

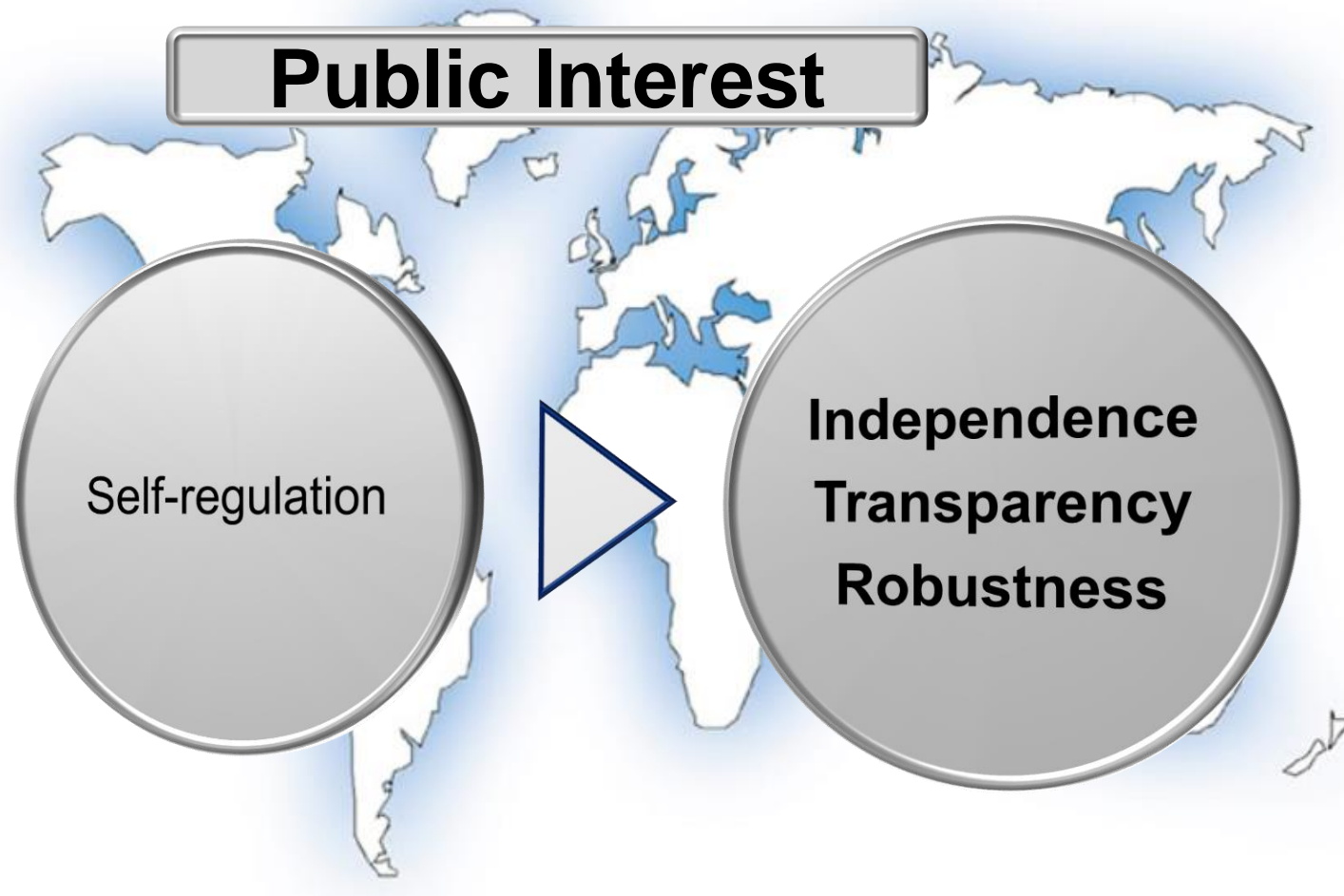
FRC – Remit and Powers

12 08 2021

Agenda

- Overview of FRC
- Oversight, Policy and Governance
- Inspection
- Investigation and Enquiry
- Discipline
- Co-operation with other regulators
- Recent publications

