

**Process Review Panel for
the Financial Reporting Council**

2021 Annual Report

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Message from the Chairperson

The Process Review Panel (“PRP”) for the Financial Reporting Council (“FRC”) is an independent non-statutory panel established in 2008 to review cases handled by the FRC and to consider whether actions taken by the FRC are consistent with its internal procedures and guidelines.

The FRC, since its establishment in 2006 as an independent statutory body to investigate auditing and reporting irregularities by auditors of listed entities as well as to enquire into possible non-compliance with accounting requirements by listed entities, has assumed an increasingly important role in the regulation of the Hong Kong accounting profession over the years. Under the auditor regulatory reform commenced on 1 October 2019, the FRC has become an independent auditor oversight body with expanded powers to inspect and discipline auditors of Public Interest Entities (“PIE”) and to recognise overseas PIE auditors. Accordingly, the scope of review of the PRP has been expanded to cover all these major regulatory functions of the FRC under the auditor regulatory regime.

In the current review cycle, the PRP completed the review of the FRC’s work under the PIE auditor regulatory regime from January to December 2020. Specifically, the PRP reviewed the FRC’s handling of (a) nine complaints, investigation and enquiry cases, (b) inspections on three PIE firms and three PIE engagements, (c) five overseas PIE auditors recognition applications, and (d) the oversight of the HKICPA’s specified functions. The PRP’s observations and recommendations for the FRC are set out in detail in this report.

I must thank all Members for their devotion to the PRP’s work, especially amidst the challenges brought by the pandemic. I would also like to express my deepest gratitude to the outgoing member, Mr TSE Kam-keung, for his unwavering support and contribution to the PRP over the past six years. With a number of new members on board, I look forward to working closely with them and drawing on their wealth of experience and expertise to formulate insightful advice for the FRC.

Finally, my special thanks to the FRC executive team for the efforts and cooperation in assisting the PRP in the review exercise.

Ms Edith SHIH
Chairperson

Chapter 1 : Background

Overview

1.1 The Process Review Panel (“PRP”) for the Financial Reporting Council (“FRC”) is an independent non-statutory panel established by the Chief Executive of the Hong Kong Special Administrative Region in 2008 to review cases handled by the FRC, and to consider whether actions taken by the FRC are consistent with its internal procedures and guidelines. The establishment of the PRP reflects the Government’s commitment to enhancing the accountability of the FRC.

1.2 The FRC plays a key role in upholding the quality of financial reporting, promoting the integrity of the accounting profession, enhancing corporate governance, and protecting investors’ interest. It was established under the Financial Reporting Council Ordinance (Cap. 588) (“FRCO”) in 2006 as an independent statutory body to investigate auditing and reporting irregularities by auditors of listed entities (i.e. listed corporations and listed collective investment schemes), with the assistance of the statutory Audit Investigation Board comprising executives of the FRC, and to enquire into non-compliance of accounting requirements by listed entities in Hong Kong, with the assistance of the Financial Reporting Review Committees (“FRRC”)¹.

1.3 In January 2019, the reform of the auditor regulatory regime commenced step by step with benchmarking against international standard and practice. From 1 October 2019, the FRC became an independent auditor oversight body and is vested, in addition to investigation powers, with inspection and disciplinary powers with regard to auditors of public interest entities (“PIE”)². The FRC also performs independent oversight over the performance of the Hong Kong Institute of Certified Public Accountants (“HKICPA”) of its statutory functions of registration, setting continuing professional development requirements and standards on

¹ The FRRC members are drawn from the statutory Financial Reporting Review Panel comprising individuals appointed by the Financial Secretary (under the authority delegated by the Chief Executive) from various professions in addition to accountants.

² A PIE means a listed collective investment scheme or a corporation with its equities listed on Hong Kong’s stock market.

professional ethics, auditing and assurance with respect to local PIE auditors. In addition, the FRC is responsible for the recognition of overseas PIE auditors. The statutory functions of the FRC was further expanded to cover major regulatory powers over the accounting profession in 2021, but this further reformed regime has yet to commence.

