

立法會 *Legislative Council*

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Panel on Financial Affairs

Meeting on 17 March 2023

Background brief on the work of the Accounting and Financial Reporting Council

Purpose

This paper provides background information on the Accounting and Financial Reporting Council (“AFRC”), including its establishment, functions, composition and funding arrangement. The paper also provides a summary of the discussion by Legislative Council (“LegCo”) Members on issues relating to AFRC’s budget at meetings of the Panel on Financial Affairs (“FA Panel”) in 2021 and 2022, and during the scrutiny of the Financial Reporting Council (Amendment) Bill 2021.

Background

Establishment of the Financial Reporting Council and the Accounting and Financial Reporting Council

2. The Financial Reporting Council Ordinance (Cap. 588) (“FRCO”) which was enacted in July 2006 provides for the establishment of the Financial Reporting Council (“FRC”).¹ At its inception, while FRC would initiate investigation into possible auditing and reporting irregularities in relation to listed entities, and conduct enquiries into possible non-compliance with accounting requirements by listed entities, it was not empowered to discipline. All regulatory powers of the accounting profession were vested with the Hong Kong Institute of Certified Public Accountants (“HKICPA”). FRC would refer relevant cases to other parties, such as HKICPA and the Securities and Futures Commission, for follow-up as necessary after performing its investigation/enquiry function.

¹ The Financial Reporting Council (“FRC”) was established in December 2006 and became fully operational in July 2007.

3. The Financial Reporting Council (Amendment) Ordinance 2019 (“the Amendment Ordinance 2019”) enacted in February 2019 establishes a new regulatory regime for auditors of public interest entities (“PIEs”) by transferring HKICPA’s regulatory powers in respect of PIE auditors to FRC (“PIE regulatory regime”).² 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 the recognition of PIE auditors from overseas.

4. The Financial Reporting Council (Amendment) Ordinance 2021 (“the Amendment Ordinance 2021”) enacted in October 2021 further reforms FRC to develop it into a full-fledged independent regulatory and oversight body for the accounting profession (“the new regulatory regime for the accounting profession”).³ By virtue of the Amendment Ordinance 2021, FRC takes over the major regulatory powers of HKICPA in respect of issuing practising certificates to certified public accountants (“CPAs”), registering CPA firms, corporate practices and local PIE auditors, as well as taking inspection, investigation and disciplinary actions of CPAs and practice units. FRC is renamed as AFRC in light of its expanded functions and FRCO is also renamed as the Accounting and Financial Reporting Council Ordinance (“AFRCO”).

5. Under the new regime, HKICPA continues to be responsible for: conducting professional examinations; registering CPAs; arranging for mutual or reciprocal recognition of accountants from places outside Hong Kong; setting continuing professional development (“CPD”) requirements; and issuing or specifying standards on professional ethics, accounting, and auditing and assurance for CPAs; and providing training for qualifying as CPAs and for CPD of CPAs. Such functions of HKICPA are subject to AFRC’s oversight.

Composition of the Accounting and Financial Reporting Council

6. Section 7 of AFRCO stipulates that AFRC is to consist of: (a) a chairperson, who is a non-executive director of AFRC; (b) a chief executive officer, who is an executive director of AFRC; and (c) at least seven other

² The Financial Reporting Council (Amendment) Ordinance 2019 (“the Amendment Ordinance 2019”) came into effect on 1 October 2019.

³ The Financial Reporting Council (Amendment) Bill 2021 was passed by the Legislative Council at its meeting of 20 October 2021, and the Financial Reporting Council (Amendment) Ordinance 2021 came into effect on 1 October 2022.

members, who are either executive or non-executive directors of AFRC.⁴ As of March 2023, the Board of AFRC consists of a chairman, a chief executive officer and 10 other non-executive directors. There are six committees⁵ to advise and assist the Board in overseeing the functions of AFRC. The governance structure of AFRC is given in **Appendix 1**.

Funding of the Accounting and Financial Reporting Council

7. The Amendment Ordinance 2019 introduces a new funding model for FRC under which FRC is funded by three levies on: (a) securities transactions (to be paid by sellers and purchasers in securities transactions); (b) PIEs; and (c) PIE auditors.⁶ To help FRC migrate to the PIE regulatory regime and to exempt the relevant levies for the first two years of implementation of the regime, the Government provided a seed capital of \$400 million to FRC in 2019. FRC had started collecting the relevant levies since 1 January 2022.

