



## Introductory message from the CEO

It is my pleasure to introduce some of the key developments since our last edition of e-News was published on 31 March 2021. Further information is provided on several of these developments after this introductory message.

### Further FRC reforms proposed

The most significant of these developments is the announcement by the SAR Government on 8 June 2021 that it proposes to further reform the FRC's regulatory scope to be the independent regulatory and oversight body for the accounting profession.

Since then, we have been involved in extensive outreach with stakeholders to listen to their comments and concerns and to answer their questions about how we might approach the proposed enhanced scope of our regulatory remit.

Given that the proposals extend our remit from listed entity auditors to all auditors and in some respects to every Certified Public Accountant (CPA), it did not come as a surprise to us that concerns raised in our outreach were often focused on whether our regulatory approach would be the same for all CPAs and practice units as the approach we adopt for listed entity auditors.

In responding, we have emphasised that both the proposed regulatory powers and our approach to regulating different classes of regulatee would reflect the principle of proportionality. We would not be applying a 'one size fits all' approach and our regulatory approach should reflect the relative significance of our potential impact on regulatees whose operations and resources are on a small or even micro scale relative to some of the largest listed entity auditors.

Further details of the reform proposals can be read below.

## **FRC adds to quality of Hong Kong's corporate governance system**

On 20 May 2021, the tenth edition of "CG Watch" was published. "CG Watch" is a biennial regional survey undertaken by the Asian Corporate Governance Association (ACGA). The report looks at macro corporate governance quality in 12 markets in the Asia-Pacific region, and provides an overall score and ranking based on scores across seven categories.

While retaining its 2nd place in the overall rankings, Hong Kong increased its overall score by 3.5% from 60.0% to 63.5%. The long-anticipated debut of the FRC as the new independent auditor regulator was hailed as one of the main reasons for Hong Kong's overall score increase. In the "Auditors and audit regulators" category the percentage score (already the category with Hong Kong's highest score in the previous survey) moved up from 74.3% to 81.4%.

I'm glad to see the importance of having an independent regulator of listed entity auditors in Hong Kong recognized in this way. It is a tribute to the wisdom and efforts of Government in taking such action to meet the expectations of international investors and thereby further underpin the status of Hong Kong as an International Financial Centre. I am confident that, with the collective efforts of my colleagues and the guidance of my fellow Board members, the FRC can help realise the benefits for the investing public of high quality auditing and financial reporting for listed entities.

The report can be read [here](#).

## **Developments in regulatory collaboration**

With a view to further strengthening our collaboration with local regulators, we signed new Memoranda of Understanding with the Hong Kong Institute of Certified Public Accountants (**HKICPA**) on 6 May 2021 (see more below) and with The Stock Exchange of Hong Kong Limited on 8 June 2021 (see more below).

On 15 June 2021, the FRC completed its first investigation involving Mainland audit working papers obtained with the assistance of the Supervision and Evaluation Bureau of the PRC Ministry of Finance (see more [here](#)).

On the international stage, with effect from June 2021, the FRC joined IOSCO as an affiliate member. Joining IOSCO will enable the FRC to benefit from the sharing of global experience in securities regulation among IOSCO members and contribute to IOSCO's important work in relation to financial reporting and auditing (see more below).

## **FRC Annual Report and annual reports on the performance of our functions**

We aim to be transparent about our Inspection findings and audit quality ratings. This enables us to set out our expectation that listed entity auditors will take action to address the audit quality deficiencies we identify and urge audit committees to address these issues with their auditors. Such action can drive continuous improvement in audit quality and provide greater confidence to the investing public about the quality of financial reporting by listed entities. For this purpose, on 3 June 2021, we published the FRC's Annual Inspection Report. It includes the results of our inspections of listed entity audits in our first year of inspections (see more [here](#)).

Transparency about our own performance and about how we have implemented our regulatory approach, processes and culture and the results of our work enables us to be accountable to the public for the efficiency and effectiveness of the performance of our regulatory functions. Therefore, on 30 June 2021, we published the FRC Annual Report 2019-2021, which can be downloaded [here](#).