Functions of the PRP

1.4 The terms of reference of the PRP are as follows –

- (a) to review and advise the FRC on the adequacy of its internal procedures and operational guidelines governing the actions taken and operational decisions made by the FRC and its staff in the performance of the regulatory functions in relation to the following areas –
 - (i) inspection in relation to PIE engagements completed by PIE auditors;
 - (ii) complaints handling, enquiry and investigation;
 - (iii) disciplinary actions against PIE auditors;
 - (iv) oversight of the performance of the HKICPA of specified functions (i.e. registration, setting requirements for continuing professional development, and setting standards on professional ethics, auditing and assurance) in relation to PIE auditors; and
 - (v) recognition of overseas PIE auditors;
- (b) to receive and consider periodic reports from the FRC on completed or discontinued cases in the areas mentioned in (a) above;
- (c) to receive and consider periodic reports on enquiries, investigations and disciplinary cases lasting more than one year;
- (d) to receive and consider periodic reports from the FRC on

complaints against the FRC or its staff;

- (e) to call for files from the FRC to review the handling of cases in the areas mentioned in (a) above to ensure that the actions taken and decisions made are adhered to and are consistent with internal procedures and guidelines and to advise the FRC where appropriate;
- (f) to advise the FRC on such other matters relating to the FRC's performance of statutory functions as the FRC may refer to the PRP or on which the PRP may wish to advise; and
- (g) to submit annual reports to the Financial Secretary which, subject to applicable statutory secrecy provisions and other confidentiality requirements, will be published.

1.5 The internal procedures which the PRP would make reference to in reviewing the FRC's cases include guidelines on its statutory functions, working protocols with other regulatory bodies, preservation of secrecy and identity of informers, and relevant legislative provisions.

1.6 The PRP is tasked to review and advise the FRC on its handling of cases, not its internal operation or administrative matters. Therefore, the work of the committees set up under the FRC Board is not subject to direct review by the PRP.

Modus operandi of the PRP

1.7 The case review cycles of the PRP run on a calendar year basis. Based on the FRC's caseload during the relevant review cycle, the PRP would select cases for review at the end of the cycle. In the discharge of their duties, members are reminded to preserve secrecy in relation to information furnished to them, and not to disclose such information to other persons. To maintain independence and impartiality of the PRP, all PRP members would declare their interests upon commencement of their term of appointment and before conducting each case review.

Composition of the PRP

1.8 In 2021, the PRP comprised nine members, including the Chairperson, from a wide spectrum of professions including the accounting, legal, business and academic sectors. The Chairman of the FRC and the representative of the Secretary for Justice are ex-officio members of the PRP.

1.9 The membership of the PRP in 2021 is as follows –

Chairperson

Ms Edith SHIH

Members

Mr Patrick LAW Fu-yuen

Mr Andrew MAK Yip-shing

Mr Frederick TSANG Sui-cheong

Mr TSE Kam-keung (retired on 31 December 2021)

Prof Anna WONG Wai-kwan

Mr YU Chung-leung

Ex-officio Members

Dr Kelvin WONG Tin-yau, SBS, JP
(in his capacity as the Chairman of the FRC)

Ms Denise LAM Kien-sau
(in her capacity as the representative of the Secretary for Justice)