8. Upon the commencement of the Amendment Ordinance 2021 on 1 October 2022, AFRC became the authority for issuing practising certificates to CPAs and registration of practice units, and thus could collect relevant application fees previously payable to HKICPA. As the unspent balance of the seed capital could help cover AFRC's expenses arising from the expanded functions in the initial years, the said fees were exempt in the first year of operation of the new regulatory regime. AFRC will start collecting application fees on 1 October 2023.

⁴ Section 7 of the Accounting and Financial Reporting Council Ordinance (Cap. 588) also provides that:

- (a) all members of the Accounting and Financial Reporting Council ("AFRC") must be non-practitioners appointed by the Chief Executive ("CE"), and a public officer is not eligible for appointment as a member;
- (b) among the members of AFRC, the number of non-executive directors must exceed the number of executive directors; and
- (c) among the members of AFRC, at least one-third must be appointed from among persons who appear to CE to be suitable for appointment because of their knowledge and experience in public interest entity engagements; and the others must be appointed from among persons who appear to CE to be suitable for appointment because of their knowledge in accounting, auditing, finance, banking, law, administration or management; or their professional or occupational experience.

⁵ The six committees are: Inspection Committee; Investigation and Compliance Committee; Discipline Committee; Policy, Registration and Oversight Committee; Finance and Corporate Affairs Committee; and Compensation and Nomination Committee.

⁶ Before the commencement of the Amendment Ordinance 2019, FRC was jointly funded by the Companies Registry Trading Fund, the Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and the Hong Kong Institute of Certified Public Accountants on an equal share basis.

9. Under sections 17 and 20 of AFRCO, AFRC is required to: (a) submit for approval of the Financial Secretary (“FS”) the estimates of AFRC’s income and expenditure for the next financial year; and (b) provide FS with a report on AFRC’s activities of the previous financial year (together with the statement of accounts and the audited report), which must be laid on the table of LegCo.

Concerns and views expressed by Members

10. The Administration briefed FA Panel on FRC’s annual budget for 2021-2022 and the preparation for the commencement of the new regulatory regime for the accounting profession at the meetings on 1 March 2021 and 4 April 2022 respectively. During its scrutiny of the Financial Reporting Council (Amendment) Bill 2021, the relevant Bills Committee also discussed issues relating to the funding of AFRC. Views and suggestions made by Members at the above meetings are summarized in the ensuing paragraphs.

Functions of the Accounting and Financial Reporting Council

11. Some Members opined that AFRC should be responsible for promoting the development of the accounting profession, in particular enhancing development opportunities for the profession in the Mainland and overseas in collaboration with the Government and HKICPA. There were also suggestions that AFRC should play a role in the CPD training of CPAs.

12. The Administration pointed out that AFRCO clearly provides AFRC’s functions must include promoting and supporting the development of the accounting profession. It was envisaged that HKICPA would concentrate its resources on promoting the professional development of the accounting profession after implementation of the new regulatory regime with HKICPA’s major regulatory powers transferred to AFRC. AFRC would continue to work with HKICPA in enhancing development opportunities for the local accounting profession and nurturing talents for the profession. On the development opportunities in the Mainland, the Administration had been discussing with the relevant Mainland authorities through various channels on 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 had been granted national treatment in respect of the requirements for becoming partners of partnership accounting firms in the Mainland. The Administration would 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 in particular.

13. As regards AFRC's role in CPD training, the Administration responded that HKICPA was playing 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 as well as in verifying the appropriate hours of CPD undertaken by CPAs. AFRC's new oversight power over HKICPA's work in these aspects would facilitate AFRC in working jointly with HKICPA and relevant stakeholders in developing quality CPD programmes that reflect the regulatory objectives and the need of the profession.

Funding mechanism of the Accounting and Financial Reporting Council

14. Members expressed concern on whether AFRC would use its levies from PIEs and securities transactions to fund its new regulatory duties relating to CPAs and practice units who did not conduct PIE engagements. The Administration pointed out that the income and expenditure for AFRC's regulatory work in respect of PIE auditors and other practice units and CPAs would be planned on the "user-pay" principle to avoid unreasonable cross-subsidization. This would be suitably reflected in AFRC's annual budgets which required approval by FS in accordance with AFRCO.

15. Members relayed concerns of the accounting profession about a possible surge in AFRC's fees for issuing CPA practising certificates and registration of practice units. Members also urged the Administration to extend the fee exemption period for issue of practising certificates and registration of practice units after commencement of the new regulatory regime and to freeze such fees at HKICPA's current level for a certain period thereafter.