## **Second FRC Summer Internship Programme**

On 5 July 2021, we welcomed 6 Hong Kong university students participating in our second Summer Internship Programme, the aim of which is to kindle their interest and passion in the accounting profession and to provide them with hands-on practical experience to prepare them for their future careers (see more below).

## **Government proposes further reform of the FRC's regulatory scope**

On 21 July 2021, the Secretary for Financial Services and the Treasury introduced the Financial Reporting Council (Amendment) Bill 2021 into the Legislative Council for scrutiny. The Bill aims to further enhance the existing regulatory regime and develop the FRC into a full-fledged independent regulatory and oversight body for the accounting profession as a whole, including CPAs and practice units. Practice units include a CPA who holds a practising certificate (**CPA(P)**), firms of CPA(P)s and corporate practices. Only practice units are allowed to carry out statutory audits.

This is part of the Government's step-by-step approach to achieve independent regulation over the accounting profession. The new proposals are in line with international standard and practice and aim to reduce the compliance burden on the accounting profession.

The new proposals build on the expansion of the FRC's regulatory powers in October 2019 (**2019 reform**) beyond carrying out enquiries into listed entity financial statements and investigations into listed entity audits. The then expansion was to cover inspection and discipline of listed entity auditors and their registered responsible persons, the recognition of overseas auditors, and oversight of the performance by the HKICPA of certain statutory functions relating to listed entity auditors.

The Government's new proposals are 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 powers of inspection, investigation and discipline to cover all CPAs and practice units; and
- (iii) Expand the FRC's oversight powers to cover the HKICPA's functions of ascertaining qualification for registration as CPAs by conducting examinations; registering CPAs; arranging for mutual or reciprocal recognition of accountants; setting continuing professional development (**CPD**) requirements, and issuing or specifying standards on professional ethics, and accounting, auditing and assurance, for CPAs; and providing training for qualifying as and the CPD of CPAs.

There are about 1.4 million registered companies\* in Hong Kong and they make an significant economic contribution to Hong Kong. The proposed reform, empowering the FRC to regulate all of their auditors and oversee the accounting profession as a whole, will further strengthen the independence of regulation and maintain regulatory consistency. It will help increase public trust in the accounting profession and strengthen sustainable development of the auditing and accounting industry. It will also reinforce the competitiveness of Hong Kong as an international financial centre.

\* Source: 2021 statistics from Companies Registry.



To proactively seek views on the proposed new reforms from the accounting profession and other key stakeholders, we have given 11 interviews to the media, met with 14 accounting firms, professional bodies and associations including the HKICPA, CPA Australia, Association of Women Accountants and Hong Kong Independent Non-Executive Director Association. We also spoke at forums organized by HKICPA, Society of Chinese Accountants and Auditors, and Accounting Development Foundation. This has enabled us to listen to comments and answer questions raised by key stakeholders. The major issues raised include the funding model and headcounts of the reformed FRC, the regulatory approach for inspection, investigation and discipline against small and medium sized practitioners and sanctions over practitioners and CPAs.

The FRC's current policies and procedures were developed to regulate PIE auditors. In exercising the powers proposed to be transferred from the HKICPA, the FRC would need to develop new policies and procedures that are appropriate in regulating efficiently and effectively those CPAs and practice units not involved in listed entity audits.

We would expect our approach to largely follow the current practice of HKICPA. In particular, the power of inspectors and investigators, the scope of investigable and sanctionable misconducts as well as the types and levels of penalties will be similar to those currently provided in the Professional Accountants Ordinance. The FRC would also continue to adopt the principle of proportionality in performing its regulatory functions to ensure efficient deployment of resources in areas where we can make the most significant impact on the protection of the public interest. The FRC would also be proportionate in its regulatory approach to different regulatees to avoid imposing excessive compliance burdens on smaller and non-complex businesses or auditors.

