

立法會

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Panel on Financial Affairs

Meeting on 1 March 2021

Updated background brief on the work of the Financial Reporting Council

Purpose

This paper provides background information on the Financial Reporting Council ("FRC") including its establishment, key roles, organization structure, and funding arrangements. The paper also provides a summary of the major views and concerns expressed by members of the Panel on Financial Affairs ("FA Panel") on the work of FRC since the 2015-2016 session.

Background

Establishment, roles and organization structure of the Financial Reporting Council

2. The Financial Reporting Council Ordinance (Cap. 588) ("FRCO") which was enacted in July 2006 provides for the establishment of FRC to take charge of investigation of complaints concerning public interest lodged against auditors. FRC was established in December 2006 and became fully operational in July 2007.

3. The roles of FRC at its inception were to: (a) conduct independent investigations into possible auditing and reporting irregularities in relation to listed entities through the Audit Investigation Board; and (b) enquire into possible non-compliances with accounting requirements on the part of listed

entities through a Financial Reporting Review Committee.¹ As FRC was not empowered to discipline when it was established, it had signed Memoranda of Understanding ("MoUs") with the Hong Kong Institute of Certified Public Accountants ("HKICPA") and other regulators including the Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited, the Hong Kong Monetary Authority and the Insurance Authority on the protocols for referring cases/complaints to FRC for investigation or conduct of enquiry, as well as for referring auditing or reporting irregularities identified by FRC to the relevant parties for follow-up.²

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 public interest entity engagements.

¹ Section 22(2) of the Financial Reporting Council Ordinance (Cap. 588) ("FRCO") provides that the Audit Investigation Board ("AIB") is to consist of the Chief Executive Officer of the Financial Reporting Council ("FRC") (as an ex-officio member and chairman of AIB) and at least one other member appointed by FRC. Section 39 of FRCO provides that the Chief Executive shall, in consultation with FRC, appoint a Financial Reporting Review Panel ("FRRP") of at least 20 suitable persons (including at least three Panel Convenors). If FRC decides to conduct an enquiry into a non-compliance with financial reporting requirements of a listed entity, it may appoint a Financial Reporting Review Committee consisting of a Panel Convenor as the Chairman and at least four other members of FRRP to conduct the enquiry.

² By the Memoranda of Understanding signed, auditing or reporting irregularities identified by FRC will be referred to the Hong Kong Institute of Certified Public Accountants ("HKICPA"); 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"), and cases involving criminal offences will be referred to the Police or the Independent Commission Against Corruption for necessary follow-up actions.

5. FRC has established several committees to advise on various aspects of its work. An independent Process Review Panel was established in November 2008 for reviewing the handling of cases by FRC to ensure its actions and decisions adhere to internal procedures and guidelines. An Honorary Advisory Panel was formed in December 2012 to advise FRC on its operations and any professional, technical and strategic issues it faces. An organization chart of FRC is given in the **Appendix I**.

6. In accordance with FRCO, FRC is required to submit its estimates of income and expenditure for approval by the Secretary for Financial Services and the Treasury annually. The accounts of FRC are to be audited by the Director of Audit. The annual report, annual accounts and auditor's report of FRC are to be laid before the Legislative Council ("LegCo") after the end of each financial year.

Implementation of a new regulatory regime for auditors under the Financial Reporting Council (Amendment) Ordinance 2019

7. Against the international trend for auditor regulatory regimes to be independent of the audit profession and be subject to independent oversight by bodies acting in the public interest, the Administration introduced the Financial Reporting Council (Amendment) Bill 2018 into LegCo in January 2018 to reform FRC by establishing a new regulatory regime for public interest entity ("PIE") auditors ("the new regulatory regime"). The Bill was passed by LegCo at the meeting of 30 January 2019 and was enacted as the Financial Reporting Council (Amendment) Ordinance 2019 ("the Amendment Ordinance"). The Amendment Ordinance commenced operation on 1 October 2019.³

8. Following the commencement of the Amendment Ordinance, FRC has become an independent oversight body for regulating PIE auditors responsible for the inspection, investigation and disciplinary functions of

