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Paper for the House Committee

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

Purpose

This paper reports on the deliberations of the Bills Committee on Financial Reporting Council (Amendment) Bill 2021 ("the Bills Committee").

Background

2. The Financial Reporting Council Ordinance (Cap. 588) ("FRCO") was enacted in 2006 to establish the Financial Reporting Council ("FRC") as an independent investigatory body of auditing and reporting irregularities in relation to listed entities. FRC became fully operational in July 2007. While FRC might initiate investigations on possible auditing irregularities related to listed entities, as well as conduct enquiries on possible non-compliance with the financial reporting requirements by listed entities, it was not empowered to discipline. All other regulatory powers with respect to the audit profession were vested with the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is a statutory professional body established under the Professional Accountants Ordinance (Cap. 50) ("PAO"). FRC would refer relevant cases to other parties for follow-up as necessary after performing its investigation/enquiry function.¹

¹ Any auditing or reporting irregularities identified by the Financial Reporting Council ("FRC") would be referred to the Hong Kong Institute of Certified Public Accountants ("HKICPA"), while 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 for necessary action.

3. In light of the international trend for regulatory regimes for auditors of public interest entities ("PIEs")² to be independent of the audit profession and be subject to independent oversight by bodies acting in the public interest, the Financial Reporting Council (Amendment) Ordinance 2019 ("the Amendment Ordinance 2019") was enacted in 2019 to establish a new regulatory regime for auditors of PIEs ("the regulatory regime for PIE auditors") by transferring HKICPA's regulatory powers in respect of PIE auditors to FRC. Under the regime, FRC is responsible for the inspection, investigation and discipline of PIE auditors and registered responsible persons of the PIE auditors, as well as recognition of PIE auditors from overseas. Practice units³ and certified public accountants ("CPAs") in general continue to be regulated under PAO except for their engagements under the PIE auditor regulatory regime as specified in FRCO. FRC also has powers to oversee the performance of HKICPA's functions of (a) registration of local PIE auditors; (b) establishing and maintaining the PIE auditors register; and (c) setting continuing professional development ("CPD") requirements, standards on professional ethics, as well as auditing and assurance practices for registered local PIE auditors. The Amendment Ordinance 2019 also provides for the new composition of FRC,⁴ an appeal mechanism regarding decisions made in relation to PIE auditors, and levies payable to FRC.⁵

² Public interest entities ("PIEs"), as defined in section 3 of the Financial Reporting Council Ordinance ("FRCO"), are listed corporations (equities) or listed collective investment schemes.

³ Only practice units may perform statutory audits. As defined in section 2 of the Professional Accountants Ordinance (Cap. 50) ("PAO"), a practice unit means (a) a certified public accountant ("CPA") (practising) practising accountancy on his own account; (b) a firm of CPAs (practising) practising accountancy; or (c) a corporate practice.

⁴ Section 7 of FRCO stipulates that FRC is to consist of: (a) a chairperson, who is a non-executive director of FRC; (b) a chief executive officer, who is an executive director of FRC; and (c) at least seven other members, who are either executive or non-executive directors of FRC. The section also provides that:

- (a) all members of FRC must be non-practitioners and the number of non-executive directors of FRC must exceed the number of executive directors; and
- (b) at least one-third of the members of FRC must be appointed from among persons who appear to the Chief Executive to be suitable for appointment, because of their knowledge and experience in PIE engagements.

⁵ A new funding model is introduced under the regulatory regime for PIE auditors. FRC is funded by three new levies on (a) securities transactions (to be paid by sellers and purchasers in securities transactions); (b) PIEs; and (c) PIE auditors. To facilitate FRC's transition to the PIE auditor regulatory regime, the Government provided a seed capital of \$400 million to FRC in 2019 to help it migrate to the regime and exempt the levies for the first two years upon the implementation of the regime. FRC will start collecting levies from 1 January 2022.

The Bill

4. According to the Administration, the international trend on accounting profession regulation is to vest the regulatory powers with a regulatory body independent from the trade to ensure impartiality. The Administration has proposed to further reform FRC to develop it into a full-fledged independent regulatory and oversight body for the accounting profession ("the proposed reform").

5. To take forward the proposed reform, the Administration has introduced the Financial Reporting Council (Amendment) Bill 2021 ("the Bill"), which received its First Reading at the Legislative Council ("LegCo") meeting of 21 July 2021. In gist, the Bill amends FRCO, PAO and the Professional Accountants By-laws (Cap. 50A) to implement the proposed reform by:

- (a) empowering FRC to issue practising certificates to CPAs and register CPA firms, corporate practices and local PIE auditors;⁶
- (b) expanding FRC's current powers of inspection, investigation and discipline over PIE auditors to cover practice units and CPAs, and renaming FRC as the Accounting and Financial Reporting Council ("AFRC") in light of the expanded scope of regulation beyond PIE auditors; and
- (c) expanding FRC's oversight powers to cover HKICPA's functions of (i) ascertaining qualification for registration as CPAs by conducting examinations; (ii) registering CPAs; (iii) arranging for mutual or reciprocal recognition of accountants; (iv) setting CPD requirements, and issuing or specifying standards on professional ethics, and accounting, auditing and assurance, for CPAs; and (v) providing training for qualifying as CPAs and for CPD of CPAs.

