



Abridged Report on the FRC's Assessment of the HKICPA's Performance of the Specified Functions

11 December 2020

This document is an abridged version of the Report on the Financial Reporting Council's Assessment of the Hong Kong Institute of Certified Public Accountants' Performance of the Specified Functions. The full version of the report is available on the FRC's website (www.frc.org.hk).

About the FRC

The Financial Reporting Council is an independent body established on 1 December 2006 under the Financial Reporting Council Ordinance. It is entrusted with the statutory duty to regulate auditors of listed entities through a system of registration and recognition, and through inspection, investigation and disciplinary action.

The mission of the FRC is to uphold the quality of financial reporting of listed entities in Hong Kong, so as to enhance protection for investors and deepen investor confidence in corporate reporting.

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Foreword from the Chief Executive Officer

I am pleased to present the FRC's report on our first assessment of the statutory functions ("specified functions") of the Hong Kong Institute of Certified Public Accountants ("HKICPA") that fall within our new Oversight function under the amended FRC Ordinance ("FRCO"). These functions are critical elements of the overall system for regulating the auditors of listed entities. The FRC is charged with acting in the public interest to oversee that system, under the FRCO.



These functions relate to the registration of local auditors of listed entities, the setting of standards on professional ethics, and auditing and assurance practices, and the setting of continuing professional development requirements for PIE auditors. Our oversight role was established because these functions continue to be performed by the HKICPA as a self-regulatory body, within what is intended to be an independent regulatory regime for auditors of listed entities.

In performing the specified functions, the HKICPA makes important decisions about the suitability of local listed entity auditors to carry out PIE audits, the professional standards those auditors are to apply in their audits, and the ongoing professional training and other development they must undertake each year to renew their registration.

We take a holistic approach to our assessment, which includes considering not only the policies, process and procedures established by the HKICPA and how they are implemented, but also the related governance arrangements. Our focus is on whether these matters ensure the effective performance of the specified functions. It is our duty to recommend improvements that we consider will serve the public interest in audit quality.

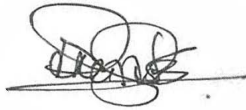
We communicated our findings and recommendations to the HKICPA and considered their responses, including their intended follow-up actions. We were satisfied that the HKICPA's follow-up actions were adequate to address our recommendations.

The findings and recommendations resulting from our assessment are included in this report. Our findings vary in their significance to the effective performance of the specified functions. However, we believe that adequate follow-up actions to address each of our recommendations will serve the public interest in audit quality well.

Many of our recommendations address the need to strengthen HKICPA's policies and procedures to ensure consistent effective discharge of the specified functions. These include its policies and procedures for the selection of members of committees responsible for the specified functions, the maintenance of the terms of reference of such committees, and for setting specific continuing professional development requirements for local PIE auditors.

In conducting our second assessment, the FRC will build on our first assessment by carefully reviewing the HKICPA's further elaboration and implementation of its intended follow-up actions. We will also focus on the HKICPA's internal controls over the performance of the specified functions.

Our experience of carrying out our first assessment was one of constructive engagement. We welcome the HKICPA's positive attitude to our important public interest role and are grateful to them for facilitating our assessment.



Marek Grabowski
Chief Executive Officer

1.1 Introduction

- 1.1.1 This abridged report summarises the key findings and recommendations of the FRC's assessment of the HKICPA's performance of the functions set out in paragraph 1.1.2 (i.e. the Specified Functions) from the commencement of the new auditor regulatory regime on 1 October 2019 to 31 March 2020 (i.e. the Assessment Period).
- 1.1.2 The FRC has a statutory duty under section 9(b) of the Financial Reporting Council Ordinance (Cap 588) (i.e. the FRCO) to oversee the following Specified Functions:
- (a) dealing with applications and other matters relating to the registration of PIE auditors;
 - (b) establishing and maintaining the PIE auditors register;
 - (c) setting CPD requirements for registered PIE auditors; and
 - (d) setting standards on professional ethics, and auditing and assurance practices, for registered PIE auditors.

1.2 Background and objective of our assessment

[The regulatory regime for PIE auditors in Hong Kong and the power of the FRC in overseeing the HKICPA's performance](#)

- 1.2.1 In January 2018, the HKSAR Government introduced the Financial Reporting Council (Amendment) Bill 2018 to enhance the independence of the regulatory regime for PIE auditors in Hong Kong. Upon the commencement of the Financial Reporting Council (Amendment) Ordinance 2019 on 1 October 2019, the FRC has become the independent auditor oversight body to:
- (a) regulate auditors of listed entities through a registration and recognition mechanism, and through inspection, investigation and disciplinary sanction;
 - (b) oversee the HKICPA's performance of the Specified Functions;
 - (c) monitor, through enquiries, the compliance by listed entities of regulatory requirements for financial reports; and
 - (d) with respect to each of the inspections, investigations or enquiries, to decide on and carry out the appropriate actions in accordance with the FRCO.