Financial Reporting Council



Legislative purpose of the Financial Reporting Council Ordinance (Cap 588)

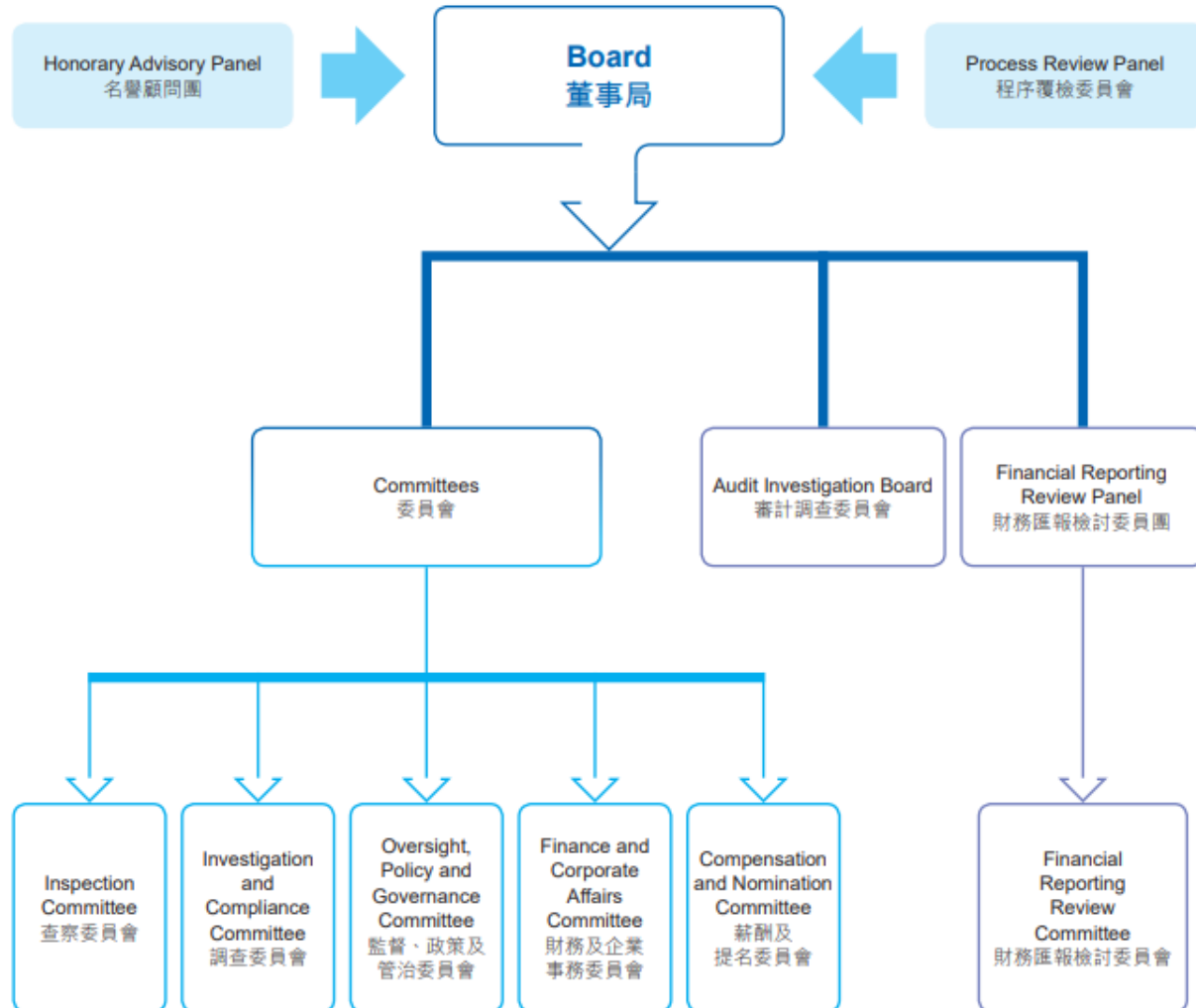
“... to establish a Financial Reporting Council **acting in the public interest** as an **independent oversight body of auditors of listed entities**; to regulate those auditors through **registration, recognition, inspection, investigation and disciplinary sanction** ... to provide for **enquiries** into non-compliances with regulatory requirements for financial reports of listed entities ...”