³ The Financial Reporting Council (Amendment) Ordinance 2019 (Commencement) Notice was tabled before LegCo at the meeting of 22 May 2019. By the Notice, the Secretary for Financial Services and the Treasury ("SFST") has appointed 1 October 2019 as the day on which the Financial Reporting Council (Amendment) Ordinance 2019 ("the Amendment Ordinance"), except sections 62 and 85 (concerning payment and calculation of levies payable to FRC by specified parties), comes into operation. SFST has also appointed 1 January 2022 as the day on which sections 62 and 85 of the Amendment Ordinance come into operation.

these auditors.⁴ FRC also has powers to recognize overseas PIE auditors, and oversee HKICPA's functions of (a) registration of local PIE auditors; (b) establishing and maintaining the PIE auditors register; and (c) setting continuing professional development requirements, standards on professional ethics, as well as auditing and assurance practices for registered local PIE auditors. The Amendment Ordinance also provides for the new composition of FRC,⁵ an appeal mechanism regarding decisions made against PIE auditors, and levies payable to FRC.

9. A new funding model is introduced under the new regulatory regime.⁶ 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. Contributions from the three parties are in the ratio of 50:25:25. To facilitate FRC's transition to the new regulatory regime, the Chief Executive announced in the 2018 Policy Address to provide no less than \$300 million as a seed capital for FRC. The Financial Secretary announced in the 2019-2020 Budget to increase the seed capital to \$400 million in order to help FRC migrate to the new regulatory regime, and to exempt the levies for the first two years upon the implementation of the new regime.

Discussions at the Panel on Financial Affairs

10. Since the establishment of FRC in 2006, the Administration and FRC have been conducting annual briefings for FA Panel on FRC's work. The major concerns and views expressed by Panel members during the discussions since the 2015-2016 session are summarized in the ensuing paragraphs.

⁴ FRC can initiate investigations to ensure that misconduct on the part of public interest entity ("PIE") auditors and registered responsible persons are detected which will be referred to the Department of Discipline to consider appropriate follow-up actions including imposition of sanctions or referral to other regulators or law enforcement agencies for conduct falling within their jurisdiction. Furthermore, FRC has the power to direct an inspector to carry out an inspection in relation to PIE engagements for ascertaining whether the PIE auditor has complied with, or is likely to be able to comply with, provisions of FRCO or a professional standard.

⁵ The new composition of FRC is set out in paragraph 4 of the background brief.

⁶ Before the commencement of the Amendment Ordinance, FRC was jointly funded by the Companies Registry Trading Fund, SFC, HKEX and HKICPA on an equal share basis.

Investigation and enquiry work of the Financial Reporting Council

11. During the discussions in 2016, 2017 and 2018, some members enquired about the measures taken by FRC to expedite its investigations and enquiries. FRC explained that the time required to complete an investigation or enquiry was influenced by a host of factors including the complexity of the case and the irregularities or non-compliances involved. FRC further advised at the meetings in 2016 and 2017 that it had reached its full staff complement and was confident that the present manpower would be sufficient for handling the outstanding investigations and enquiries. FRC would consider the need of increasing its manpower resources if there was a dramatic increase in the number of pursuable complaints. Moreover, under FRC's new measures for dealing vexatious complaints, such complaints would be handled in a simplified manner and hence would not affect the resources in handling other complaints.

12. At the FA Panel meetings in 2017 and 2019, some members remarked that there was a perception among small-sized accounting firms that FRC's investigation was targeted at them as audits performed by the "Big Four" accounting firms were seldom the subject of investigation. Members also enquired about the trend of proportion of complaints against the accounting firms of various sizes received in the recent years.

13. FRC stressed that it would not be biased when handling complaints against accounting firms, and would not avoid taking action against the "Big Four" accounting firms. FRC would respond to complaints and would not target any firm because of its size. The trend of proportion of pursuable complaints against accounting firms of various sizes between 2014 and 2018 had remained steady. 31% of the pursuable complaints received in 2016 involved the "Big Four" accounting firms, 50% were against medium-sized accounting firms (i.e. firms with six or more partners/directors), and 19% were against small-sized accounting firms (i.e. firms with five or less partners/directors).

Manpower of the Financial Reporting Council after the establishment of the new regulatory regime

14. At the FA Panel meeting in 2020, some members expressed concern about the adequacy of FRC manpower for discharging its various functions, noting that there was a 20% reduction in the number of staff in the Department of Investigation and Compliance since the commencement of the new regulatory regime in October 2019. They also enquired about the establishment targets of FRC under the new regime.