The main provisions of the Bill are set out in **Appendix I**.

The Bills Committee

6. At the meeting of the House Committee held on 23 July 2021, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix II**. Under the chairmanship of Mr CHEUNG Kwok-kwan, the Bills Committee has held four meetings to study the Bill with the Administration. The Bills Committee has also received 16 written

⁶ FRC will be responsible for issuing practising certificates to qualified CPAs while HKICPA will continue to be responsible for registration of CPAs subject to FRC's oversight.

submissions, and a list of the organizations/parties which have provided the submissions is in **Appendix III**.

Deliberations of the Bills Committee

7. Members of the Bills Committee in general support the Bill. The main subjects deliberated by the Bills Committee are set out below:

- (a) need for introducing the proposed reform (paragraphs 8 – 10);
- (b) conformity of the proposed reform with Article 142 of the Basic Law (paragraphs 11 – 12);
- (c) establishment of a new statutory advisory committee (paragraphs 13 – 14);
- (d) issue and renewal of practising certificate (paragraphs 15 – 18);
- (e) imposition of pecuniary penalties by AFRC (paragraphs 19 – 22);
- (f) development of the accounting profession (paragraphs 23 – 29);
- (g) funding mechanism of AFRC (paragraphs 30 – 32); and
- (h) transitional arrangements and implementation details for the proposed reform (paragraphs 33 – 35).

Need for introducing the proposed reform

8. The Bills Committee has requested the Administration to elaborate on the benefits of the proposed reform including how it will make the existing regulatory regime of the accounting profession more in line with the relevant international standards and practices, and reduce compliance burden of the profession.

9. The Administration has pointed out 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. For example, 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 ("UK"), the

independent regulator, namely the UK Financial Reporting Council, is the ultimate authority that recognizes accounting professional bodies and has regulated practice units and CPAs through the oversight on recognized professional bodies. A reform is underway in UK 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. The proposed reform will make the Hong Kong regulatory regime of the accounting profession more in line with the relevant international standards and practices and reinforce Hong Kong's status as an international financial centre and business hub.

10. As regards the benefit of the proposed reform in reducing the compliance burden of the accounting profession, the Administration has explained that as under the PIE auditor regulatory regime, practice units and CPAs in general continue to be regulated under PAO except for their PIE engagements, individual practice units and CPAs are subject to separate inspections by FRC and HKICPA in accordance with FRCO and PAO respectively for their quality control systems which are applicable for both PIE engagements and all other engagements. The arrangement has led to inefficient use of resources and unnecessary compliance burden. Moreover, while FRC has assumed regulatory functions over local PIE auditors, HKICPA is still responsible for the registration of such auditors which results in a fragmented approach in regulation. The proposed reform will therefore reduce compliance burden of the profession and enhance FRC's efficiency in regulation.

Conformity of the proposed reform with Article 142 of the Basic Law

11. The Bills Committee notes that Article 142(3) of the Basic Law ("BL") provides, among others, that the Hong Kong Special Administrative Region ("HKSAR") Government shall continue to recognize the professional organizations recognized prior to the establishment of the Region, and these organizations may, on their own, assess and confer professional qualifications. Given that the Bill seeks to, among others, transfer HKICPA's functions in respect of issuing practising certificate and regulating the accounting profession through inspection, investigation, taking disciplinary actions and imposing sanctions to FRC, some members of the Bills Committee have expressed concern about whether the proposed reform is in conformity with BL 142(3). These members, in particular note that when considering the issue and renewal of practicing certificates, AFRC may dispense with HKICPA's requirement for applicants to sit examinations in ascertaining whether they possess the necessary local experience and knowledge (the proposed new section 20AAL(1)(b) and (3), and (4) of FRCO).

12. The Administration has responded that the proposed reform, as a whole, is in conformity with BL 142(3). While BL 142(3) recognizes the professions and the professional organizations recognized prior to the establishment of HKSAR and their professional functions, it does not rule out the need of the Government in introducing changes to the relevant regulatory system(s) to meet changing developments. In the context of the proposed reform, AFRC will be empowered to be the authority to register CPA firms, corporate practices and PIE auditors and issue practising certificates to CPAs, 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)). HKICPA will continue to register CPAs and discharge a number of related functions including administration of the qualification programme, conducting professional examination, as well as setting the examination papers and the passing criteria. The proposed reform continues to recognize the role and professional functions of the professional body, and is compatible with BL 142(3). In response to the Bill Committee's enquiry as whether AFRC would consult HKICPA and take its views into account before dispensing any requirement pursuant to the proposed section 20AAL(4), the Administration has responded that AFRC would make the relevant decision based on the facts of each case.

Establishment of a new statutory advisory committee

13. The proposed new section 10A of FRCO provides for the establishment of an advisory committee to advise AFRC on its policy for achieving its regulatory objectives and functions ("Advisory Committee"). The Bills Committee has enquired about the composition and appointment of members to the Advisory Committee, and how these matters are reflected in the Bill. Members further note the views of some deputations that the Advisory Committee should represent a diversified user group of accounting and auditing services (including the director community), as well as professional bodies.