... 在設立按公眾利益行事的財務匯報局，作為上市實體核數師的獨立監察機構；透過註冊、認可、查察、調查及紀律處分，規管該等核數師 ... 就對上市實體的財務報告沒有遵從規管性規定而進行查訊 ...

Mission statement

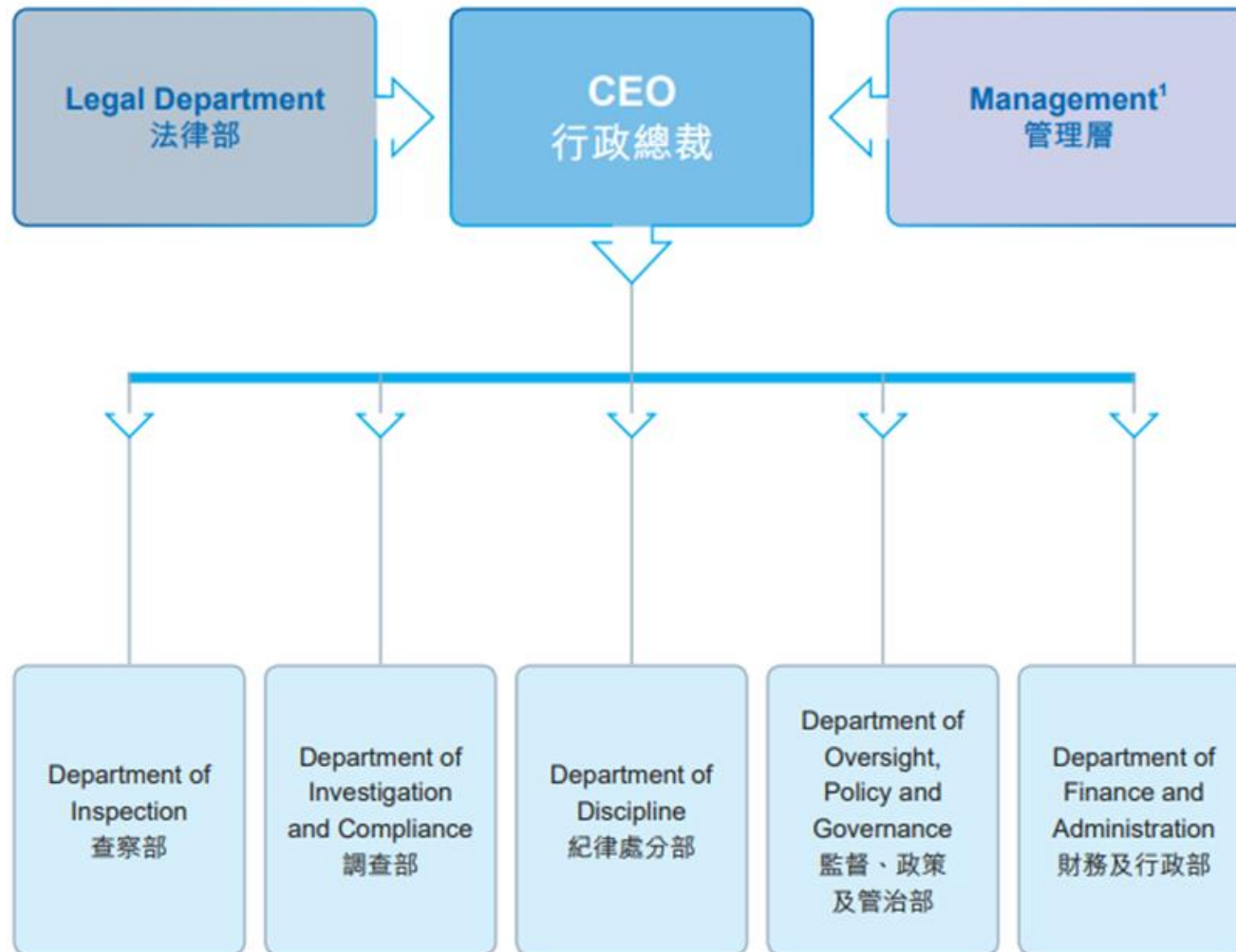
To uphold the quality of financial reporting of listed entities in Hong Kong so as to enhance protection for investors and deepen investor confidence in corporate reporting.

