

**Process Review Panel for
the Financial Reporting Council**

2020 Annual Report

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Chapter 1 : Background

Overview

1.1 The Process Review Panel for the Financial Reporting Council (“the PRP”) is an independent non-statutory panel established by the Chief Executive of the Hong Kong Special Administrative Region in 2008 to review cases handled by the Financial Reporting Council (“the FRC”), and to consider whether actions taken by the FRC are consistent with its internal procedures and guidelines. The establishment of the PRP reflects the Government’s commitment to enhancing the accountability of the FRC.

1.2 The FRC plays a key role in upholding the quality of financial reporting, promoting the integrity of the accounting profession, enhancing corporate governance, and protecting investors’ interest. It was established under the Financial Reporting Council Ordinance (Cap. 588) (“the FRCO”) in 2006 as an independent statutory body to investigate auditing and reporting irregularities by auditors of listed entities (i.e. listed corporations and listed collective investment schemes), with the assistance of the statutory Audit Investigation Board (“the AIB”) comprising executives of the FRC, and to enquire into non-compliance of accounting requirements by listed entities in Hong Kong, with the assistance of the Financial Reporting Review Committees (“the FRRC”)¹.

1.3 In January 2019, the Legislative Council enacted a bill to enhance the independence of the auditor regulatory regime by benchmarking against international standard and practice. Upon the commencement of the new regime on 1 October 2019, the FRC became an independent auditor oversight body and is vested, in addition to investigation powers, with inspection and disciplinary powers with regard to auditors of public interest entities (“PIE”)². The FRC also performs independent oversight over the performance of the Hong Kong Institute of Certified Public Accountants (“HKICPA”) of its statutory functions of registration, setting

¹ The FRRC members are drawn from the statutory Financial Reporting Review Panel comprising individuals appointed by the Financial Secretary (under the authority delegated by the Chief Executive) from various professions in addition to accountants.

² A PIE means a listed collective investment scheme or a corporation with its equities listed on Hong Kong’s stock market.

continuing professional development requirements and setting standards on professional ethics, auditing and assurance with respect to local PIE auditors. In addition, the FRC is responsible for the recognition of overseas PIE auditors.

Functions of the PRP

1.4 The terms of reference of the PRP are as follows –

- (a) to review and advise the FRC on the adequacy of its internal procedures and operational guidelines governing the actions taken and operational decisions made by the FRC and its staff in the performance of the regulatory functions in relation to the following areas –
 - (i) inspection in relation to PIE engagements completed by PIE auditors;
 - (ii) complaints handling, enquiry and investigation;
 - (iii) disciplinary actions against PIE auditors;
 - (iv) oversight of the performance of the HKICPA of specified functions (i.e. registration, setting requirements for continuing professional development, and setting standards on professional ethics, auditing and assurance) in relation to PIE auditors; and
 - (v) recognition of overseas PIE auditors;
- (b) to receive and consider periodic reports from the FRC on completed or discontinued cases in the areas mentioned in (a) above;
- (c) to receive and consider periodic reports on enquiries, investigations and disciplinary cases lasting more than one year;
- (d) to receive and consider periodic reports from the FRC on complaints against the FRC or its staff;

- (e) to call for files from the FRC to review the handling of cases in the areas mentioned in (a) above to ensure that the actions taken and decisions made are adhered to and are consistent with internal procedures and guidelines and to advise the FRC where appropriate;
- (f) to advise the FRC on such other matters relating to the FRC's performance of statutory functions as the FRC may refer to the PRP or on which the PRP may wish to advise; and
- (g) to submit annual reports to the Financial Secretary which, subject to applicable statutory secrecy provisions and other confidentiality requirements, will be published.

1.5 The internal procedures which the PRP would make reference to in reviewing the FRC's cases include guidelines on its statutory functions, working protocols with other regulatory bodies, preservation of secrecy and identity of informers, and relevant legislative provisions.

1.6 The PRP is tasked to review and advise the FRC on its handling of cases, not its internal operation or administrative matters. Therefore, the work of the committees set up under the FRC Board is not subject to direct review by the PRP.