14. The Administration has responded that in order to facilitate AFRC's regulatory work under the new regime in relation to a variety of areas in accounting, audit and assurance and with reference to the arrangements of other financial regulators,⁷ the Advisory Committee will consist of practitioners, service users and other stakeholders of the accounting profession. Section 13A(1)(d) of the proposed new Part 4A of Schedule 2 to FRCO provides that the Advisory Committee is to be consisted of at least eight but not more than 12 other persons as appointed by the Financial Secretary ("FS") after consulting

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

AFRC.⁸ The Administration has pointed out that when being consulted by FS on the appointment of members to the Advisory Committee, AFRC would consider factors including but not limited to the background and experience of such persons to ensure diversity of expertise of the Advisory Committee relevant to AFRC's prevailing regulatory work focus. With a view to providing flexibility for the appointment of members from different background to cater for the regulatory focus and operational needs of AFRC which will evolve in the future, it is considered appropriate not to specify in the Bill the details on the composition of the Advisory Committee or the specific matters to be taken into account by AFRC when being consulted on the appointment of Advisory Committee members.

Issue and renewal of practising certificate

15. The proposed new sections 20AAB(2) and 20AAG(2) of FRCO respectively provide that AFRC must not grant a practising certificate application or a renewal application unless the requirements under the proposed new section 20AAL are met. Such requirements include that the applicant is a registered CPA, has approved accounting experience, local experience and knowledge of local law, as well as has complied with CPD requirements set by HKICPA. The Bills Committee has enquired about the factors AFRC will consider in granting or renewing a practising certificate application, and the reasons for not specifying in the Bill the requirement that the applicant must be a "fit and proper" person.

16. The Administration has advised that the existing section 24(1)(b) of PAO requires that the applicant has to be a "fit and proper" person when applying to be registered as a CPA. HKICPA will make the assessment which will also form the basis for the annual renewal of CPA registration and application for practising certificate of CPAs.⁹ However, PAO does not contain additional express provisions on the "fit and proper" requirement regarding the renewal of CPA registration and the application for practising certificate. Meeting the "fit-and-proper test" is a basic requirement for CPAs and the requirement must be observed at all time. Therefore, though the existing legislation does not contain express provisions on the "fit and proper" requirement for renewal of CPA registration and application for practising certificate, investigation and disciplinary proceedings may be initiated against individual CPAs including CPAs (Practising) if their

⁸ Besides the members to be appointed by the Financial Secretary, members of the Advisory Committee also include the chairperson, chief executive officer and not more than two executive directors of the Accounting and Financial Reporting Council ("AFRC") (section 13A(1)(a) to (c) of the proposed new Part 4A of Schedule 2 to FRCO).

⁹ At present, for the renewal of CPA registration and the application and renewal of practising certificates, applicants are subject to continuing professional development requirements in addition to meeting the "fit and proper" requirement.

fitness and properness is in doubt. Having regard to the importance of "fit and proper" requirement on CPAs and CPAs (Practising), as well as the actual regulatory practices, the Administration will introduce amendments in the proposed new section 20AAL(1) of FRCO to expressly provide for the "fit and proper" requirement for the issue and renewal of practising certificate. For completeness, similar amendments will be made for the relevant provisions on renewal of CPA registration under PAO.

17. The Bills Committee notes that the proposed new sections 20AAB(3) and 20AAG(3) of FRCO respectively provide that AFRC may grant or renew a practicing certificate application subject to the condition that the applicant must comply with the additional CPD requirements set by HKICPA. Some members have enquired about AFRC's role, if any, in setting additional CPD requirements when processing the application for the issue and renewal of practising certificate.

18. On the CPD requirements for the issue and renewal of practising certificate, the Administration has explained that as HKICPA will continue to be vested with the duties of setting the general CPD requirements for the accounting profession, the Bill has proposed to retain HKICPA's power to set additional CPD requirements for individual applications of practising certificate if necessary. After considering the views of Bills Committee members and some stakeholders, the Administration agrees that it is reasonable for AFRC, as the ultimate authority for the issue and renewal of practising certificates, to have the power to set additional CPD requirements when processing individual applications. Hence, the Administration will move amendments to the proposed new sections 20AAB(3) and 20AAG(3) of FRCO to replace HKICPA with ARFC as the authority for setting additional CPD requirements for application of the issue and renewal of practicing certificate.

Imposition of pecuniary penalties by the Accounting and Financial Reporting Council

19. The Bills Committee has enquired how AFRC will exercise its sanctioning power on misconduct committed by CPAs and practice units, in particular when imposing pecuniary penalties. Some members further note the concern expressed by some deputations that the proposed maximum pecuniary penalty of \$500,000 for CPA misconduct (the proposed new section 37CA(2)(b) of FRCO which is to be transferred from PAO) may be increased shortly after implementation of the new regime.

20. The Administration has stressed that the proportionality approach will be adopted for AFRC's regulatory work in future. FRC has applied a higher level of regulatory control to PIE auditors where significant interests of public investors

are involved.¹⁰ For other practice units and CPAs, the consequences of non-compliance with regulatory requirements to be adopted by AFRC will remain comparable to those currently provided in PAO. The types and levels of penalties¹¹ for CPA misconduct provided in the Bill largely follow those currently provided in PAO with which the profession is familiar. There is currently no plan to revise the proposed maximum level of pecuniary penalty of \$500,000. If needs arise for review of the level in future, the profession and relevant stakeholders will be consulted.

