

**G.N. 5961**

FINANCIAL REPORTING COUNCIL ORDINANCE (Chapter 588)

Notice is hereby given that pursuant to sections 13 and 37(H)(1) of the Financial Reporting Council Ordinance (Chapter 588), the Financial Reporting Council publishes the following FRC Guidelines for Exercising the Power to Impose a Pecuniary Penalty which shall become effective on 1 October 2019.

27 September 2019

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*Financial Reporting Council*

# **FRC Guidelines for Exercising the Power to Impose a Pecuniary Penalty**

(With effect from 1 October 2019)

# **FRC GUIDELINES FOR EXERCISING THE POWER TO IMPOSE A PECUNIARY PENALTY**

## **Introduction**

1. These guidelines are made under section 37H of the Financial Reporting Council Ordinance (Cap 588) (**FRCO**) to indicate the manner in which the Financial Reporting Council (**FRC**), when considering the imposition of sanctions on regulated persons (i.e. public interest entity (**PIE**) auditors and registered responsible persons of a registered PIE auditor), will exercise its powers to impose a pecuniary penalty on (I) a PIE auditor under section 37D(3)(b)(iv), or (II) a registered responsible person of a registered PIE auditor under section 37E(3)(b)(iii). Section 37H(1)(b) requires the FRC to have regard to these guidelines in imposing any pecuniary penalty.
2. Terms defined in the FRCO shall have the same meanings in these guidelines.
3. Nothing in these guidelines is intended to be inconsistent with the FRCO and the FRC must proceed in accordance with the FRCO and the overriding requirements of natural justice.

## Pecuniary penalties

### *Introduction*

4. A pecuniary penalty may be ordered either alone or in combination with one or more other sanctions. Given that it will normally be in the public interest for any misconduct warranting the imposition of a pecuniary penalty to be accompanied by some degree of censure, the FRC should not impose a pecuniary penalty in isolation (i.e. without any other sanction) without satisfying itself that that is the appropriate course and providing reasons for that decision.
5. Under section 37D(3)(b)(iv) of the FRCO, the FRC may order the person who is or was a PIE auditor to pay a pecuniary penalty, not exceeding the amount which is the greater of—
  - (A) \$10,000,000; or
  - (B) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct
6. Under section 37E(3)(b)(iii) of the FRCO, the FRC may order a person who is or was a registered responsible person of a registered PIE auditor to pay a pecuniary penalty, not exceeding the amount which is the greater of—
  - (A) \$10,000,000; or

- (B) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

*Ordering a pecuniary penalty*

- 7. In order to determine whether a pecuniary penalty is appropriate the factors to be considered will normally include whether:
  - (a) deterrence can be achieved by a reprimand alone or other sanctions;
  - (b) the regulated person(s) has derived any financial gain or benefit (including avoidance of loss) as a result of the misconduct;
  - (c) the misconduct involved, caused or risked the loss of significant sums of money; and
  - (d) a pecuniary penalty was ordered in similar previous cases.

*Determining the amount of a pecuniary penalty*

- 8. In cases where the FRC considers that a pecuniary penalty is appropriate, it should aim to impose a pecuniary penalty that:
  - (a) is proportionate to the misconduct and all the circumstances of the case;
  - (b) will act as an effective deterrent to future misconduct;
  - (c) will promote public confidence in the regulation of PIE audits and in the way in which misconduct is addressed.
- 9. In undertaking this assessment, the FRC will normally take into consideration:
  - (a) the nature, extent and importance of the standards or regulations breached;
  - (b) the seriousness of the misconduct;
  - (c) the factors set out in paragraphs 12 and 13 below; and
  - (d) the upper limit on the pecuniary penalty that can be imposed.
- 10. Where a regulated person submits that the pecuniary penalty may put him in financial jeopardy and provides relevant information in support of such submission, the FRC may consider the following factors. In the cases of a PIE auditor, the FRC will have regard to the PIE auditor's size/financial resources and financial strength, for example as indicated by the total turnover of the PIE auditor and the effect of a pecuniary penalty on its practice.