Financial Reporting Council – Governance structure



- **The Board** - ultimate governing body
 - Currently, the Board comprises 14 members including the Chairman who is non-executive, 11 non-executive directors and 2 executive directors
- All directors must be non-practitioners
- The number of non-executive directors must exceed executive directors
- At least one-third of the directors possessing knowledge of and experience in PIE engagements

Financial Reporting Council – Organisation structure



¹ Management comprises Heads of Departments

Department of Oversight, Policy and Governance



Department of Oversight, Policy and Governance

■ 3 major functions:

- Oversight the specified functions of the Hong Kong Institute of Certified Public Accountants (HKICPA)
- Recognition of overseas public interest entity (PIE) auditors
- Policy and Governance research

FRC – Department of Oversight, Policy and Governance

Oversight the specified functions of the HKICPA

- Oversight of the HKICPA's performance of functions relating to PIE auditors:
 - Registration of Hong Kong auditors
 - Setting of standards for ethics and auditing and assurance
 - Setting of requirements for continuing professional development in relation to PIE auditors

- Oversight through the following means:
 - Request information and periodic reports
 - Conduct assessment
 - If satisfied that it is in the public interests to do so, give written directions
 - HKICPA must comply with any direction given by the FRC

- “Statement of Protocol” between the two parties signed on 27 September 2019 (available on the FRC's website)

Oversight, Policy and Governance

Recognition of overseas PIE auditors

- It is an offence for an overseas auditor to undertake or carry out a PIE engagement for an overseas entity unless the overseas auditor has been recognised
- The listed entity must apply to the FRC for the audit firm to be recognised as a PIE auditor
- If a particular overseas audit firm carries out PIE engagements for more than one listed entity, each listed entity concerned must apply for recognition of the same overseas firm
- Recognition of an overseas auditor attaches to the specific listed entity that applied for recognition
- Recognition is valid to 31 December and renewed annually
- Mainland auditors
 - under a mutual recognition agreement between the Mainland and the HKSAR, endorsed as being qualified to act as an auditor for Mainland corporations listed in Hong Kong (apply ASBE and Mainland auditing standards)
 - 11 Mainland audit firms have been endorsed

Oversight, Policy and Governance

Policy and Governance research

- Conduct policy research that is conducive to enhancing the quality of financial reporting and audit quality, and publish guidance on governance and other issues where appropriate
- 1st research report of the Market for Listed Entity Audits in Hong Kong published in March 2021

Department of Inspection



Department of Inspection

- Responsible for carrying out inspections with the objectives of monitoring and promoting audit quality
- Focus of the compliance with applicable professional standards and legal and regulatory requirements
 - Effective internal quality control systems of PIE auditors
 - Performance of high quality PIE engagements