21. The Bills Committee notes that the proposed amended section 37H of FRCO provides, among others, that AFRC must not impose a pecuniary penalty under the proposed section 37CA(2)(b) for any CPA misconduct unless AFRC has had regard to the guideline(s) published in the Gazette (which are not subsidiary legislation) indicating the way in which AFRC exercises its power to impose the penalty. Members have enquired whether the matters that may be included in such guidelines are specified in the Bill, and how AFRC will formulate the guidelines. Some members have suggested that the Bill should explicitly provide for the requirement of AFRC to consult relevant parties when formulating the guideline under section 37H.

22. The Administration has responded that AFRC will start formulating guidelines for the exercise of its sanctioning power (including the imposition of pecuniary penalties) after the passage of the Bill, and will engage stakeholders including but not limited to accounting professionals and practices during the process. With reference to the similar guidelines on imposition of pecuniary penalties published for PIE auditors in 2019, the guidelines to be promulgated by AFRC 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 the penalty. In light of the experience of the formulation of the guidelines for PIE auditors in 2019, the Administration is of the view that it is not necessary to specify in the Bill the matters to be covered in the guidelines in order to provide flexibility for adjustment in response to views of the profession and stakeholders, operational needs and regulatory experience of AFRC, as well as market conditions. This arrangement aligns with that of other financial regulators, including the Securities and Futures Commission and the Insurance Authority. A regulatee who is dissatisfied with AFRC's decision to impose pecuniary penalties under the

¹⁰ The current level of maximum pecuniary penalty for misconduct committed by PIE auditors is \$10,000,000, or 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct, whichever is the greater (section 37D(3)(b)(iv) of FRCO).

¹¹ They include the removal of a name from the register, the cancellation of a practising certificate, the issue of a reprimand, the issue of an order to pay a penalty not exceeding \$500,000, etc.

disciplinary proceedings may also apply for a review of the decision by the statutory Accounting and Financial Reporting Review Tribunal.

Development of the accounting profession

Function of the Accounting and Financial Reporting Council in promoting the development of the accounting profession

23. The Bills Committee considers that besides taking over the regulation of practice units and CPAs, AFRC should be entrusted with the duty to promote the development of the accounting profession, and such duty should be explicitly stated in the proposed amended section 9 of FRCO regarding its functions.

24. The Administration has explained that when discharging its independent regulatory functions under the new regime, AFRC will at the same time play the role of promoting the development of the profession through effective regulation. Upon the expansion of FRC's functions, its influence over the development of the accounting profession will be enhanced. Nonetheless having considered the Bills Committee's views, the Administration will introduce amendments to the proposed amended section 9 of FRCO to clearly specify AFRC's function to promote and support the development of the accounting profession.

Role of the Accounting and Financial Reporting Council in pursuing development opportunities and providing continuing professional development training for the accounting profession

25. Some members of the Bills Committee are of the view that AFRC should enhance the development opportunities for the accounting profession in the Mainland and overseas in collaboration with the Government, and play a role in the CPD training of CPAs.

26. The Administration has assured the Bills Committee that it will explore with AFRC ways to step up the latter's work in areas such as nurturing more professionals, strengthening CPD, enhancing access to information on professional business opportunities, and reinforcing professional standards and competitiveness, so as to support the future development of the accounting profession. On the development opportunities in the Mainland, the Administration has been discussing with the relevant Mainland authorities through various channels on introducing measures to facilitate the accounting professionals in Hong Kong to pursue development opportunities in the Mainland. Under the framework of the Agreement on Trade in Services of the Mainland and Hong Kong Closer Economic Partnership Arrangement, Hong Kong accountants qualified as Chinese CPAs have been granted national treatment in respect of the requirements for becoming partners of partnership accounting firms in the Mainland. The Administration will continue to work at the government level for

further measures to facilitate the accounting professionals in Hong Kong to pursue development opportunities in the Mainland, and facilitate them in working and expanding services in the Guangdong-Hong Kong-Macao Greater Bay Area ("Greater Bay Area") in particular. Besides, the Advisory Committee will consist of practitioners, service users and other stakeholders of the accounting profession to provide advice to AFRC in these areas. The Administration will also join hands with AFRC and professional accounting bodies in exploring how to enhance training of professionals to tie in with the future development of the profession in Hong Kong, the Mainland and overseas countries.

27. As regards AFRC's role in CPD training, the Administration has responded that at present, HKICPA plays a key role not only in setting CPD requirements and providing CPD training to CPAs, but also in assessing the relevance and quality of CPD content provided by other institutions through the CPD audit process, and in verifying the appropriate hours of CPD undertaken by CPAs. The proposed new oversight power of AFRC over HKICPA on CPD is intended to cover HKICPA's role in these respects, and will facilitate AFRC in working jointly with HKICPA and relevant stakeholders for developing quality CPD programmes that reflect the regulatory objectives and the need of the profession.

Prohibited descriptions on certified public accountants and practice units

28. The existing PAO prohibits an individual or a company from using certain descriptions in an attempt to mislead the public into believing that the individual or company is a CPA or a practice unit registered under PAO. Some members have urged AFRC to step up work in prohibiting misleading descriptions to enhance protection for the interests of service users and assist the profession in combating the situation of bogus accountants.