Modus operandi of the PRP

1.7 The case review cycles of the PRP run on a calendar year basis. Based on the FRC's caseload during the relevant review cycle, the PRP would select cases for review at the end of the cycle. In the course of work of the PRP, members are reminded to preserve secrecy in relation to information furnished to them, and not to disclose such information to other persons. To maintain independence and impartiality of the PRP, all PRP members would declare their interests upon commencement of their terms of appointment and before conducting each case review.

Composition of the PRP

1.8 In 2020, the PRP comprised six members, including the Chairman who is from the legal sector, a member from the accountancy sector, three other members from the field of business management and academia, and the FRC Chairman as an ex-officio member.

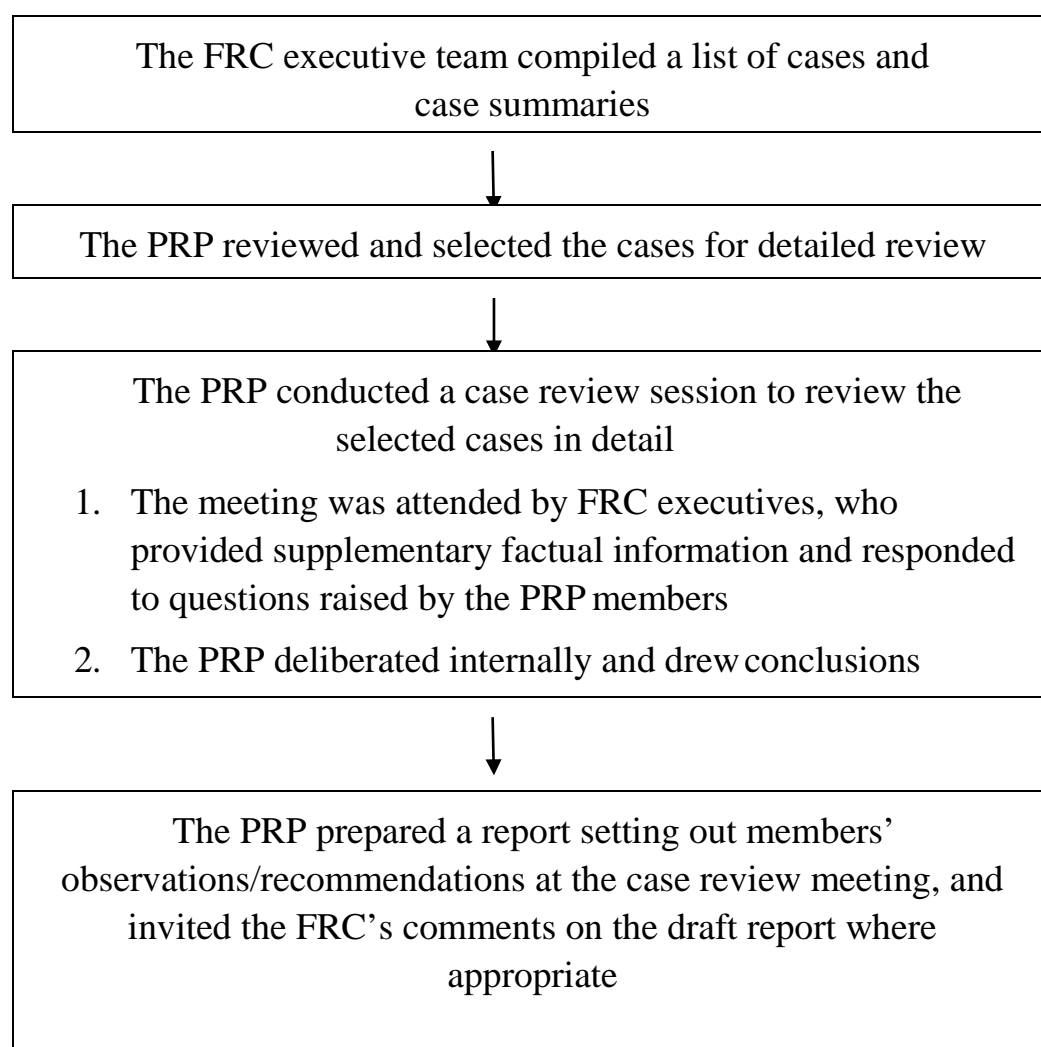
1.9 The membership of the PRP in 2020 is at **Annex**.