Secretariat

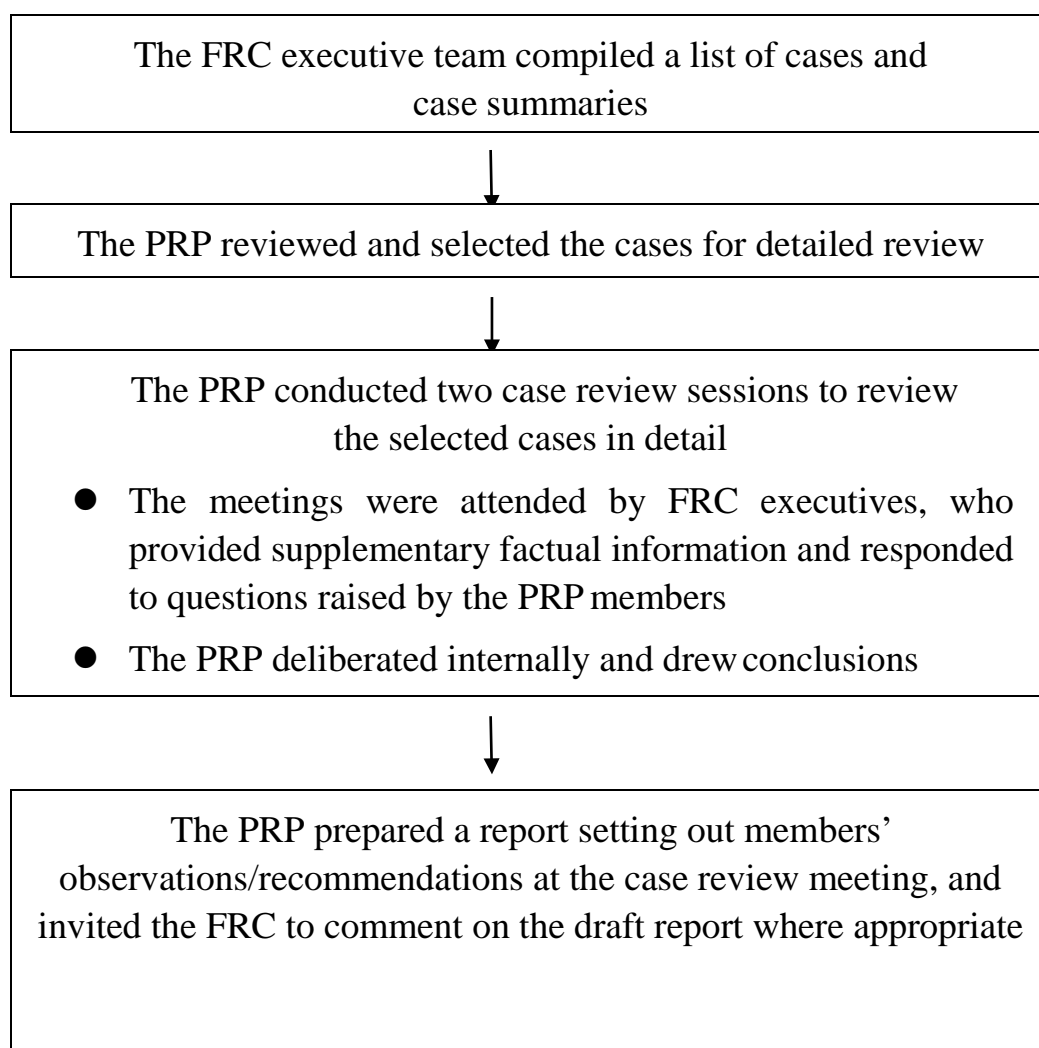
Financial Services and the Treasury Bureau

Chapter 2 : Work of the PRP in 2021

2.1 This Annual Report covers the work of the PRP in 2021, which reviewed reports from the FRC on cases it handled under the PIE auditor regulatory regime during the 13th review cycle which ran from January to December 2020.

Case review work flow

2.2 The work flow adopted by the PRP in reviewing the cases is set out below –



Selection of cases for consideration/review

2.3 The FRC executive team provided the PRP with the summaries of cases that were completed, discontinued or ongoing for more than one year in 2020. The distribution of the cases and the number of cases selected for review by the PRP are as follows –

<u>Category of cases</u>	<u>Number of cases completed / discontinued / ongoing for more than one year as at 2020</u>	<u>Number of cases selected for review</u>
(A) Inspection	55	6
<i>Completed inspection on quality control system of PIE firms</i>	18	3
<i>Completed inspection on PIE engagements</i>	37	3
(B) Handling of complaints, investigations and enquiries	98	9
<i>Ongoing cases lasting more than one year as at 31 December 2020</i>	37	2
<i>Ongoing investigations/ enquiries</i>	15	3
<i>Completed investigations arising from complaints</i>	16	2
<i>Completed investigations arising from financial statements review programme</i>	10	2
<i>Complaints not taken further due to unsubstantiated allegations</i>	20	-
(C) Recognition of overseas PIE auditors	89	5
<i>New applications from overseas corporations</i>	12	1
<i>New applications from listing applicants</i>	7	1
<i>Renewal applications from overseas corporations</i>	50	1
<i>Renewal applications from collective investment scheme</i>	19	1

<i>Renewal applications from listing applications</i>	<i>1</i>	<i>1</i>
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In addition to the above selected cases, the PRP also reviewed the FRC’s work in relation to the oversight of the HKICPA’s performance of specified functions in 2020.

2.4 Highlight of the PRP’s observations and recommendations are set out in Chapter 4. Follow-up actions taken by the FRC on PRP’s recommendations in the 12th review cycle are set out in Chapter 3.