- 1.2.2 Under section 10(1A) of the FRCO, the FRC may, for overseeing the HKICPA's performance of the Specified Functions:
- (a) request the HKICPA to provide information and periodic reports on the HKICPA's performance of a Specified Function;
 - (b) conduct assessment of the HKICPA's performance of a Specified Function; and
 - (c) if satisfied that it is in the public interest to do so, give written directions to the HKICPA on the performance of a Specified Function.

Statement of Protocol on Oversight Arrangements

1.2.3 On 27 September 2019, the FRC entered into a Statement of Protocol on Oversight Arrangements with the HKICPA to set out the oversight arrangements to be put in place between the FRC and the HKICPA.

1.2.4 Pursuant to the Statement of Protocol on Oversight Arrangements, the FRC and the HKICPA agreed that:

- (a) representative(s) from the FRC would sit on the relevant committees of the HKICPA responsible for the performance of the Specified Functions (i.e. the RPC, the EC and the AASC) as an observer;
- (b) the HKICPA would provide the FRC with:
 - (i) the information on the applicable due process in relation to the Specified Functions and the annual work plan each year;
 - (ii) the terms of reference and composition of the relevant committees of the HKICPA each year;
 - (iii) quarterly activity reports containing information that would enable the FRC to understand the activities of the HKICPA in relation to the Specified Functions, with all relevant supporting materials including agendas and approved minutes of meetings of the relevant committees of the HKICPA and/or the HKICPA Council; and
 - (iv) any other information, documents, or reports in the HKICPA's possession that the FRC may reasonably require for the performance of the oversight function; and
- (c) the FRC would conduct regular assessments of the HKICPA's performance of the Specified Functions, and where appropriate, make recommendations. The HKICPA would provide a written response including any follow-up actions to the FRC regarding the recommendations.

- 1.2.5 A report on the key findings and recommendations of the FRC’s assessment regarding the HKICPA’s performance of the Specified Functions will be published on a regular basis and be made available on the websites of the FRC and the HKICPA.

1.3 How we conducted the assessment

- 1.3.1 In conducting the assessment, the FRC performed the following procedures:

- (a) observed and reviewed minutes of the meetings of the HKICPA committees responsible for the performance of the Specified Functions (i.e. the RPC, the EC and the AASC) during the Assessment Period;
- (b) reviewed the two quarterly reports provided by the HKICPA on the performance of the Specified Functions for the periods from 1 October 2019 to 31 December 2019 and from 1 January 2020 to 31 March 2020, respectively;
- (c) conducted an on-site assessment from 27 April 2020 to 15 May 2020 of the performance of the HKICPA in relation to the Specified Functions during the Assessment Period, including:
 - examining the internal documents, written policies and procedures of the HKICPA; and
 - interviewing selected members of the committees and staff members of the HKICPA.

1.4 Summary of findings and recommendations

- 1.4.1 A summary of our findings and recommendations based on our assessment is set out below, in the order of importance. Details of findings and recommendations are set out in Section 2 to Section 4 of the full report.

General

Selection of members of the HKICPA committees responsible for the performance of the Specified Functions

[Paragraphs 2.3.5-2.3.9; 3.3.4-3.3.6; 4.3.3-4.3.5 of the full report]

1.4.2 The HKICPA designates a committee for the performance of each Specified Function (i.e. the RPC for registration of PIE auditors; the EC for setting CPD requirements and the standards on professional ethics; and the AASC for setting the standards on auditing and assurance practices). The HKICPA has issued general internal guidance for the appointment of committee members. However, the FRC noted that such guidance does not set out the specific knowledge and skills expected from committee members in discharging their duties concerning the performance of the Specified Functions. The documentation on the selection and approval of appointment does not indicate that the HKICPA conducted a formal evaluation of the contribution of committee members apart from reviewing the attendance records, when reappointing them to the committees.

1.4.3 The HKICPA should develop a skills matrix specific to the Specified Functions to ensure the committee members being selected possess the appropriate knowledge and skills in discharging their duties and to foster diversity of thought. Gender and other aspects of diversity enable the committees to better understand the industry and stakeholders. The HKICPA should also put in place policies and criteria to evaluate contribution of the committee members, in addition to their attendance of past meetings, when considering reappointment.