Chapter 2 : Work of the PRP in 2020

2.1 This Annual Report covers the work of the PRP in 2020, which reviewed reports from the FRC on cases handled by it during the 12th review cycle which ran from January to December 2019.

Case review work flow

2.2 The work flow adopted by the PRP in reviewing the cases is set out below –



Selection of cases for consideration/review

Investigation and enquiry

2.3 The FRC executive team advised the PRP that the FRC had completed 63 cases related to investigation/enquiry during the 12th review cycle. Other than these 63 cases, there were 28 cases which had lasted for more than one year by the end of the cycle. The PRP was provided with summaries of all these 91 cases for review as follows –

<u>Category</u>	<u>Distribution of cases</u>	<u>Number</u>
(I)	On-going investigations/enquiries which had lasted for more than one year	28
(II)	Completed investigations/enquiries	9
(III)	Unsubstantiated cases	7
(IV)	Cases that were referred to other regulatory bodies for follow-up or the FRC taking follow-up action directly with the listed entity/auditor	2
(V)	Completed review of complaints/review of relevant financial statements with on-going investigations/enquiries	19
(VI)	Pursuable complaints not taken further (i.e. complaints that are vexatious, abusive and/or of unreasonably persistent nature)	26
Total		91

2.4 The PRP reviewed the case summaries of the 91 cases and selected the following seven cases for review by taking into account various factors including case nature, duration and previous review of the cases (if any) with a view to covering a good mix of cases from different categories –

- (a) Two on-going investigation cases which had lasted for more than one year (Category I);
- (b) One completed investigation case (Category II);
- (c) Two completed review of complaints with on-going investigation/enquiries (Category V);
- (d) One completed review of financial statements with on-going investigations/enquiries (Category V); and
- (e) One pursuable complaint that was not taken further (Category VI).

The PRP also took the opportunity to review a complaint against a former member of staff of the FRC.

Recognition of overseas PIE auditors

2.5 The FRC executive team advised the PRP that the FRC had handled a total of 78 recognition applications during the 12th review cycle. The PRP was provided with summaries of all these applications for review as follows –

<u>Category</u>	<u>Distribution of cases</u>	<u>Number</u>
(I)	Recognition applications filed by overseas corporations	49
(II)	Recognition applications filed by overseas collective investment schemes	19
(III)	Recognition applications filed by listing applicants	10
Total		78

2.6 The PRP reviewed the summaries of the 78 recognition applications and selected the following three for review by taking into account various factors including case nature and duration with a view to covering a good mix of cases from different categories –

- (a) Two recognition applications filed by overseas corporations (Category I); and
- (b) One recognition application filed by a listing applicant (Category III).

Case review session

2.7 The case review meeting was held on 9 December 2020 to conduct detailed review on the selected cases and applications. The PRP Secretariat invited all members to declare any potential conflicts of interest before the meeting. At the start of the case review session, the PRP Chairman reminded members to declare any possible conflict of interest in the cases and applications to be reviewed. No member made such a declaration. The PRP's observations in respect of the selected cases and applications are set out in chapter 3 below.

Review of procedural manuals of the FRC under the new regulatory regime

2.8 As per the recommendation at the case review session of the 11th review cycle held on 6 December 2019, the PRP conducted review in 2020 on the new procedural manuals for the FRC's regulatory functions under the new regime in addition to its ordinary review on cases handled by the FRC. A PRP meeting was held on 11 June 2020 to review the FRC's procedural manuals for the new functions of (i) enquiry and investigation in relation to PIEs and their auditors respectively, (ii) inspection in relation to PIE auditors, and (iii) recognition of overseas PIE auditors. The FRC also took the opportunity to brief the PRP on the progress of the preparation of procedural manuals for the new functions of (i) the oversight of the HKICPA's specified functions in relation to PIE auditors and (ii) disciplinary actions against PIE auditors. The PRP members sought clarifications on and asked some questions about the details in the procedural manuals. In conclusion, they were satisfied with the new manuals.