Chapter 3 : Follow-up Actions Taken by FRC on PRP's Recommendations in the Past Year

3.1 In its 2020 Annual Report, the PRP made a number of recommendations to the FRC in relation to the handling of investigation and enquiry cases and recognition applications. The FRC's follow-up actions are summarised as follows.

A. *Expedite the handling of investigation cases to clear existing backlogs*

3.2 While the PRP noted that the FRC had handled cases in accordance with its internal procedures, it recommended the FRC to review its procedures and explore possible ways to expedite the case-handling processes in a bid to clearing the backlogs more efficiently.

3.3 In response, the FRC introduced the following measures –

- (a) compressing the time spent at the complaint stage which only allows the FRC to make informal inquiries without placing statutory obligation on the party under complaint to respond, and initiate enquiry and investigation as early as possible, such that formal requirements could be issued in accordance with the statutory powers under the FRCO;
- (b) critically reviewing deadlines to be set for relevant parties' response to formal requirements as well as their requests for deadline extensions with due consideration of the rights of the listed entities and auditors of being heard as well as timely completion of the cases in the interest of the investing public;
- (c) requiring auditors to proactively monitor and report progress on the procedures for obtaining audit working papers kept in the Mainland (if any), such that the FRC may take appropriate actions in the case of delays and timely seek assistance from the relevant Mainland authorities; and

- (d) delegating its power to the executive team to conduct the more straight-forward procedure of identifying persons who might be adversely affected by the publication or disclosure of the enquiry and investigation reports and providing them with an opportunity of being heard.

B. Review internal practice of handling incoming letters

3.4 The PRP noted that in one of the cases selected for review in 2020, there had been unintended disclosure of a complaint against staff to the relevant staff member. The PRP recommended that the FRC should review its internal practice for processing incoming letters to prevent similar mishaps.

3.5 In response, the FRC enhanced the relevant procedures under which all incoming letters would be handled by general staff while letters addressed to specific senior staff would be opened by the addressees. For complaints against staff, they would be immediately passed to the Chief Executive Officer (“CEO”) for handling and delegation to relevant staff as appropriate, except for complaints against the CEO which would be passed to the FRC Chairman for handling. The review of the procedures is ongoing with a view to further ensuring effectiveness and prudence in future handling of complaints.

C. Expedite the handling of applications for recognition of overseas PIE auditors

3.6 The PRP observed that the FRC had taken relatively long processing time, especially for the initial sorting of applications and checking of completeness of application documents in the handling of recognition applications. It recommended the FRC to explore ways to expedite such procedures, such as through maximising the use of automation.

3.7 The FRC responded positively to the PRP’s recommendation and is pursuing maximised use of automation in its ongoing development of online system for handling recognition applications to streamline the process. In order to further expedite the process, the FRC had revised the

application forms based on the operational experience in processing applications since October 2019 to make information requirements more specific, so as to minimise the time for requesting supplementary information from applicants. The revised forms have been put to use from 1 July 2021.

3.8 The PRP welcomed the above follow-up actions and looked forward to the FRC's continuous efforts to ensure procedural efficiency and effectiveness of the PIE auditors regulatory regime.

Chapter 4 : Observations and Recommendations on Cases Reviewed

4.1 In the current review cycle, the PRP reviewed the FRC's handling of (a) nine complaint, investigation and/or enquiry cases, (b) inspections on three PIE firms and three PIE engagements, (c) five overseas PIE auditors recognition applications, and (d) the oversight of the HKICPA's specified functions. The PRP recognised the FRC's efforts in discharging its various expanded functions under the PIE auditors regulatory regime, and was satisfied that the FRC had handled the cases selected for review in accordance with the internal procedures set out in the FRC's Operations Manuals.

4.2 During the review, the PRP noted some areas for enhancements, and its observations and recommendations are summarised in ensuing paragraphs.

A. Consistency and robustness of regulatory judgements across inspections

Observations and recommendations

4.3 The PRP noted that the FRC has completed inspections of the quality control systems of 18 PIE auditors and a total of 37 PIE engagements in 2020. The PIE auditors are grouped under three categories according to the number of PIE audit clients of the auditors, i.e. Category A firms are those with more than 100 PIE audit clients, Category B firms with 10 to 100 PIE audit clients, and Category C firms with less than 10 PIE audit clients. Inspections of Category A auditors were led by an Inspection Team Leader at Director level or above, who was underpinned by inspectors at Associate Director or Manager level, while inspections of Category B and C auditors were led by an Inspection Team Leader at Associate Director underpinned by inspectors at Manager level and subject to the supervision of a Case Reviewer at Director level or above.