29. The Administration has responded that while it recognizes the profession's concern over the use of certain misleading descriptions, different stakeholders have expressed concerns about the prohibition provisions, in particular about the need to strike a balance between prohibiting the use of misleading descriptions and allowing room for development for general businesses such as book-keeping and tax services. The Administration is prepared to discuss with the accounting regulatory and professional bodies to explore how public protection against misleading descriptions can be enhanced. Given that the matters involved are complicated and controversial, it will be important for the Administration to fully consider the views of various stakeholders including the accounting profession, relevant service providers and service users in examining ways to improve the situation including whether and how to amend the relevant provisions. The Administration will brief the Panel on Financial Affairs ("FA Panel") on the progress of the work next year. The Bills Committee welcomes the Administration's undertaking in this regard.

Funding mechanism of the Accounting and Financial Reporting Council

30. The Bills Committee notes that FRCO has provided for a levy mechanism (i.e. the collection of levies from PIE auditors, PIEs and sellers and purchasers of securities) for funding FRC's functions under the PIE auditor regulatory regime. As the functions of AFRC will include regulating practice units and CPAs who do not conduct PIE engagements, some members have questioned whether it is fair and reasonable to fund AFRC's operation through levies from PIEs and securities transactions. Furthermore, the Bills Committee also notes that the accounting profession has expressed concern about a possible surge in AFRC's fees for the issue of practising certificate for CPA and registration of firms and corporate practices. These members consider that the Administration should provide undertakings that (a) AFRC will maintain HKICPA's current level of fees in respect of the above mentioned functions for a certain period of time after implementation of the proposed reform, and (b) the Administration will inject additional seed capital into FRC to help it migrate to the new regime.

31. The Administration has advised that the Government injected a seed capital of \$400 million into FRC in 2019 to help it migrate to the PIE regulatory regime and exempt the levies for the first two years which will only be collected starting from 1 January 2022. The Administration has stressed that the levies arrangement and rate will not be affected by the proposed reform. Upon full implementation of the proposed reform, AFRC will be responsible for the issue of practising certificate and the registration of firms and corporate practices of the accounting profession, and will also collect the relevant application fees in place of HKICPA. The Administration is pursuing the exemption of the aforementioned application fees in the first year of implementation of the proposed reform. For the application fees to be collected thereafter, the Administration plans to freeze the fees for the first few years of implementation at a level no higher than that which is currently collected by HKICPA, so as to assist the accounting profession to adapt to the new regime. In the initial stage of discharge of expanded functions by AFRC, the deficit resulted from the exemption and freeze on the application fees will be met by the unspent balance of the \$400 million seed capital provided by the Government. The Administration will review AFRC's assessment of its operational and resources requirements under the new regime, and propose the specific timing for start collecting as well as the level of the relevant application fees by way of subsidiary legislation for LegCo scrutiny in the next legislative session. The Administration will also attend to the financial position of AFRC and consider different measures as and when necessary, including injection of additional funding, to ensure AFRC's financial competence for the implementation of its various tasks.

32. As regards views on possible cross-subsidization between AFRC's levy income and its expenditure for the regulation of non-PIE auditors, the Administration has stressed that the income and expenditure for AFRC's regulatory work in respect of PIE auditors and other practice units and CPAs will be planned on the "user-pay" principle to avoid unreasonable cross-subsidization. This will be suitably reflected in AFRC's annual budgets which are required to be submitted to FS for approval in accordance with FRCO. AFRC and the Administration will also brief FA Panel on the key points of the budgets. The Administration will ensure that AFRC continues to exercise stringent cost control and utilize its resources in an effective manner under the new regime.

Transitional arrangements and implementation details for the proposed reform

33. The Bills Committee has enquired about the timetable for commencing the new regime and transitional arrangements for the transfer of regulatory powers from HKICPA to FRC.

34. The Administration has advised that it is preparing the subsidiary legislation to provide for the transitional arrangements (including those for handling ongoing cases) and other technical details of the new regime. Subject to the passage of the Bill by LegCo within the current legislative session, the plan is to table the subsidiary legislation for negative vetting by LegCo in 2022 as soon as possible. Meanwhile, FRC will develop guidelines and other administrative documents in relation to its expanded powers over practice units and CPAs, and develop a cooperation mechanism with HKICPA. The new regime will commence when all such preparatory work is satisfactorily completed.

35. For the new registration function to be taken up by AFRC, the proposed transitional arrangements are that all applications approved by HKICPA before the commencement of the new regime will remain valid. In case there are any outstanding applications the processing of which has not been completed on the commencement date, they will be transferred to AFRC for processing. For the practice review, investigation and disciplinary functions, any proceedings carried out under PAO which have not been completed on the commencement date of the new regime will continue to be conducted under the PAO mechanism. The result of a practice review or investigation conducted in accordance with PAO mechanism under the transitional arrangement will then be referred to AFRC for follow-up action. Any new cases that come up after the commencement of the new regime, irrespective of whether the engagements which are the subjects of these cases were conducted before the commencement, will be handled by AFRC. In other words, AFRC will also take up new cases of the inspection and disciplinary work for PIE engagements completed before the commencement of the regulatory regime for PIE auditors on 1 October 2019.