2.9 The PRP will consider in due course how its approach of review

should be adjusted in view of the expanded scope of regulatory functions of the FRC.

Chapter 3 : The PRP's review of cases handled by the FRC

3.1 On the whole, having considered the cases reviewed in the 12th cycle, the PRP was of the view that the FRC had followed the internal procedures in handling the cases.

(1) An on-going investigation and enquiry case which had lasted for more than one year

Case facts and the FRC's actions

3.2 The case arose from the FRC's financial statement review programme. It took the FRC eight months to complete the assessment, nine months for the enquiry, and one year and eleven months for the investigation. The auditor was found to have failed to comply with relevant auditing standards. The investigation report (as adopted by the FRC Board) was referred to the HKICPA for follow-up actions.

The PRP's areas of review

3.3 The PRP inquired about the selection mechanism of financial statements for review. The FRC advised that financial statements would be selected according to the selection criteria considered by the then Operations Oversight Committee ("OOC") (before 1 October 2019) or the Investigation and Compliance Committee ("ICC") (since 1 October 2019). The criteria had been set with a risk-based approach by taking into account multiple factors including media reports and relevant intelligence. They were also subject to review and approval by the OOC/ICC on an annual basis.

3.4 Noting that the FRC had declined the auditor's request for extension of deadline for responding to the FRC's formal requirement, the PRP looked into the basis and authority of the decision. The FRC explained that relevant factors included the nature of the FRC's requirement, the justifications presented by the respondents and the extent of the extension. As regards the authority to approve extension, there was

a two-tier arrangement. For request for extension of deadline that fell within two months from the date of requirement, the authority was vested with the Chief Executive Officer. Other requests required approval by the Chairman of the OOC. The PRP noted that the FRC would holistically consider all circumstances before granting or declining the requests.

3.5 In relation to the enquiry case, the PRP asked about the consideration behind the decision of not issuing preliminary findings to the relevant parties. The FRC advised that while the procedural manual provided that the FRC might issue the preliminary findings of an enquiry to relevant persons for comment before circulating the draft enquiry report, it was not necessary in the subject case as the relevant listed entity had admitted to and rectified the non-compliance.

Conclusion

3.6 Having reviewed the FRC's handling of the case and in light of the above clarification, the PRP agreed that the FRC had been handling the case in accordance with its internal procedures.

(2) An on-going investigation case which had lasted for more than one year

Case facts and the FRC's actions

3.7 The case arose from the FRC's financial statement review programme. The FRC took seven months to conduct the assessment, and one year and nine months for the investigation. The auditor was found to have failed to comply with relevant auditing standards. The investigation report was referred to the HKICPA for follow-up action.

The PRP's areas of review

3.8 The PRP noted that the FRC granted four extensions of deadlines to the listed entity for response to the FRC's request for information and inquired about the rationale. The FRC advised that the extensions were granted on the considerations of retrieval of dated file records and specific

circumstances of the listed entity. The FRC further clarified that the purpose of the relevant request was to help determining the scope of subsequent investigation, and that it was not a formal requirement to which the respondent had legal obligation to answer.

3.9 The PRP inquired about follow-up actions taken in light of investigation findings. The FRC replied that the investigation report had been referred to the HKICPA for further actions because auditing irregularities were identified. The HKICPA would keep the FRC posted of its developments through regular liaison channels.

Conclusion

3.10 Having reviewed the FRC's handling of the case and in light of the above clarification, the PRP agreed that the FRC had been handling the case in accordance with its internal procedures.

(3) A completed investigation case

Case facts and the FRC's actions

3.11 This case arose from the FRC's financial statements review programme. The assessment took two months, and the investigation took two years and four months. The investigation report (as adopted by the FRC Board) was referred to the HKICPA for follow-up.

