

**For discussion  
5 July 2021**

**Legislative Council Panel on Financial Affairs**

**Further Reform of the Regulatory Regime of Accounting Profession**

**Purpose**

This paper seeks Members' views on proposed amendments to the Financial Reporting Council Ordinance (Cap. 588) ("FRCO") to further develop the Financial Reporting Council ("FRC") into a full-fledged independent regulatory and oversight body for the accounting profession.

**Justifications**

*Deepening Reform to Achieve Independent Regulation*

2. An effective regulatory regime of the accounting profession, including auditing, is crucial for the business community and is essential for maintaining Hong Kong's status as an international financial centre and business hub. The international trend on accounting profession regulation is to vest the regulatory powers with a regulatory body independent from the trade to ensure impartiality.

3. In 2018, taking a step-by-step approach to achieve regulatory reform, the Government introduced the Financial Reporting Council (Amendment) Bill 2018 to transfer the powers to regulate auditors of public interest entities ("PIE")<sup>1</sup> from the Hong Kong Institute of Certified Public Accountants ("HKICPA") to the FRC. Under the new regime, the FRC is mainly responsible for the inspection, investigation and discipline over PIE auditors and registered responsible persons of the PIE auditors, as well as recognition of PIE auditors from overseas. Meanwhile, practice units<sup>2</sup> and certified public accountants ("CPA") in general

<sup>1</sup> 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.

<sup>2</sup> Only practice units may perform statutory audits. As defined in section 2 of the PAO, a practice unit is (i) a certified public accountant (practising) practising accountancy on his own account; (ii) a firm of certified public accountants (practising) practising accountancy; or (iii) a corporate practice.

continue to be regulated under the Professional Accountants Ordinance (Cap 50) (“PAO”) except for their engagements under the PIE auditor regulatory regime as specified in the FRCO.

4. Since the coming into operation of the new regime in October 2019, the FRC has been discharging its expanded regulatory functions effectively. The FRC has delivered a number of achievements as an independent regulatory body, including –

- (i) **Regulatory functions:** The FRC has completed the first annual inspection work on PIE auditors, covering their engagements and quality control systems. Reports have also been issued on its oversight on the HKICPA regarding statutory functions in relation to PIE auditors, and the overview of the market for listed entity audits in Hong Kong.
- (ii) **Focused research:** The FRC has conducted research on whether the change of auditors for listed companies would warrant regulatory intervention. It has also researched on how the boards of listed companies can more effectively supervise audits.
- (iii) **Regulatory cooperation:** The FRC signed a Memorandum of Understanding (“MOU”) with the People’s Republic of China Ministry of Finance on collaboration in respect of audit regulation, and the FRC has successfully obtained the first batch of the audit working papers of Hong Kong listed companies kept in the Mainland. MOUs on regulatory cooperation were also signed with the Securities and Futures Commission and the Hong Kong Exchange and Clearing Limited respectively.

#### *Reducing Compliance Burden with Enhanced Professionalism*

5. Since the reform in 2019 only transferred mainly the regulatory powers relevant to PIE auditors to the FRC, individual practice units and CPAs come under similar regulatory requirements of both the FRCO and PAO for their respective PIE engagements and other engagements, and are subject to separate inspections by the FRC and the HKICPA. The arrangement has led to inefficient use of resources and unnecessary compliance burden. Moreover, investigation and discipline matters of practice units and CPAs also come under two different regulatory systems under the FRCO and the PAO respectively depending on whether the subject of investigation is a PIE engagement or not despite the same

professional standards being applicable to relevant accounting tasks. These arrangements lead to regulatory inconsistency which is not conducive to achieving the objective of up-keeping the standards and performance across the profession.

6. In addition, while the FRC has assumed regulatory functions over local PIE auditors, the HKICPA is still responsible for the registration which results in a fragmented approach in regulation.

### *Aligning with International Standard and Practice*

7. Most comparable overseas accounting jurisdictions, including those of the UK, Australia, Singapore and the US, have already given expanded power to their respective independent regulators which oversee the accounting profession to ensure that professional accounting services are duly regulated. The further reform will make our regulatory regime more in line with international standard and practice and reinforce our status as an international financial centre and business hub.

## **Legislative Proposals**

8. We propose legislative amendments to –

- (i) empower the FRC to issue practising certificates to CPAs and register all practice units and local PIE auditors;
- (ii) expand the FRC's current powers of inspection, investigation and discipline over PIE auditors to cover all CPAs and practice units ; and
- (iii) expand the FRC's oversight powers to cover the HKICPA's functions of the registration of CPAs and related matters, and the setting of standards on professional ethics, accounting, auditing and assurance and the setting of requirements for continuing professional development ("CPD") requirements for the accounting profession.

### *Registration*

9. Registration is the first critical step to ensure the overall competency of a profession. Some comparable jurisdictions have the

most essential registration functions in respect of auditors vested with the regulators independent of the profession to ensure impartiality.

10. We propose that the FRC should likewise play the role of an independent registrar and be responsible for the registration functions in relation to audit practitioners and practices, which include the issue of practising certificates and the registration of practice units and local PIE auditors. For continuity, the criteria and relevant requirements currently provided in the PAO (concerning issue of practising certificates and registration of practice units) and the FRCO (concerning registration of local PIE auditors) will remain largely the same upon the change of the registration authority.