15. FRC advised that two staff members had been promoted and transferred from the Department of Investigation and Compliance to the Department of Oversight, Policy and Governance and the Department of Inspection during the period mentioned by members. It was expected that FRC's total headcount would reach 52 by end of 2020 and 63 by end of 2021 which would be the optimal level. FRC had successfully recruited 8 new staff for the Department of Inspection as at 31 March 2020 and there would be 13 staff for that Department by end of May 2020.

Sanctions guidelines for imposing pecuniary penalty

16. At the FA Panel meeting in 2019, members noted that FRC had conducted a consultation exercise on the proposed sanctions guidelines ("the Guidelines") for FRC in imposing pecuniary penalty,⁷ and enquired about the views collected during the consultation and when the Guidelines would come into force.

17. FRC advised that the draft Guidelines was issued on 17 March 2019 to all the stakeholders including professional bodies and audit firms of listed companies. FRC had also arranged from March to April 2019 a number of meetings and briefings for the stakeholders which had resulted in fruitful discussions on the draft Guidelines. On the whole, FRC had received positive comments from the stakeholders. FRC would hold a council meeting in mid-May 2019 to discuss the written views received during the consultation and the formulation of FRC's responses.⁸

Cross-border cooperation of the Financial Reporting Council

18. At the FA Panel meeting in 2017, some members expressed concern about the difficulty encountered by some accounting firms in Hong Kong in bringing the audit working papers out of the Mainland for meeting FRC's requirements, as disclosure of such documents might be prohibited by the Mainland laws and regulations for reason of "state secrets". Some members

⁷ Under sections 37D(3)(b)(iv) and 37E(3)(b)(iii) of FRCO, FRC might order a person who was or had been an auditor of a public interest entity ("PIE auditor") or a registered responsible person of a registered PIE auditor and had committed a misconduct to pay a pecuniary penalty. The maximum pecuniary penalty was the greater of \$10 million, or three times the amount of the profit gained or loss avoided as a result of the misconduct.

⁸ The FRC Guidelines for Exercising the Power to Impose a Pecuniary Penalty, which are available on the web site of FRC at: <https://www.frc.org.hk/en-us/Documents/discipline/Gazette%20Notice%20EN.pdf>, have become effective on 1 October 2019.

enquired at the FA Panel meetings in 2018 and 2019 about the timetable for concluding an MoU with the Ministry of Finance ("MoF") in the Mainland which would allow FRC to access audit working papers in the Mainland.

19. FRC responded that due to tightening of the relevant regulations in 2015 by the Mainland authorities, neither FRC nor HKICPA could access audit working papers kept in the Mainland without the MoU. FRC would not require the firms to hand over the audit working papers concerned until the MoU with MoF was in place, which aimed to promote cross-boundary collaboration on audit regulation, and would facilitate FRC in gaining access to audit working papers located in the Mainland. With FRC taking up the new role as an independent oversight body for regulating auditors under the Amendment Ordinance, FRC and MoF planned to sign the MoU in May 2019.

20. Members enquired at the FA Panel meeting in 2020 about how the MoU signed with MoF in May 2019 had helped FRC's investigation work. FRC advised that it had been following up with MoF on matters relating to the MoU. While MoF had obtained certain audit working papers located in the Mainland upon request by FRC, MoF's work was affected by the outbreak of COVID-19. It was envisaged that the process of obtaining audit working papers would resume to normal when the COVID-19 outbreak subsided.

International collaborations of the Financial Reporting Council

21. At the FA Panel meetings in 2019 and 2020, some members expressed support for Hong Kong's application for membership of the International Forum of Independent Audit Regulators ("IFIAR"), and enquired about the progress of the application. There was also a suggestion that FRC should liaise with the European Union ("EU") in pursuing the European Commission ("EC") adequacy status.