The PRP's areas of review

3.12 The PRP asked about the function of the engagement quality control reviewer ("EQCR") in the case and why the auditor was unable to contact him to offer assistance in the investigation. The FRC explained that the EQCR was responsible for conducting a quality control review on the audit engagement and could either be an in-house staff or engaged externally. In the subject case, the EQCR was engaged externally and the auditor did not have contact with him after completion of the relevant audit engagement.

3.13 The PRP was also concerned on the long processing time of this case. The FRC explained that it was due to staff shortage and competing priorities at that time. The FRC Board had endorsed proposal to increase staff resources to handle growing workload.

Conclusion

3.14 Having reviewed the FRC's handling of the case and in light of the above clarification, the PRP agreed that while the FRC had been handling the case in accordance with its internal procedures, it should explore ways to clear backlog of cases timely.

(4) A case arising from a review of complaint with an on-going investigation

Case facts and the FRC's actions

3.15 The case arose from a complaint received in April 2016 concerning suspected accounting non-compliances and auditing irregularities. An enquiry and an investigation were conducted concurrently. It took the FRC two years and four months to complete the enquiry. The investigation was expected to be completed in a few months' time as at the end of the 12th review cycle.

The PRP's areas of review

3.16 Noting that both the listed entity and the auditor requested for annexes to the preliminary findings when they were invited to comment on the draft preliminary findings, the PRP queried why the annexes were not enclosed in the first place. The FRC replied that the annexes contained information and documents gathered from the respondents. If considered appropriate for disclosure, the annexes would be provided for reference upon request. In the subject case, the annexes had been provided to the listed entity and the auditor as requested.

3.17 In the enquiry case, a further extension of deadline for submitting comments on the preliminary findings was granted to the listed entity after

the “final” extension of deadline. The PRP questioned the justification of this decision. As advised by the FRC, the listed entity needed to engage an accounting expert to review the issues in order to provide supplementary information, thus requested for a further extension. Having considered this justification, the FRRC approved granting of further extension of deadline.

3.18 The PRP noted that it had taken a rather long period of time to receive comment from the auditor on the preliminary findings of the investigation in order to draw conclusions. The FRC explained that the auditing issues involved were complicated and contested by the auditor. As at the case review session, the investigation report was being finalised.

Conclusion

3.19 Having reviewed the FRC’s handling of the case and in light of the above clarification, the PRP agreed that the FRC had been handling the case in accordance with its internal procedures.

(5) A case arising from a review of complaint with an on-going investigation

Case facts and the FRC’s actions

3.20 The case arose from two complaints received in August and September 2018 concerning possible accounting non-compliances in the 2017 financial statements and 2018 interim financial statements as well as possible auditing irregularities in respect of the audit of the 2017 financial statements. After a six-month assessment, an enquiry and an investigation were initiated. By the end of the 12th review cycle, the preliminary findings of the enquiry was being finalised while the investigation continued.

The PRP’s areas of review

3.21 The PRP observed that, in addition to the initiation of the enquiry and the investigation, a letter of advice was issued to both the listed entity

and the auditor in March 2019, and inquired about the nature of such letter and the circumstances under which it should be issued. The FRC explained that among the five issues arising from the complaint, three concerned immaterial accounting deficiencies which required no adjustments to the financial statements. In such case, although no follow-up action for these three issues was required, the letter of advice was issued to raise the listed entity's and the auditor's awareness to the deficiencies.

3.22 The PRP noted that the case chronology showed no record of development of the enquiry and the investigation since the receipt of information from the relevant parties in 2019, and queried on the absence of record. The FRC explained that it was due to staff shortage coupled with the increased workload arising from the rolling out of auditory regulatory reform at that time. The PRP further inquired about the FRC's internal mechanism for monitoring case handling progress. In response, the FRC advised that there were bi-weekly meetings to keep track of progress. The FRC added that the Management Team had been working on proposals to expedite case handling process for consideration by the FRC Board.

Conclusion

3.23 Having reviewed the FRC's handling of the case and in light of the above clarification, the PRP agreed that while the FRC had been handling the case in accordance with its internal procedures, it should continue to explore ways to expedite handling of cases.