Amendments to the Bill

36. Besides the proposed amendments explained in paragraphs 16, 18 and 24 above, in light of comments made by the Bills Committee, the legal adviser to the Bills Committee and stakeholders, the Administration will introduce other amendments to the Bill which are mostly textual, technical or consequential in nature.¹² The draft amendments to be moved by the Administration and received by the Bills Committee on 6 October 2021 are in **Appendix IV**. The Bills Committee will not propose amendments to the Bill.

Resumption of Second Reading debate

37. The Bills Committee has no objection to the Administration's giving notice to resume the Second Reading debate on the Bill at the Council meeting of 20 October 2021.

Advice sought

38. The Chairman of the Bills Committee made a verbal report on the deliberations of the Bills Committee at the meeting of the House Committee on 24 September 2021. Members are invited to note this written report.

Council Business Division 1
Legislative Council Secretariat
7 October 2021

¹² The Legal Adviser to the Bills Committee has invited the Administration to consider providing in the Bill, among others, the meaning of "conduct unbecoming of a professional person" and the "fit and proper requirement" under the respective new sections 10AA(3)(a) and 20AAL(1)(h) in FRCO. The Administration has explained, among others, that the two terms are not defined in PAO. The meaning of "conduct unbecoming of a professional person" is not defined in the Bill in order to avoid any inadvertent limitation on the existing scope of such conduct. AFRC will take into account HKICPA's practical experience and endorsed precedents, as well as engage with the profession in developing the relevant guidelines on such conducts. As for the fit and proper requirement, AFRC will refer to HKICPA's existing mechanism and relevant guidelines when assessing whether the requirement has been satisfied. Hence, the Administration considers it unnecessary to provide for the meaning of the two terms in the Bill. Separately, the Administration has confirmed that the change in the Chinese rendition from "出示" to "交出" in the proposed new section 10AA(2)(a)(i), (b)(i), (c)(i) and (d)(i) meets the policy intent so that a professional person may be asked to give a requisite document to AFRC for its further action.

The main provisions of the Financial Reporting Council (Amendment) Bill 2021

According to the Administration, the Bill is divided into three parts as follows:

- (a) Part 1 sets out preliminary provisions such as the short title and provides for the commencement of the Bill;
- (b) Part 2 contains amendments to the Financial Reporting Council Ordinance (Cap. 588) ("FRCO"). The main provisions of this Part are set out as follows –
 - (i) Clause 5 provides for the new and revised definitions of key terms and subjects all registration and disciplinary decisions made by the Financial Reporting Council ("FRC") to the review and appeal mechanism;
 - (ii) Clauses 12 and 13 amend FRCO to provide for the new functions and powers of FRC under the new regime;
 - (iii) Clause 14 introduces a new provision in FRCO for the set-up of an advisory committee under FRC to provide advice to FRC;
 - (iv) Clause 19 introduces new provisions in FRCO for the direct powers of FRC to issue practising certificates and register CPA firms and corporate practices;
 - (v) Clauses 20 to 41 amend FRCO to provide for the direct powers of FRC to register PIE auditors;
 - (vi) Clause 42 introduces new provisions in FRCO to provide for the powers of FRC to conduct recurring inspections on practice units and carry out investigations on practice units and CPAs;
 - (vii) Clause 64 introduces new provisions in FRCO to provide for the powers of FRC to impose disciplinary sanctions against practice units and CPAs;

- (viii) Clause 98 introduces a new provision to provide for the power of making transitional arrangements and consequential amendments to other enactments by way of subsidiary legislation; and
- (c) Part 3 contains related and consequential amendments to the Professional Accountants Ordinance (Cap. 50) and the Professional Accountants By-laws (Chapter 50 Sub. Leg. A).

(Source : Extracted from paragraph 26 of the Legislative Council Brief (File Ref.: ACCT/2/1/2C))

Bills Committee on Financial Reporting Council (Amendment) Bill 2021

Membership list *

Chairman

Hon CHEUNG Kwok-kwan, JP

Members

Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon Mrs Regina IP LAU Suk-yee, GBM, GBS, JP
Hon Paul TSE Wai-chun, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon Holden CHOW Ho-ding
Hon CHAN Chun-ying, JP
Hon Tony TSE Wai-chuen, BBS, JP

(Total : 9 members)

Clerk

Ms Connie SZETO

Legal Adviser

Miss Evelyn LEE

* Changes in membership are shown in **Annex to Appendix II**

Bills Committee on Financial Reporting Council (Amendment) Bill 2021

Changes in membership

Member	Relevant date
Dr Hon CHENG Chung-tai	Up to 25 August 2021

[According to the announcement made by the Hong Kong Special Administrative Region Government on 26 August 2021 pursuant to the Decision of the Standing Committee of the National People's Congress on Issues Relating to the Qualification of the Members of the Legislative Council of the Hong Kong Special Administrative Region, CHENG Chung-tai was disqualified from being a member of LegCo on 26 August 2021.]