22. FRC advised that in preparing the application for IFIAR membership, representatives of FRC had attended IFIAR's plenary meeting in 2019 as an observer to better pave the way for Hong Kong in joining IFIAR, and to update IFIAR members on FRC's new regulatory regime under the Amendment Ordinance. At the FA Panel meeting in 2020, FRC responded that it had formally submitted the IFIAR membership application in November 2019 and was closely following up the matter with the IFIAR Secretariat. As regards the pursuit of EC adequacy status, the Administration and FRC advised that that Hong Kong had discussed the matter with the EU during the recent EU-Hong Kong Annual Structured

Dialogue. The Administration would follow up the matter with the EU through the Hong Kong Economic and Trade Office in Brussels.

Relevant questions raised at Council meetings

23. At the LegCo meeting of 17 January 2018, a Member raised an oral question on Hong Kong accountancy firms' compliance with laws and regulations of different jurisdictions. Matters covered by the question include whether the Administration has plans to require FRC to establish a mechanism with the Mainland authorities to facilitate FRC in obtaining audit papers from Mainland enterprises, and the procedure for handling audit papers involving state secrets and sensitive information.

Latest development

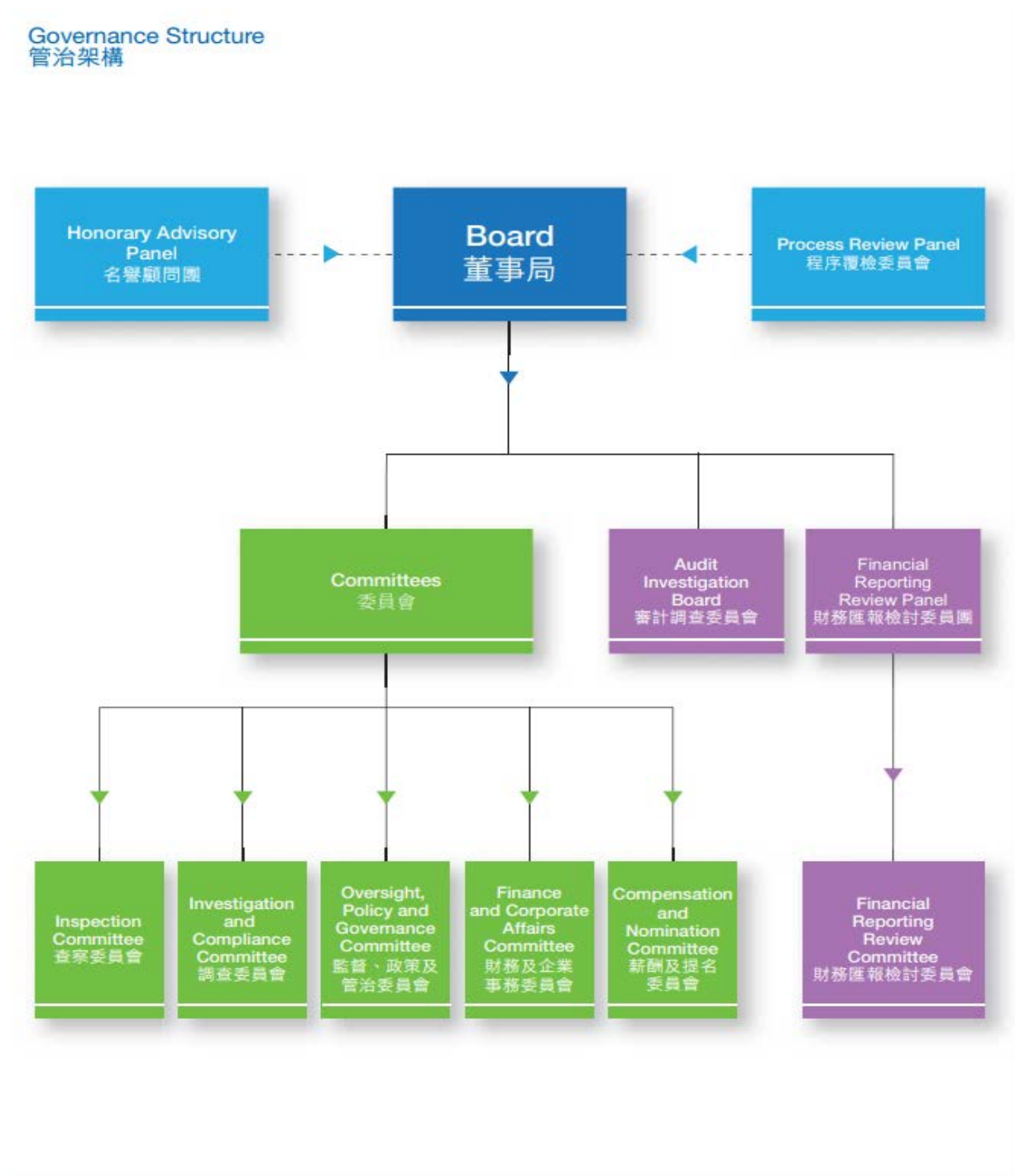
24. FRC will brief FA Panel on its work in the past year at the meeting on 1 March 2021.