Department of Inspection

Function and powers

- Power to carry out inspection of a PIE auditor
- Can appoint an employee (who must be a CPA or equivalent) as an inspector
- An inspection can be carried out in respect of PIE engagements completed on or after 1 October 2019
- An inspector has powers of entry into any business premises of the auditor, to require production of records and documents, to make copies and to require answers to inquiries, to apply for search warrant
- To require an auditor to give certain information to determine the frequency of inspection or the scope of an inspection
- Issue guidelines

Department of Inspection

Inspection report and outcome

- Contains the inspection findings including areas in need of improvement and an overall evaluation of the audit quality of the engagement inspected
- Provide a dated draft of the report to the PIE auditor and anyone named in the report, to give them an opportunity to be heard
- PIE auditor is required to provide a plan and timetable to remediate the findings
- Outcome:
 - no follow-up action is required
 - to take a measure or corrective action
 - to carry out a further inspection
 - refer the matter to the department of investigation
 - refer the matter to the department of discipline
 - take any other follow-up action as appropriate

Department of Inspection

Key operations statistics

	2019-21 (18 months)
Listed entity auditor firms inspected	18
Listed entity audit engagements inspected	38
Narrow-focus inspections initiated	2
Annual inspection report published	3 June 2021

Department of Investigation and Compliance



Department of Investigation and Compliance

Two major functions:

■ Investigation

- Relevant irregularities – auditing or reporting irregularities (Pre-amended FRCO, sec 4)
- Practice irregularities (FRCO, sec 4)
- Misconduct (FRCO, sec 37A-C)

■ Enquiry

- Relevant non-compliance – non-compliance with accounting requirements (FRCO, sec 5, Part 1 and 2 of Schedule 1)

Department of Investigation and Compliance

- Sources of work
 - Complaints from the public
 - Whistleblower complaints
 - Referrals from other regulators
 - FRC's own financial statements review programme (proactive initiative)
 - Internal referrals arising from inspections
- Outcome of complaint assessments
 - Initiate investigations or enquiries
 - Refer to other regulators
 - Not pursue further



Department of Investigation and Compliance

Investigation (FRCO, sec 23)

- has reason to inquire into whether there has been “misconduct” on the part of a PIE auditor or registered responsible person, for considering whether to impose a sanction
- has reasonable cause to believe that a PIE auditor or registered responsible person has contravened a provision of the FRCO
- has reasonable cause to believe that a PIE auditor has carried out a PIE engagement in a way which is not in the interest of the investing public or in the public interest

Department of Investigation and Compliance

Investigation - “Misconduct” (FRCO, sec 37A-B)

- “practice irregularity” (FRCO, sec 4), examples:
 - Failing or neglecting to observe, maintain or otherwise apply a professional standard
 - Negligence in the conduct of his profession
 - Professional misconduct
 - Act or omission which would reasonably be regarded as bringing or likely to bring discredit on the auditor, the HKICPA or the accountancy profession
 - Falsifying a document
 - Making a statement in respect of a document which is material, knowing the statement to be false or not believing it to be true
- contravention of a provision of the FRCO
- contravention of a condition imposed in relation to the registration or recognition of the PIE auditor
- contravention of a requirement imposed on a PIE auditor or registered responsible person
- conduct in relation to a PIE engagement which, in the opinion of the FRC, is or is likely to be prejudicial to the interest of the investing public or the public interest

Department of Investigation and Compliance

Investigation - Powers (FRCO, sec 25, 26)

- Require to produce any record or document specified by the investigator that—
 - is or may be relevant to the investigation and
 - is in the person's possession
- Require to give an explanation or further particulars in relation to a record or document produce
- Require to attend an interview at a time and place specified
- Require to answer in writing relating to any matter under investigation
- Require to give the investigator all other assistance in connection with the investigation
- Apply for search warrant
- No right to silence due to self-incrimination but may claim protection in criminal proceedings
- Require explanation to be verified by statutory declaration