11. The HKICPA will remain the registration authority of CPAs and continue to administer the professional examination, Qualification Programme and CPD mechanisms, as well as the mutual or reciprocal recognition agreements with accountancy bodies of other jurisdictions in relation to registration of CPAs in Hong Kong, which are the essential foundation building blocks of the professional qualifications in accountancy.

#### *Inspection, investigation and discipline*

12. The FRC has already established itself for exercising inspection, investigation and discipline powers over PIE auditors as a regulator independent from the profession. As with the international development towards independent regulation, the same independent regulatory arrangement is warranted for all other engagements carried out by accounting professionals which are of public interest as they are the cornerstone of the integrity and governance of Hong Kong's business sector. We therefore propose empowering the FRC to exercise these regulatory powers, namely, inspection, investigation and discipline over practice units, and investigation and discipline over individual CPAs. The change will, in addition to strengthening the independence of regulation, help streamline the compliance burden of the regulatees and ensure regulatory consistency.

13. In transferring those regulatory powers to the FRC, the scope of powers (including investigable and sanctionable misconducts and powers

of inspectors and investigators) as well as types and levels of penalties<sup>3</sup> will follow those currently provided in the PAO<sup>4</sup> with which the profession is familiar. In terms of procedures, those established under the FRCO which are carried out by the FRC executive team under the supervision of the FRC Board comprising all non-practitioners will be adopted for exercising these new powers to ensure impartiality and independence from the profession.

#### *Oversight power*

14. The FRC's oversight power will be expanded corresponding to the expanded powers of the FRC in our legislative proposals to include registration of CPAs and related matters including examination and training, and setting of CPD requirements and professional and ethical standards for the accounting profession.

#### *Review and appeal mechanism*

15. An independent review tribunal, namely the PIE Auditors Review Tribunal, has been established under the FRCO with jurisdiction to review and make determination on a review of the HKICPA's decisions relating to registration of local PIE auditors and the FRC's decisions relating to recognition of overseas PIE auditors and discipline of all PIE auditors. We propose that the scope of review of the Tribunal should be expanded to cover all decisions concerning the issue of practising certificates, registration of practice units and disciplinary actions against practice units and CPAs under the FRCO in the reformed regime. The name of the Tribunal will also be revised correspondingly.

#### *Transitional arrangements*

16. For the registration function, all applications approved by the HKICPA before the commencement of the reformed 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 the FRC for processing.

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<sup>3</sup> 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.

<sup>4</sup> Except for rectifying a few anomalies in the existing provisions on investigation and sanctions in respect of omission of investigative and/or disciplinary powers against certain categories of regulatees concerning specific types of misconduct.

17. For the inspection, investigation and disciplinary functions, any proceedings carried out under the PAO which have not been completed on the commencement date of the reformed new regime will continue to be conducted under the PAO mechanism to avoid unnecessary disturbance to ongoing cases. The result of an inspection or investigation conducted in accordance with the PAO mechanism under the transitional arrangement will then be referred to the FRC for follow-up action. Any new cases that come up after the commencement date of the reformed new regime, irrespective of whether the engagements which are the subjects of these cases were conducted before the commencement, will be handled by the FRC.

18. In view of the procedural and technical nature of the transitional arrangements, these arrangements will be provided for by way of subsidiary legislation to be made after the enactment of the Amendment Bill. Subject to the passage of the Bill by the Legislative Council (“LegCo”) within this legislative session, we plan to table the subsidiary legislation for negative vetting of LegCo in 2022.

#### *Funding*

19. The Government injected a seed capital of \$400 million into the FRC in 2019 to help it migrate to the new regime before it starts collecting levy from 1 January 2022. We expect that the unspent seed capital can help fund the FRC’s expanded functions in the initial years of this further reform. We will review the FRC’s funding arrangement and consider the appropriate registration fee mechanism in due course.

#### *Governance of the FRC*

20. Pursuant to the existing provisions of the FRCO, all members of the FRC Board must be non-practitioners, and among them, at least one-third are appointed because of their knowledge and experience in PIE engagements. In order to facilitate the FRC’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 regulators, a statutory advisory committee consisting of practitioners, service users and other stakeholders of the accounting profession will be established to provide advice to the FRC.

21. In the light of the expansion of the scope of regulation beyond PIE auditors, the FRC will be renamed as Accounting and Financial Reporting Council to reflect its roles and functions after the reform.

### **Stakeholders Engagement**

22. The Government has been engaging stakeholders including the FRC, the HKICPA, major accounting bodies, accounting professionals and trade groups who are users of professional accounting services. Stakeholders are generally supportive of the direction of the proposed reform.

23. We have explained our proposals and made clarifications in response to the concerns of some stakeholders. Among other things, we have emphasized that the principle of proportionality will be adopted when the FRC exercises its proposed regulatory functions over the accounting profession when compared to its existing powers over PIE auditors. For all the regulatees to be newly handled by the FRC, including many small and medium practices which do not work on PIE engagements, the regulatory scope and requirements applicable to them and the consequences of non-compliance under the proposed regime will remain comparable to those currently provided in the PAO.

### **Legislative Timetable**

24. We will continue to take views from stakeholders and plan to introduce the above legislative proposals into LegCo within this legislative year.

### **Advice Sought**

25. Members are invited to provide views on the legislative proposals set out in this paper.

**Financial Services Branch**  
**Financial Services and the Treasury Bureau**  
**24 June 2021**