the system and accountability of the AFRC, particulars of disclosure of interests will be required to be recorded for public inspection.

Power to make regulations (Paragraph 13 of the list of questions)

14. The principle of proportionality has been adopted in the formulation of the reform proposal. In the light of the significant public interest involved in PIE engagements, a higher level of regulatory control needs to be exercised over PIE auditors and thus the Financial Reporting Council is currently empowered under section 60B of the FRCO to make regulations providing for matters related to the regulation of PIE auditors, contravention with which constitutes criminal offence punishable by fine and imprisonment. Whereas, under the Bill, the AFRC will regulate practice units and CPAs who do not carry out PIE engagements through other available means such as promulgation of guidelines or administrative documents.

Consequential and related amendments (Paragraphs 14 to 15 of the list of questions)

15. One of the aims of this reform exercise is to rationalise the roles of the AFRC and the HKICPA by transferring all major regulatory functions to the AFRC for independent regulation while retaining functions in relation to professional development with the HKICPA. With consideration that the functions of investigation and discipline, which are for deterrent of dishonourable conduct, will be transferred to the AFRC, the HKICPA's object to discourage dishonourable conduct and practices and hold inquiries into the conduct of practice units and CPAs for this purpose which is

currently provided under section 7(h) of the PAO should be removed.

16. With regard to Professional Accountants By-laws 28, 29 and 29A, while they are not directly transplanted to the FRCO, more appropriate and flexible alternative arrangements will be put in place under the reformed new regime. For instance, By-laws 28 and 29 currently provide the HKICPA Council with the power to approve, inter alia, the practice with certain persons or under certain names, which would otherwise be regarded as professional misconduct. Under the new regime, as mentioned in paragraph 10 above, the AFRC will promulgate guidelines for its disciplinary function, including the circumstances constituting professional misconduct. The AFRC can make reference to the said By-laws to consider its guidelines to grant approval to exceptional cases where appropriate. As regards By-Law 29A under which the HKICPA Council currently can permit the practice of a CPA (Practising) in the name or style in which a deceased CPA (Practising) was lawfully practising prior to his death, the proposed new section 20AAZH of the FRCO provides that the registration of a firm name under which a CPA (Practising) practises accountancy on the accountant's own account must be revoked if the accountant dies. Hence, in the case where such a CPA (Practising) is deceased and thus the registration of the relevant firm name is revoked, any other CPA (Practising) may apply for registration of the same firm name under a fresh application for the AFRC's consideration.

Financial Services and the Treasury Bureau
30 August 2021