(6) An investigation case arising from review of financial statements with on-going investigations

Case facts and the FRC's actions

3.24 The case arose from the FRC's financial statements review programme. It concerned three audits for three financial years. The assessment took one year and four months and led to three investigations being initiated. The first investigation took two years and two months, and the third investigation almost three years. By the end of the 12th

review cycle, the second investigation was on-going. This outstanding second investigation took longer because it had to pause due to a complaint against a member of staff involved in the investigation. Upon closing of the complaint in 2019, the second investigation resumed. As at the case review session, the draft investigation report was ready for consideration by the AIB.

The PRP's areas of review

3.25 The PRP observed that two of the three auditors concerned had similar names and inquired into it. The FRC explained that it was resulted from the corporatisation of the two auditors during the process. Despite the corporatisation, in conducting the subject case, the relevant auditors had been regarded as two separate entities.

Conclusion

3.26 Having reviewed the FRC's handling of the case and in light of the above clarification, the PRP agreed that the FRC had been handling the case in accordance with its internal procedures.

(7) A pursuable complaint that was not taken further

Case facts and the FRC's actions

3.27 The case arose from a complaint received by the FRC in January 2019 alleging non-compliance with an accounting requirement. Upon receiving the FRC's request for information, the listed entity and the auditor gave a timely and adequate explanation and rectified the disclosure deficiency in the subsequent financial statements. When informed of the OOC's decision to close the case, the complainant sought further explanation. It took the FRC about four months to complete the case.

The PRP's areas of review

3.28 The PRP reviewed how the FRC had followed up on the complainant's further queries. The FRC advised that it had clarified the

accounting/auditing standards applied in the subject financial statements, and explained the reasons supporting the OOC's decision to close the case. The complainant eventually accepted the case outcome.

Conclusion

3.29 Having reviewed the FRC's handling of the case and in light of the above clarification, the PRP agreed that the FRC had been handling the case in accordance with its internal procedures.

(8) Three recognition applications

Case facts and the FRC's actions

3.30 The FRC advised that, upon satisfaction of these criteria –

- (a) the applicant obtained a statement of no objection from the Hong Kong Exchanges and Clearing Limited or the Securities and Futures Commission (as the case may be) for appointing an overseas auditor;
- (b) the overseas auditor concerned was a member of an accountancy body that was a member of the International Federation of Accountants and was subject to the regulation of an overseas regulatory organisation recognised by the FRC; and
- (c) the overseas auditor had adequate resources and possessed the capability to carry out a PIE engagement for the applicant,

an approval-in-principle with a validity period of six months would be granted. When the overseas auditor undertook a PIE engagement during the validity period, the recognition of the overseas auditor would take effect.

3.31 In relation to the three applications, the FRC supplemented that two were made by listed entities and one by a listing applicant. Although the assessment procedures were the same, it would normally take longer

time for processing applications made by listing applicants.

The PRP's areas of review

3.32 The PRP observed that the three applications under review had taken relatively longer processing time as compared with other applications processed in 2019. In each application, after the listed entity/listing applicant and the auditor submitted the application forms, the FRC took two to 11 days to input the relevant data into the system and took another six to nine weeks to complete an assessment. The FRC explained that upon receipt of the application forms, the FRC needed to sort out the incoming documents from both the overseas listed entity/listing applicant and overseas auditor and check the prima facie completeness of the documents submitted before inputting the relevant data into the system for further assessment. All the above procedures had been conducted manually and the department was understaffed to handle the 78 applications at the early stage of handling such applications for the first time.

3.33 In response to the PRP's enquiry as to whether there had been any urgent application upon the commencement of the new regime, the FRC advised that a transitional arrangement was put in place. As provided in the FRCO, an overseas auditor which had undertaken but not yet completed a PIE engagement before the commencement of the new regime might, by written notice, notify the FRC of its intention to continue to carry out the engagement and be taken as a recognised overseas PIE auditor while the FRC was processing its application for recognition. The FRC further informed the PRP of its target to inform the applicant of the outcome within 30 business days upon receipt of all required information. Also, efforts were being made to identify measures to expedite application processing, including automation of data entry.