Department of Investigation and Compliance

Investigation report

- Contains the investigation findings of misconduct
- Provide a dated draft of the report to the PIE auditor and anyone named in the report, to give them an opportunity to be heard
- Where there is sufficient evidence of misconduct, the investigation report will be referred to:
 - the FRC's department of discipline to consider disciplinary sanction for PIE financial statements signed on or after 1 October 2019
 - the HKICPA for PIE financial statements signed before 1 October 2019 (transitional provision under the FRCO)

Department of Investigation and Compliance

Enquiry (FRCO, sec 40)

- Directed at a listed entity's relevant financial reports
- Relevant non-compliance, an accounting requirement as to the matters or information to be included in the relevant financial report as provided in:
 - The Companies Ordinance
 - Standards of accounting practices under section 18A of the Professional Accountants Ordinance (Cap 50)
 - The International Financial Reporting Standards
 - The Listing Rules
 - Any GAAP allowed under the Listing Rules

Department of Investigation and Compliance

Enquiry - Powers

- Require the production of any record or document or giving of any information or explanation by
 - The listed entity or its relevant undertaking
 - The auditor
 - Officer or employee of the listed entity or relevant undertaking

- There is no right to silence due to self-incrimination but may claim protection in criminal proceedings

Department of Investigation and Compliance

Enquiry report

- Provide a draft of the report to anyone named in the report and give them an opportunity to be heard
- The FRC may adopt an enquiry report
- Follow-up actions, where there is sufficient evidence of relevant non-compliance, the FRC may:
 - Send a notice to the directors or manager of the PIE specifying how the relevant non-compliance should be revised or otherwise remedied with a deadline
 - If the directors have not taken action before the deadline to explain, rectify or otherwise remedy the relevant non-compliance, the FRC may make a court application to require revision or other remedy

Department of Investigation and Compliance

Key operations statistics

	2020	2019	2018	2017
Pursuable complaints received	43	45	85*	126*
Investigations completed	7	12	16	11
Enquiries completed	0	3	1	0

* Of these pursuable complaints received, 50 cases for 2018 and 101 cases for 2017 appear to have come from the same source and were directed at a single audit firm.

Department of Discipline



Department of Discipline

- Take firm and appropriate action in cases of misconduct by applying commensurate sanctions for the purposes of deterrence, investor protection, maintaining market confidence in the audit quality of listed entities and upholding the standards of conduct among PIE auditors and registered responsible persons

Department of Discipline

- Wide range of disciplinary sanctions
 - Reprimand an auditor (private and public)
 - Direct an auditor to carry out remedial action (e.g. training)
 - Impose condition on registration or recognition
 - Revoke/suspend registration or recognition
 - Prohibit from applying for registration/ recognition
 - Order an auditor to pay a pecuniary penalty with maximum level capped at HK\$10 million or three times the amount of profit gained/loss avoided, whichever is higher
- Sanctions Guidelines published

Department of Discipline

Review and appeal mechanism

- A new “Public Interest Entities Auditors Review Tribunal” (appointed on 30 September 2019)
- To review:
 - The FRC’s disciplinary decision
 - The FRC’s recognition decision
 - The HKICPA’s registration decision
- Party may, with leave, appeal the Tribunal’s determination to the Court of Appeal
 - Question of law
 - Question of fact
 - Question of mixed law and fact

Cooperation with other regulators

- Memorandum of understanding
 - The Supervision and Evaluation Bureau of the PRC Ministry of Finance
 - The Securities and Futures Commission
 - The Stock Exchange of Hong Kong Limited
 - The Hong Kong Institute of Certified Public Accountants
 - The Hong Kong Monetary Authority
 - The Insurance Authority

- Liaison meetings

Recent publications

- Interim Inspection Report (11 Dec 2020)
- Report on the FRC's Assessment of the HKICPA's Performance of the Specified Functions (11 Dec 2020)
- Overview of the Market for Listed Entity Audits in Hong Kong (11 Mar 2021)
- Annual Inspection Report (3 Jun 2021)
- FRC Annual Report
- eNews



Questions & Answers