Regular review of terms of reference for the committees responsible for the performance of the Specified Functions, and communication amongst committee members

[Paragraphs 3.3.1-3.3.3 of the full report]

1.4.4 The existing terms of reference for the EC as adopted since June 2014 do not reflect the committee's power and responsibility in setting CPD requirements for certified public accountants which has been delegated from the HKICPA Council since 2009. Two of the three committee members interviewed by the FRC were not aware of the EC's power and responsibility in setting CPD requirements for certified public accountants.

1.4.5 The HKICPA should regularly review the terms of reference for the committees responsible for the performance of the Specified Functions to ensure the roles and responsibilities of the committees are fully reflected in the respective terms of reference, enabling the committee members to fully understand their responsibilities.

Registration of PIE auditors

Development of additional policies and guidelines regarding the determination of conditions for PIE auditor registration
[Paragraphs 2.3.18-2.3.21 of the full report]

- 1.4.6 Pursuant to section 20S of the FRCO, the HKICPA Council may impose any condition in relation to the registration of a local PIE auditor that the HKICPA Council considers appropriate.
- 1.4.7 The FRC noted that the HKICPA has developed policies during the Assessment Period for imposing CPD requirements as a condition to registration. The HKICPA should develop additional policies and guidelines regarding other types of conditions to promote proportionality, clarity, consistency and transparency in decision making; and to ensure that all applicants are aware from the outset of the approach which might be taken when determining what conditions to impose.

Setting of CPD requirements for registered PIE auditors

Prescription of specific CPD requirements for registered PIE auditors
[Paragraphs 3.3.15; 3.3.19 of the full report]

- 1.4.8 The existing CPD requirements prescribed by the HKICPA are set out in Statement 1.500 “Continuing Professional Development” which applies to all certified public accountants, including registered PIE auditors. Considering the professional competence and capabilities that are expected from a registered PIE auditor may be different from other certified public accountants, the HKICPA should consider prescribing specific CPD requirements for registered PIE auditors to ensure they have the knowledge and skills for discharging their duties in performing PIE engagements. The HKICPA should also consider providing a CPD course on the new auditor regime, to facilitate the registered PIE auditors to understand the relevant implications to their work.

Ensure the CPD requirements for registered PIE auditors are reflected completely in the professional standards
[Paragraphs 3.3.12-3.3.14; 3.3.16-3.3.18 of the full report]

- 1.4.9 The HKICPA did not include the requirements set out in IES 8 “Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)”, issued by the IAESB in December 2014 with an effective date of 1 July 2016, in any subsequent version of Statement 1.500.

- 1.4.10 Under IES 8, the HKICPA needs to require certified public accountants performing the role of an audit engagement partner to develop and maintain professional competence that is demonstrated by the achievement of learning outcomes in 15 competence areas categorized under technical competence, professional skills, and professional values, ethics and attitudes.
- 1.4.11 The HKICPA considered that the requirements in IES 8 need not be reflected as requirements in Statement 1.500 as the requirements have already been covered by other professional standards and the HKICPA practice review team had already been assessing the competence of the auditors. Instead, the HKICPA issued a Financial Reporting and Auditing Alert in June 2016, which does not form part of CPD requirements, informing certified public accountants that the HKICPA would adopt IES 8 effective from 1 July 2016.
- 1.4.12 The HKICPA should ensure the professional standards include all the CPD requirements for registered PIE auditors. This helps ensure the registered PIE auditors are made aware of the requirements and effective regulatory actions can be taken as needed. Accordingly, the HKICPA should revise Statement 1.500 to include the requirements as set out in IES 8.
- [Ensure the CPD requirements for registered PIE auditors are updated in a timely manner](#)
[Paragraphs 3.3.9-3.3.11 of the full report]
- 1.4.13 As a member body of the IFAC, the HKICPA adopts and implements the IESs issued by the IAESB. Statement 1.500 draws on the CPD requirements as prescribed in IES 7 “Continued Professional Development” by the IAESB.
- 1.4.14 In response to the revisions to IES 7 issued by the IAESB in December 2018, the HKICPA provided the revised Statement 1.500 for approval by the EC at its meeting on 18 October 2019, which was 10 months after the IAESB had issued the revisions to IES 7. The revisions to IES 7 did not require a change to the HKICPA’s CPD requirements for certified public accountants, and the amendments to Statement 1.500 were made to align the wording in the Statement 1.500 with the revised IES 7. The EC was not notified of the issuance of the revised IES 7 nor the forthcoming change in Statement 1.500 until the meeting on 18 October 2019.
- 1.4.15 To ensure any additional standard-setting activity and other local requirements or guidance can be considered by the EC in a timely manner, the HKICPA should put in place controls to ensure the committee can consider any changes in international standards relating to CPD issued by the IAESB promptly even if the HKICPA does not expect a change in local CPD requirements.