“Further to our recent engagement with accounting organizations, CPAs and various stakeholders, we will continue our stakeholder engagement activities and consultations, and work closely with the Government to take the proposed reform forward,” said Mr Marek Grabowski, Chief Executive Officer of the FRC. “With the experience we have gained as the independent regulator of auditors of listed entities, we are confident that the FRC will be able to discharge the new functions entrusted to us effectively and efficiently.”

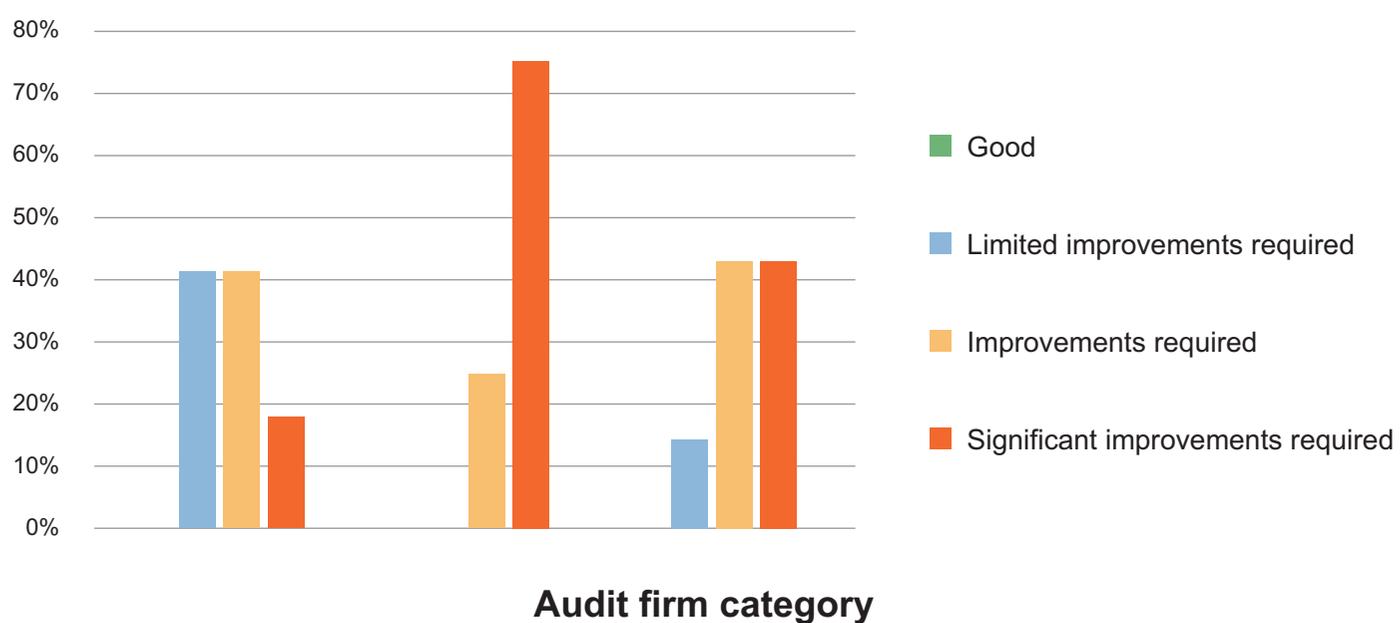
# Annual Inspection Report published

The FRC’s [Annual Inspection Report](#), published on 3 June 2021, includes the results of our inspections of listed entity audits in our first year of inspections. The report includes the significant findings and audit quality ratings for all of the 37 engagement inspections we completed, the key drivers of those ratings, and how we are responding. The report also highlights common deficiencies in the systems of quality control of the 18 firms that we inspected, and our expectations of auditors and audit committees in response to these results.

The chart below sets out the percentage of our completed engagement inspections that were assigned each of our quality ratings, for each Category of audit firm. The categorisation of audit firms is based on the number listed entities audited by a firm.

Our report shows that 73%, or almost three-quarters, of the listed entity engagements that we inspected needed either “Improvement” or “Significant improvement” and are therefore below the high standard required of audits of listed entities. Firms of all sizes need to take robust action to address these findings and audit quality results should improve substantively when appropriate measures are taken.