Bills Committee on Financial Reporting Council (Amendment) Bill 2021

**List of organizations from which the Bills Committee
has received written submissions**

1. Accountancy Caring Alliance Limited
2. Accounting Development Foundation Limited
3. Association of Women Accountants (Hong Kong) Limited
4. CFA Society Hong Kong
5. CPA Australia Ltd
6. Hong Kong Association of Registered Public Interest Entity Auditors Limited
7. Hong Kong Securities Association
8. Hong Kong Professionals and Senior Executives Association
9. Several members of the Hong Kong Institute of Certified Public Accountants
10. The Hong Kong Chartered Governance Institute
11. Hong Kong Institute of Certified Public Accountants
12. The Hong Kong Institute of Directors
13. Hong Kong Investment Funds Association
14. The Institute of Financial Planners of Hong Kong
15. The Society of Chinese Accountants & Auditors
16. The Taxation Institute of Hong Kong

Financial Reporting Council (Amendment) Bill 2021

Committee Stage

Amendments to be moved by the Secretary for Financial Services and the Treasury

<u>Clause</u>	<u>Amendment Proposed</u>
7	<p>By deleting the proposed section 3B(2)(a) and (b) and substituting—</p> <p>“(a) while being a certified public accountant (practising), practises accountancy on the person’s own account under a name other than—</p> <ul style="list-style-type: none">(i) the person’s own name as registered under section 22(2) of the PA Ordinance at the time the person so practises; or(ii) the person’s firm name as registered in the AFRC register at the time the person so practises; <p>(b) renders any service as, or purporting to be—</p> <ul style="list-style-type: none">(i) a partner of a firm of certified public accountants (practising) the name of which does not, at the time of rendering the service, appear in the AFRC register; or(ii) a director of a corporate practice the name of which does not, at the time of rendering the service, appear in the AFRC register;”.
7	<p>In the proposed section 3B(4)(d), by deleting “or”.</p>
7	<p>In the proposed section 3B(4)(e), by deleting “conduct.” and substituting “conduct; or”.</p>
7	<p>In the proposed section 3B(4), by adding—</p> <p>“(f) while being a director of a corporation that is a TCSP licensee—</p> <ul style="list-style-type: none">(i) causes or allows a breach of an AML/CTF requirement by the corporation; or(ii) fails to take reasonable steps to prevent such a breach.”.

7 In the proposed section 3B(5), in the definition of *AML/CTF requirement*, in paragraph (b)(ii), by deleting “subsection (2)(e)—under” and substituting “subsections (2)(e) and (4)(f)—under”.

8 By adding—

“(3A) Section 4(2)(a)(vi), after “Council”—

Add

“, or any direction lawfully given by the AFRC”.

8 By adding—

“(6A) Section 4(3)(b), after “Council”—

Add

“, or any direction lawfully given by the AFRC”.

8(7) By deleting “and (4)(b)”.

8 By adding—

“(7A) Section 4(4)(b), after “Council”—

Add

“, or any direction lawfully given by the AFRC”.

(7B) Section 4(4)(b), Chinese text, before “理事會” (wherever appearing)—

Add

“公會”.

8 By adding—

“(8A) Section 4(5)(g), after “Council”—

Add

“, or any direction lawfully given by the AFRC”.

12(11) In the proposed subparagraph (iv), in the English text, by deleting “and”.

12 By adding—

“(11A) Section 9(g), Chinese text—

Repeal

“及”.

(11B) After section 9(g)—

Add

“(ga) to take any steps that the AFRC considers appropriate to promote and support the development of the accountancy profession; and”.

14 In the heading, by deleting “**Section 10A**” and substituting “**Sections 10AA and 10A**”.

14 By adding before the proposed section 10A—

“10AA. AFRC’s powers to give directions

- (1) The AFRC may, in connection with the performance of a function under this Ordinance, give directions to professional persons.
- (2) A direction under subsection (1) may require a professional person—
 - (a) if the person is or was a certified public accountant—
 - (i) to produce or provide to the AFRC a document or information in connection with the registration of the person under the PA Ordinance as a certified public accountant; or
 - (ii) to deliver to the AFRC a certificate in the possession, custody or control of the person if the registration to which the certificate relates has ceased to be valid;
 - (b) if the person is or was a certified public accountant (practising)—
 - (i) to produce or provide to the AFRC a document or information in connection with the issue of a practising certificate to the person; or
 - (ii) to deliver to the AFRC a practising certificate in the possession, custody or control of the person if the practising certificate has ceased to be valid;
 - (c) if the person is or was a CPA firm—

- (i) to produce or provide to the AFRC a document or information in connection with the registration of the firm name of the CPA firm; or
- (ii) to deliver to the AFRC a certificate of registration in the possession, custody or control of the person if the certificate to which the registration relates has ceased to be valid; or
- (d) if the person is or was a corporate practice—
 - (i) to produce or provide to the AFRC a document or information in connection with the registration of the corporate practice; or
 - (ii) to deliver to the AFRC a certificate of registration in the possession, custody or control of the person if the certificate to which the registration relates has ceased to be valid.
- (3) Also, a direction under subsection (1) may require a professional person to give to the AFRC an explanation for an act or omission of the person that appears to the AFRC to be—
 - (a) conduct unbecoming of a professional person;
 - (b) conduct that may affect the reputation, integrity and status of the AFRC or of the accountancy profession; or
 - (c) conduct that may fall within section 3B.
- (4) Nothing in this section is to be taken to compel the production by a person of a record or document containing privileged communication by or to a legal practitioner in that capacity.
- (5) For the purposes of sections 3B(1)(f)(ii) and 4(2)(a)(vi), (3)(b), (4)(b) and (5)(g), a direction given under subsection (1) is a direction lawfully given by the AFRC.
- (6) This section does not limit section 10.”.