References

25. A list of relevant papers is at **Appendix II**.

Council Business Division 1
Legislative Council Secretariat
25 February 2021

Organization structure of the Financial Reporting Council



Source: Financial Reporting Council Annual Report 2019

List of relevant papers

Date	Event	Papers/Minutes of meeting
23 May 2016	FA Panel discussed the work of FRC since April 2015	<p><u>Powerpoint presentation materials at the meeting</u> (LC Paper No. CB(1)955/15-16(01))</p> <p><u>Administration's paper</u> (LC Paper No. CB(1)918/15-16(03))</p> <p><u>Minutes</u> (LC Paper No. CB(1)1142/15-16)</p>
5 June 2017	FA Panel discussed the work of FRC since April 2016	<p><u>Powerpoint presentation materials at the meeting</u> (LC Paper No. CB(1)1078/16-17(02))</p> <p><u>Administration's paper</u> (LC Paper No. CB(1)1030/16-17(04))</p> <p><u>Minutes</u> (LC Paper No. CB(1)1356/16-17)</p>
17 January 2018	Hon Kenneth LEUNG raised an oral question on "Compliance with laws and regulations of different jurisdictions by Hong Kong accounting firms"	<p><u>Hansard</u> (pages 5147- 5156)</p>
13 February 2018	First meeting of the Bills Committee on Financial Reporting Council (Amendment) Bill 2018	<p><u>The Bill</u> (LC Paper No. CB(3)287/17-18)</p> <p><u>Legislative Council Brief</u> (File Ref: ACCT/2/1/2C)</p> <p><u>Legal Service Division Report</u> (LC Paper No. LS25/17-18)</p>

Date	Event	Papers/Minutes of meeting
15 May 2018	FA Panel discussed the work of FRC since April 2017	<p><u>Powerpoint presentation materials at the meeting</u> (LC Paper No. CB(1)967/17-18(01))</p> <p><u>Administration's paper</u> (LC Paper No. CB(1)926/17-18(03))</p> <p><u>Minutes</u> (LC Paper No. CB(1)1305/17-18)</p>
30 January 2019	Council	<p><u>Report of the Bills Committee on Financial Reporting Council (Amendment) Bill 2018</u> (LC Paper No. CB(1)505/18-19)</p>
6 May 2019	FA Panel discussed the work of FRC since April 2018	<p><u>Powerpoint presentation materials at the meeting</u> (LC Paper No. CB(1)1019/18-19(02))</p> <p><u>Administration's paper</u> (LC Paper No. CB(1)954/18-19(04))</p> <p><u>Minutes</u> (LC Paper No. CB(1)1315/18-19)</p>
22 May 2019	The Financial Reporting Council (Amendment) Ordinance 2019 (Commencement) Notice was tabled before the Legislative Council	<p><u>The Notice</u></p> <p><u>Report of the Subcommittee</u> (LC Paper No. CB(1)1209/18-19)</p>

Date	Event	Papers/Minutes of meeting
4 May 2020	FA Panel discussed the work of FRC since April 2019	<u>Powerpoint presentation materials at the meeting</u> (LC Paper No. CB(1)582/19-20(02)) <u>Administration's paper</u> (LC Paper No. CB(1)564/19-20 (04)) <u>Information paper</u> (LC Paper No. CB(1)576/19-20 (01)) <u>Minutes</u> (LC Paper No. CB(1)899/19-20)
21 October 2020	Registration of Determinations and Orders of Public Interest Entities Auditors Review Tribunal Rules were tabled before the Legislative Council	<u>Registration of Determinations and Orders of Public Interest Entities Auditors Review Tribunal Rules</u> <u>Report of the Subcommittee</u> (LC Paper No. CB(1)266/20-21)