16. The Administration responded that the fees relating to AFRC's new functions would be exempt in the first year of implementation of the new regulatory regime for the accounting profession. As regards the fees to be collected thereafter, the Administration planned to freeze them for the first few years of implementation at a level no higher than that which was currently collected by HKICPA. In the initial stage of discharge of expanded functions by AFRC, the deficit resulted from the exemption and freeze on the relevant fees would be met by the unspent balance of the \$400 million seed capital provided by the Government in 2019.

17. In response to Members' enquiry about the mechanism for AFRC to reduce its levies, the Administration explained that it was stipulated in AFRCO that AFRC must consult FS with a view to recommending to the Chief

Executive in Council that the levies be reduced if the reserves of AFRC were more than twice its estimated operating expenses for that financial year. This arrangement was in line with that of other local financial regulators.

Staff recruitment of the Accounting and Financial Reporting Council

18. Members asked how AFRC would recruit new staff for carrying out functions under the new regulatory regime for the accounting profession. The Administration replied that AFRC planned to recruit new staff in 2022-2023 for the phasing-in of the new regulatory regime. HKICPA's existing staff of suitable calibre and with experience on the functions to be transferred to AFRC would also be considered for recruitment. The new staff to be recruited in 2022-2023 would be responsible for tasks such as issuing practising certificates and registration of practice units, and following up on the investigation and disciplinary cases handed over by HKICPA or newly arising, and preparing for the inspection of practice units.

Relevant questions raised at Council meetings

19. At the LegCo meeting of 11 May 2022, a Member raised an oral question concerning the Agreement on Development Strategies for the Accounting Profession in Guangdong, Hong Kong and Macao. Matters covered by the question included whether the Administration would instruct FRC to enhance its work in strengthening the exchanges and training for the talents in the accountancy sectors of the three places. Details of the oral question are available in **Appendix 2**.

Latest development

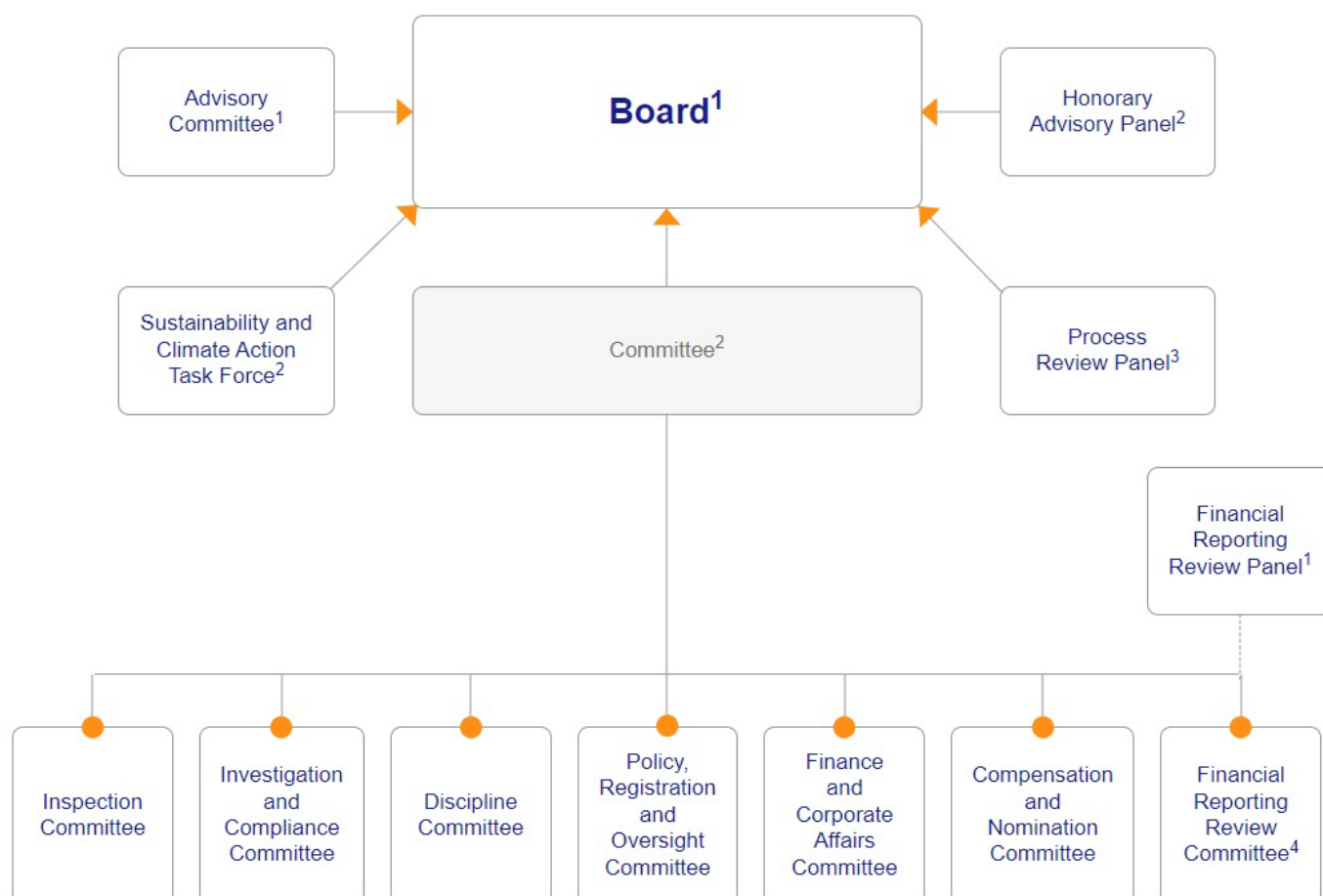
20. AFRC and the Administration will brief FA Panel on the budget of AFRC for the financial year of 2023-2024 at the meeting on 17 March 2023.