19 In the proposed section 20AAB(3), by deleting “HKICPA” (wherever appearing) and substituting “AFRC”.

19 In the proposed section 20AAG(3), by deleting “HKICPA” (wherever appearing) and substituting “AFRC”.

- 19 In the proposed section 20AAL(1)(f)(ii), by deleting “and”.
- 19 In the proposed section 20AAL(1)(g), by deleting “(practising).” and substituting “(practising); and”.
- 19 In the proposed section 20AAL(1), by adding—
“(h) the applicant satisfies the fit and proper requirement to be a certified public accountant under the PA Ordinance.”.
- 19 In the proposed section 20AAL(7), in the Chinese text, in the definition of 認可會計經驗, by deleting “公會理事會不時” and substituting “獲公會理事會”.
- 19 In the proposed section 20AAZZR(3), in the Chinese text, by deleting “、會計師事務所” (wherever appearing).
- 30 By deleting the clause and substituting—
“30. Section 20Q amended (determination of fit and proper)
(1) Section 20Q—
Renumber the section as section 20Q(1).
(2) Section 20Q(1)—
Repeal
“HKICPA Council”
Substitute
“AFRC”.
(3) Section 20Q(1)(d)—
Repeal
“Professional Accountants Ordinance (Cap. 50)”
Substitute
“PA Ordinance”.
(4) After section 20Q(1)—
Add
“(2) To avoid doubt, this section only applies for the purposes of sections 20H and 20Y.”.”.

- 42 In the proposed section 20ZZH(3)(a), by deleting “a PIE auditor or non-PIE auditor;” and substituting “or was a PIE auditor, a non-PIE auditor or a registered responsible person of a registered PIE auditor;”.
- 42 In the proposed section 20ZZH(3)(b), by deleting “person;” and substituting “auditor;”.
- 60 In the proposed section 37AA(3)(a), by deleting “auditor;” and substituting “auditor or a registered responsible person of a registered PIE auditor;”.
- 60 In the proposed section 37AA(3)(c), by deleting “37A.” and substituting “37A or 37B.”.
- 85 By deleting subclause (2) and substituting—
“(2) Section 50G(1)—
Repeal
everything after “whether the HKEC” and before “under this Part.”
Substitute
“is complying with or has complied with a provision under this Part, the AFRC may, in writing, authorize a person to, at reasonable times, inspect and make copies of the accounts kept by the HKEC”.”.
- 90(4) In the proposed definition of *specified matter*, by deleting paragraph (a)(i) and (ii) and substituting—
“(i) a practice irregularity within the meaning of section 4 has been committed in relation to a PIE engagement or non-PIE engagement carried out for the entity;
(ii) there is a relevant non-compliance within the meaning of section 5 in relation to the entity; or
(iii) misconduct within the meaning of section 37A or 37B has been committed in relation to a PIE engagement or non-PIE engagement carried out for the entity; or”.
- 101(4) In the proposed paragraph (ga), by deleting “20ZZA” and substituting “20ZZA(1)(b)”.

- 101(4) In the proposed paragraph (gb), by deleting “20ZZG” and substituting “20ZZG(1)(b)”.
- 113 By deleting the clause and substituting—
- “113. Section 15 amended (vacation of office by Council members)**
Section 15(1)(e)—
- Repeal**
“27(1)(a) or section 35(1)(a);”
- Substitute**
“27(1)(a), under section 35(1)(a) of the pre-amended Ordinance or under section 37CA(4) of the AFRC Ordinance;”.”.
- 117 By deleting subclause (3) and substituting—
- “(3) Section 27(6)—
- Repeal**
“section or section 35—”
- Substitute**
“section, under section 35(1)(a) of the pre-amended Ordinance or under section 37CA(4) of the AFRC Ordinance—”.”.
- New By adding—
- “117A. Section 28 amended (expiry of registration and renewal)**
- (1) Section 28(2)(b)—
- Repeal**
“and”.
- (2) Section 28(2)(c)—
- Repeal**
“development.”
- Substitute**
“development; and”.
- (3) After section 28(2)(c)—

Add

“(d) must not be granted unless the Council is satisfied that the applicant is a fit and proper person to be a certified public accountant.”.”.

124 By deleting the clause and substituting—

“124. Sections 41A and 41B repealed

Sections 41A and 41B—

Repeal the sections.”.

135(3) In the proposed definition of *Student Disciplinary Committee*, by deleting “33A(3)” and substituting “33A”.

136 By deleting the proposed by-law 33A and substituting—

“33A. Student Disciplinary Committee

The Council may from time to time constitute a Student Disciplinary Committee for dealing with a complaint under by-law 34.”.

New By adding—

“142A. By-law 36B added

In Part VIII, after by-law 36A—

Add

“36B. Immunity

- (1) The chairperson or a member of the Student Disciplinary Committee performing any function under this Part has the same privileges and immunities a judge of the Court of First Instance has in relation to civil proceedings in that court.
- (2) At the hearing of a complaint, a registered student or a witness, or any counsel, solicitor or person representing the registered student at the hearing, has the same privileges or immunities that the registered student, witness, or counsel, solicitor or person would have had in relation to civil proceedings in the Court of First Instance.”.”.