*Engagement Inspection Results by Size of Firm*



Category A (Firm audits more than 100 listed entities)	Category B (Firm audits 11 to 100 listed entities)	Category C (Firm audits up to 10 listed entities)	
22	8	7	Number of engagements inspected



The report also discloses the percentage of our engagement inspections completed for individual Category A audit firms that were assigned each of our quality ratings. Category A audit firms collectively audit 90% of listed entities by market capitalisation. These six firms therefore play important roles in upholding the quality of financial reporting by listed entities through performing their audits to a high quality.

In this context, the decision to disclose the inspection results and name the individual audit firms in this category, but not to do so for other categories, was taken by the FRC after applying the regulatory principles of transparency and proportionality. In doing so, the FRC carefully weighed the public interest impact of transparency for firms in Category A compared with firms in other categories and of other possible public impacts of disclosure. Where such disclosure is made, it provides a powerful incentive for firms to improve the quality of their listed entity audits, which would enhance confidence in the quality of listed entity financial statements.

It is important to recognize that our inspection results do not necessarily indicate that the financial statements are materially misstated but rather that the quality of the audit has been affected by deficiencies in important aspects of the work. If our inspection work indicates that there is reason to believe that the financial statements may be materially misstated, the matter would be considered for investigation or other follow up action.

Engagements classified as “Improvements required” or “Significant improvements required” are considered to be less than satisfactory and had one or more findings in the application of professional standards in an area of significant audit risk or a key audit matter (KAM), or had a number of findings that collectively led to a significant impact on audit quality.

In all cases, we require firms that have been inspected to identify the underlying causes of the deficiencies and develop an appropriate remediation plan to prevent them from reoccurring. Inspected engagements rated as “significant improvements required” are likely to be referred for enforcement action, such as investigation or discipline and other cases where improvements are required may also be referred, depending on the nature of the findings identified. Other actions we consider include performing a further inspection or requiring the auditor to take a specific corrective action.

The report also highlights the pivotal role of audit committees in the quality of financial reporting through their oversight of auditors. In our report we urge them to consider our key findings and challenge their auditor as to whether they are taking the necessary action to ensure that audit quality findings do not occur on their audits.

The report can be downloaded [here](#).

## Keeping stakeholders informed about our regulatory findings

The FRC strives to keep our stakeholders informed about our regulatory findings and our recommendations for addressing them through multiple channels. One important channel is media briefings. On 3 June 2021, we hosted a press briefing to present to the media the full results of our inspections of listed entity audits in our first period of inspections from 1 October 2019 to 31 December 2020.

At the briefing, Dr Kelvin Wong, Chairman of the FRC, extended a warm welcome to representatives from 12 local digital and print media. Mr Marek Grabowski, CEO of the FRC gave an overview of the report, while Mr Benjamin Rhys, Head of Inspection explained in detail some of the key findings concluded from our inspections. After the presentations, they answered questions from the press representatives.



Dr Kelvin Wong, Chairman, FRC (centre) met with the press together with Mr Marek Grabowski, CEO (left) and Mr Benjamin Rhys, Head of Inspection at the press briefing.

Publicising our findings through press briefings enables greater public accountability both of the FRC for the effective discharge of our statutory functions and of our regulatees for financial reporting and auditing in respect of listed entities. It also enables the FRC to contribute to public education in relation to these matters.

## Strengthening collaboration with local regulators

On 8 June 2021, the FRC and the Stock Exchange of Hong Kong (the Exchange) held a signing ceremony for a new Memorandum of Understanding (MoU) to further strengthen collaboration in upholding the quality of financial reporting and auditing of listed entities. The new MoU replaces the one signed in 2007 when the FRC was first established.

Under the new MoU, key modes of collaboration include liaison, coordination and cooperation in cases of mutual interest, mutual referral of complaints and cases, exchange and use of information and mutual assistance. To ensure proper coordination of their regulatory efforts, the FRC and the Exchange have also agreed to notify each other when preparing and issuing policies or guidelines that may have a significant impact on their respective regulatory functions.