3.34 The PRP observed that, among the three applications under review, while the date of notification of the FRC's decision and the effective date of recognition were the same for applications made by listed entities; for the application made by a listing applicant, the two dates were two months apart. In relation to such difference, the FRC explained that for the two applications by listed entities, since the relevant overseas auditors had

already undertaken the engagements and notified the FRC its intention to continue to carry out the engagement under the transitional arrangement, the recognition took effect upon the FRC's decision to grant recognition. On the other hand, for the application by a listing applicant, since the relevant overseas auditor had not yet undertaken the PIE engagement, the FRC granted approval-in-principle, and the recognition came into effect when the overseas auditor undertook the PIE engagement, which was two months after the FRC's approval-in-principle was granted.

3.35 The PRP noted that the FRC had the power to impose conditions on recognised PIE auditor and sought examples of possible conditions. The FRC gave the example where the FRC considered that the auditors lacked certain technical skills or knowledge, additional continuing professional development requirements might be imposed.

Conclusion

3.36 Having reviewed the FRC's handling of the applications and in light of the above clarification, the PRP agreed that while the FRC had been handling them in accordance with its internal procedures, it should expedite the processing of applications by adopting measures like automation of data input.

(9) *Complaint against a former FRC staff*

3.37 The PRP reviewed a complaint against a former FRC staff which involved allegation on conflict of interests in an investigation case.

3.38 The PRP noted that as there was no indication on the first incoming letter addressed to the FRC Chairman that it was a complaint, that letter was inadvertently opened and handled by the Case Director of the investigation case in question. After clarifying the nature of the first letter as a complaint, the FRC handled the complaint as per the internal procedural manual. An external senior counsel was engaged to review the allegation, and advised that there should be no conflict of interests. The FRC Board endorsed this view and the complainant was informed accordingly.

3.39 In response to the PRP's queries, the FRC advised that the Management Team had been reviewing and revising the procedures on handling incoming letters. The PRP suggested that it would be a good practice for addressees to open their incoming letters so that unintended disclosure could be minimised.

Chapter 4 : Observations and way forward

4.1 On the cases and applications reviewed during the 12th review cycle, the PRP concluded that the FRC had handled them in accordance with its internal procedures.

4.2 The PRP made the following recommendations to the FRC –

- (a) to continue its efforts in expediting the handling of investigation cases in a bid to clearing the existing backlogs;
- (b) to continue exploring ways to expedite the processing of recognition application, such as automation of the recognition procedures; and
- (c) to review the internal practice for processing incoming letters.

The PRP also gave advice to the FRC on improving the presentation of case materials so as to facilitate more efficient preparation for case review sessions in the future.

4.3 The FRC thanked the PRP for their comments and undertook actions in response to the PRP's observations and recommendations above.

4.4 The PRP will continue to study how its approach of review can be adjusted in consideration of the expanded regulatory scopes of the FRC.

4.5 Comments on the work of the PRP can be referred to the Secretariat of the PRP for the FRC by post (Address: Secretariat of the PRP for the FRC, 15th Floor, Queensway Government Offices, 66 Queensway, Hong Kong) or by email (email address: frcprp@fstb.gov.hk)³.

³ For enquiries or complaints not relating to the process review work of the FRC, they should be made to the FRC directly –

By post	:	24 th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong
By telephone	:	(852) 2810 6321
By fax	:	(852) 2810 6320
By email	:	general@frc.org.hk or complaints@frc.org.hk

Chapter 5 : Acknowledgement

5.1 The PRP would like to express its gratitude towards the FRC for its assistance in facilitating the review work, and its cooperation in responding to the PRP's enquiries and recommendations in the past year.

**Secretariat of the Process Review Panel
for the Financial Reporting Council
May 2021**

**Process Review Panel
for the Financial Reporting Council**

2020 Membership

Chairman

Dr. Anthony CHOW, SBS, JP

Members

Ms. Florence CHAN

Prof. CK LOW

Ms. Edith SHIH⁴

Mr. KK TSE

Dr. Kelvin WONG, JP (ex-officio member)

(With secretariat support provided by
the Financial Services and the Treasury Bureau)

⁴ Appointed as the Chairperson of the PRP from 1 January 2021.