Relevant papers

21. A list of relevant papers is in **Appendix 2**.

Governance structure of the Accounting and Financial Reporting Council

Governance Structure



Footnotes:

1. Established under the Accounting and Financial Reporting Council Ordinance (“AFRCO”) and their members are appointed by Government Officials designated under AFRCO.
2. Established by and their members appointed by the Board.
3. Established in 2008 by the Chief Executive (“CE”) of Hong Kong Special Administrative Region and its members are appointed by CE to enhance the accountability of the Financial Reporting Council.
4. The members are appointed from amongst the members of the Financial Reporting Review Panel.

Source: Accounting and Financial Reporting Council’s website [Accessed March 2023] (<https://www.afrc.org.hk/en-hk/corporate-governance/governance-structure/>)

List of relevant papers

Date	Event	Papers/Minutes of meeting
30 January 2019	The Legislative Council (“LegCo”) passed the Financial Reporting Council (Amendment) Bill 2018	The Bill passed Legislative Council Brief Report of the Bills Committee (LC Paper No. CB(1)505/18-19)
1 March 2021	The Panel on Financial Affairs (“FA Panel”) was briefed on the budget of the Financial Reporting Council (“FRC”) for the financial year of 2021-2022	Administration’s paper on Financial Reporting Council – Budget for the financial year 2021-2022 (LC Paper No. CB(1)604/20-21(06)) Updated background brief on the work of the Financial Reporting Council prepared by the Legislative Council Secretariat (LC Paper No. CB(1)604/20-21(07)) Meeting minutes (LC Paper No. CB(1)883/20-21)
20 October 2021	LegCo passed the Financial Reporting Council (Amendment) Bill 2021	The Bill passed Legislative Council Brief Report of the Bills Committee (LC Paper No. CB(1)1417/20-21)
7 March 2022	The Administration provided an information paper to FA Panel on FRC’s budget for the financial year of 2022-2023	Administration’s paper on Financial Reporting Council – Budget for the financial year 2022-2023 (LC Paper No. CB(1)117/2022(04))

Date	Event	Papers/Minutes of meeting
4 April 2022	FA Panel was briefed on the progress of preparatory work for the new regulatory regime of the accounting profession	<p><u>Administration's paper on progress of preparatory work for the new regulatory regime of accounting profession</u> (LC Paper No. CB(1)156/2022(04))</p> <p><u>Background brief on the Financial Reporting Council and the new regulatory regime for the accounting profession prepared by the Legislative Council Secretariat</u> (LC Paper No. CB(1)156/2022(05))</p> <p><u>Meeting minutes</u> (LC Paper No. CB(1)321/2022)</p>
11 May 2022	Hon Edmund WONG raised an oral question on "Agreement on Development Strategies for the Accounting Profession in Guangdong, Hong Kong and Macao"	<p><u>Hansard</u> (pages 20-28)</p>