The MoU was signed by Mr Marek Grabowski, CEO of the FRC (front, right) and Mr Romnesh Lamba, HKEX Co-President (front, left) in the presence of Dr Kelvin Wong, Chairman of the FRC (back, right) and Mr Calvin Tai, HKEX Co-President and Chief Operating Officer (back, left).

On 6 May 2021, the FRC and the HKICPA signed a Memorandum of Understanding to enhance efficient and effective cooperation and coordination of their respective functions. The FRC and the HKICPA share a common goal in improving audit quality and the standards of professional conduct of PIE auditors and of the accountancy profession in general. Under the MoU, the FRC and the HKICPA agree to refer cases to each other, and to share information to assist each other in the timely exercise of their respective functions.



The MoU was signed by Mr Marek Grabowski, CEO of the FRC and Ms Margaret W.S. Chan, Chief Executive and Registrar of the HKICPA in the presence of Mr Sam Hui, Deputy Secretary for Financial Services & the Treasury (Financial Services) (middle, back row), Dr Kelvin Wong, Chairman of the FRC (right, back row), and Mr Raymond Cheng, President of the HKICPA (left, back row).

## Completion of first investigation involving Mainland working papers

The first investigation involving audit working papers located in the Mainland obtained with the assistance of the Supervision and Evaluation Bureau (SEB) of the PRC's Ministry of Finance was completed with the investigation report adopted by the FRC on 15 June 2021.

The case involved a material misstatement of the disclosed earnings per share (EPS) by a listed entity for the year ended 31 December 2015.

The investigation found that the auditor had failed to identify the misstatement because the engagement partner failed to apply a competent understanding of the applicable financial reporting standard. The firm's back-stop quality control measure, an objective review of the engagement by a review partner, also failed to identify the audit quality failure by the engagement.

Further details of the investigation are included in our press release [here](#).

The FRC announces the adoption of reports on audit investigations and enquiries into financial reporting of listed entities to:

- (a) promote continuous improvement in the quality of auditing and financial reporting by all our regulatees,
- (b) caution audit committee members to consider the implications of our findings for the financial reporting and audits of their listed entities; and
- (c) maintain public trust and confidence in the capital market and the effective functioning of the FRC as an independent auditor regulator.

Under the transitional provisions of the amended FRC Ordinance, since the relevant audit was completed before 1 October 2019, the investigation report has been referred to the HKICPA to determine if any disciplinary actions are warranted.

## **FRC joins IOSCO as an affiliate member**

With effect from June 2021, the FRC joined IOSCO as an affiliate member. As the independent auditor regulator of Hong Kong, one of the leading capital markets in the world, the FRC recognises the importance of the global regulatory partners working closely together for the benefit of investors both globally and locally.

Our membership of IOSCO signifies our resolve and determination to participate, as a key member of the international regulatory community, in cross-border cooperation and collaboration which is crucial to the financial security and stability of Hong Kong as an international financial centre.

# Students on board for the FRC Summer Internship Programme

The FRC launched the 2021 Summer Internship Programme (SIP) on 5 July 2021, welcoming six interns from six different universities in Hong Kong. There was strong competition for the internships with 300 applications received from which 30 students were shortlisted for interview. The evaluation panel ultimately selected six interns of various years and majors from six different universities for the SIP. They are Ms Minnie Cheung, Mr Jacky Cheung, Ms Jessie Lam, Ms Viann Lau, Mr John Law and Ms Sherry Yu.



FRC summer interns attending orientation meeting

The SIP aims to kindle the interest and passion of the interns in the accounting profession and provide them with hands-on practical experience to prepare for their future careers. Through the programme the FRC strives to nurture young talent for Hong Kong to safeguard its future as a leading international financial centre.

The interns are now undergoing a comprehensive 8-week programme comprising job rotations in each of our departments and training workshops, culminating with a competitive presentation exercise to conclude.

## Contacts

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