In the case of a registered responsible person, the FRC will have regard to the registered responsible person's financial resources (including his annual income and assets) and the effect of a pecuniary penalty on that individual and his future employment.

11. Where a case potentially gives rise to multiple pecuniary penalties, the FRC will look at the totality of the penalties to ensure that it is not disproportionate to the seriousness of the misconduct in question for each of the regulated persons.

*Nature and seriousness of misconduct*

12. In assessing the nature and seriousness of the misconduct and in determining which sanction(s) might be appropriate, the FRC will normally consider the factors summarised in the next paragraph. This list is not exhaustive and not all factors will be applicable in a particular case. The FRC should also consider carefully whether there may be other factors, not listed, that are relevant. Having identified the factors that it regards as relevant, the FRC should decide the relative weight to ascribe to each relevant factor.

13. Factors which may be considered include:

- (a) the nature, extent and importance of any standards or regulations breached;
- (b) the gravity and the duration of the misconduct;
- (c) the financial benefit derived or intended to be derived from the misconduct (the amounts of the profits gained or losses avoided by the regulated person(s), in so far as they can be determined). This may include any loss avoided or intended to be avoided where it is practicable to quantify this (for example, this could be quantified in appropriate cases by the fees received by the regulated person(s)). The FRC may also allocate an amount in respect of interest on the benefit obtained;
- (d) whether the misconduct caused or risked the loss of significant sums of money;
- (e) the passage of time since the misconduct occurred;
- (f) whether the misconduct was intentional or unintentional;
- (g) whether the misconduct was dishonest, deliberate or reckless;
- (h) whether the misconduct adversely affected, or potentially adversely affected, a significant number of people (such as the public, investors or other market users, consumers, clients, employees, pensioners or creditors);
- (i) whether the misconduct was isolated, or repeated or ongoing;
- (j) if repeated or ongoing, the length of time over which the misconduct occurred;

- (k) whether similar misconduct has been identified previously;
- (l) whether steps had been taken to address any similar misconduct previously identified;
- (m) other previous misconduct by the regulated person(s);
- (n) whether the regulated person(s) has failed to comply with any previous direction or order relevant to this misconduct;
- (o) whether it is likely that the same type of misconduct will recur;
- (p) whether the misconduct undermines the purpose or effectiveness of the FRCO;
- (q) whether the misconduct could harm investor, market and public confidence in the truth and fairness of the financial statements of PIEs;
- (r) whether the misconduct could undermine confidence in the standards of conduct in general of auditors or regulated persons;
- (s) in the case of a PIE auditor, the effectiveness of its relevant procedures, systems or internal controls and/or its implementation of any relevant Hong Kong Standards on Quality Control (or their equivalent);
- (t) in the case of a PIE auditor, when the PIE auditor's senior management became aware of the misconduct and what action was taken at that point; and
- (u) whether the regulated person(s) caused or encouraged other individuals to commit misconduct.

#### Other considerations

14. When deciding the level of pecuniary penalty to impose, the FRC should consider whether there are any arrangements that would result in the pecuniary penalty or part thereof being paid or indemnified by insurers, or by a PIE auditor or employer. The existence of any such arrangements should not be a ground for increasing any pecuniary penalty beyond the level that would otherwise be considered appropriate.
15. Having arrived at a figure for the pecuniary penalty based on the nature and seriousness of the misconduct, the FRC should consider whether the amount of the pecuniary penalty should be adjusted:
  - (a) to take account of any aggravating and mitigating factors;
  - (b) to ensure the pecuniary penalty has the necessary deterrent effect;

- (c) to reflect any discount for admissions and/or early disposal; and/or
- (d) to avoid the likely effect of putting a regulated person in financial jeopardy. However, if a regulated person takes deliberate steps to create the false appearance that the pecuniary penalty will place it, him or her in financial jeopardy, e.g. by transferring assets to third parties, this will be taken into account.