Setting of Standards on Professional Ethics, and Auditing and Assurance Practices for registered PIE auditors

Regular review of policy documents

[Paragraphs 4.3.8-4.3.9 of the full report]

- 1.4.16 The Amended Preface published by the HKICPA, which sets out the HKICPA's processes in setting the standards of auditing and assurance practices, did not (until July 2020) reflect the fact that the HKICPA's Executive Committee had taken over the responsibility for overseeing the HKICPA's standard-setting functions since the discontinuance of the HKICPA's Standards and Quality Accountability Board in 2017. The HKICPA updated the Amended Preface to reflect the above change only in July 2020.
- 1.4.17 The HKICPA should develop a policy for its policy documents to be reviewed and updated regularly, to ensure the general public has access to accurate information for public oversight and scrutiny.

Ensure local constituents are consulted on requirements proposed by the IESBA and the IAASB

[Paragraphs 4.3.10-4.3.15 of the full report]

- 1.4.18 Under the HKICPA's established due process in the adoption of the IESBA and IAASB pronouncements, the HKICPA issues invitations to comment on the proposed IESBA and IAASB pronouncements for comment by local stakeholders. This is to ensure views from local stakeholders can be duly considered in the standard-setting process.
- 1.4.19 The HKICPA issued the invitations to comment within ten days upon the issuance of the consultative documents by the IESBA and the IAASB during the Assessment Period, except for the IESBA's consultative document on "Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers". The HKICPA neither issued an invitation to comment nor performed any local consultation activity regarding this consultative document because of an oversight by staff members of the HKICPA.
- 1.4.20 The HKICPA should put in place controls to ensure invitations to comment are issued and the need to conduct any local standard-setting initiatives is considered in response to all consultative documents issued by the IESBA and the IAASB in order that views from our local stakeholders can be duly considered in the standard-setting process.

Ensure post-implementation reviews are performed on the Standards of Professional Ethics, and Auditing and Assurance Practices and the CPD requirements

[Paragraphs 3.3.20-3.3.21; 4.3.19-4.3.20 of the full report]

- 1.4.21 The FRC noted that the HKICPA does not have policies and procedures in place to proactively review the standards of professional ethics, and auditing and assurance practices, and the CPD requirements for registered PIE auditors after such requirements have been issued for a certain period of time (i.e. post-implementation review). The HKICPA should put in place policies and procedures to ensure post-implementation reviews are performed regularly, to ensure the relevant standards and CPD requirements are still fit for purpose.

Abbreviations

AASC	Auditing and Assurance Standards Committee
Amended Preface	Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements
Assessment Period	The period from 1 October 2019 to 31 March 2020
CPD	Continuing professional development
EC	Ethics Committee
FRC	Financial Reporting Council
FRCO	Financial Reporting Council Ordinance (Cap 588)
HKICPA	Hong Kong Institute of Certified Public Accountants
HKICPA Council	Council of the HKICPA established by section 10(1) of the PAO
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IES	International Education Standard
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
Listing Rules	The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited; or the Rules Governing the Listing of Securities on the GEM of the Stock Exchange of Hong Kong Limited, approved by the Securities and Futures Commission under section 24 of the Securities and Futures Ordinance (Cap 571), and as in force at the material time.
PAO	Professional Accountants Ordinance (Cap 50)
Public interest entity (PIE)	Has the same meaning as in section 3(1) of the FRCO, i.e. any listed entity except a listed corporation whose listed securities do not include shares or stocks.
PIE auditor	Has the same meaning as in section 3A of the FRCO, i.e. an auditor who undertakes a PIE engagement (who, before

doing so, is required to be registered or recognized as a PIE auditor under the FRCO).

PIE engagement

Has the same meaning as in Part 1 of Schedule 1A of the FRCO, i.e. any of the following types of engagement carried out by an auditor:

- (a) an auditor's report on a PIE's annual financial statements required by the Companies Ordinance (Cap 622), the Listing Rules or any relevant code issued by the Securities and Futures Commission;
- (b) a specified report required to be included in (i) a listing document for the listing of the shares or stocks of a corporation seeking to be listed or a listed corporation, or (ii) a listing document of a collective investment scheme seeking to be listed or a listed collective investment scheme; or
- (c) an accountant's report required under the Listing Rules to be included in a circular issued by a PIE for a reverse takeover or a very substantial acquisition.

RPC

Registration and Practising Committee