4.4 For inspections of quality control systems of PIE auditors, the FRC identified common areas of deficiencies and areas for improvements, in response to which the auditors were required to implement remedial

measures. As regards inspections of PIE engagements, the FRC adopted a rating system consisting a total of four ratings from “1” for engagements with good audit quality, “2” for engagements requiring limited improvements, “3” for engagements requiring improvements, and “4” for engagements requiring significant improvements.

4.5 The PRP observed that the inspections selected for review were conducted by teams with different combinations of staff. Given the variation in the scale, nature and complexity of the PIE engagements inspected, the PRP took the view that it would be necessary to implement appropriate measures to ensure that the ratings have been assigned in a consistent manner with robust justifications across inspections carried out by different inspection teams.

Response from the FRC

4.6 The FRC has accorded high priority to the consistency and fairness in the evaluation of the PIE auditors’ performance and in the assignment of ratings to individual PIE engagements. The FRC has internal guidance on how to evaluate the severity of an identified deficiency and its impact on the overall audit quality rating. Before an inspection report is issued, it is reviewed by the Head of Inspection, or where there is a conflict of interest, by the CEO, to ensure the appropriateness of the deficiencies identified and ratings assigned to the engagements.

4.7 In order to set a robust foundation in the first year of the FRC’s inspection work, a subcommittee has been set up under the FRC’s Inspection Committee to scrutinise the FRC’s rating of PIE engagements at “3” and “4” (i.e. the two lowest ratings) through review of work documents, inspection team composition, inspection findings and procedures. The subcommittee was chaired by a retired practitioner with rich experience in PIE engagements and had three non-accounting professionals and another retired practitioner as members. The subcommittee concurred with the audit quality rating assigned to the inspections selected for review. With the benefit of the subcommittee’s advice, the FRC was able to conduct a calibration process before the issue of inspection reports with ratings for all the inspections conducted in 2020.

4.8 Drawing on the operational experience in 2020, the FRC is also reviewing its inspection procedures with the aim of enhancing the effectiveness in the conduct of inspections.

B. Procedural guidelines for handling of investigation cases

Observations and recommendations

4.9 In the review of an ongoing investigation which had lasted for more than one year as at 2020, the PRP observed that the FRC initiated an investigation arising from a complaint and later on expanded the investigation scope of the case to cover a second complaint against the same listed entity auditor but concerning the audits for two other financial years. The FRC advised that it had expanded the scope of the ongoing investigation with consideration of the progress of the case and the parties concerned in the second complaint with a view to conducting a holistic review of all relevant financial statements for the assessment of the audit quality of the auditor in question.

4.10 While there are precedents of expansion of investigation scope of ongoing cases, the FRC's Operations Manual for the investigation function does not include procedural guidelines for such expansion. The PRP recommended the FRC to consider reviewing its experience and devise a set of standard procedures for more systematic handling of similar cases in future.

Response from the FRC

4.11 Following the enactment of the Financial Reporting Council (Amendment) Ordinance 2021 in October 2021 and in preparation of the commencement of the new regulatory regime of the accounting profession, the FRC has been updating the operations manual regarding the expanded functions including, inter alia, the function of investigation. The update will include procedures for more systematic handling of decisions relating to possible scope expansion of ongoing investigation cases.

C. Manpower planning for efficient handling of investigation and enquiry cases

Observations and recommendations

4.12 The PRP noted in the review of selected investigation and enquiry cases that the long processing time could be attributed partly to staffing issues, including the shortage of human resources, reallocation of cases due to departure of case officers or internal review of workload, and unforeseen circumstances such as conflict of interest identified during the case handling process. It suggested that FRC explores ways to improve the situation through, for instance, better manpower planning, enhanced oversight by senior management and guidance for junior staff, as well as proactive coordination with other financial regulators to manage case intake.

Response from the FRC

4.13 The FRC's budget for 2022/2023 as approved by the Financial Secretary has taken into account the manpower needs for the full operation of the PIE auditor regulatory regime as well as gearing up for the FRC's expanded functions under the new regulatory regime of the accounting profession. The budget includes an increase of 56 new headcount, which will bring the FRC's total headcount from 59 in 2021/22 to 115 in 2022/23. After the expansion of the FRC's establishment, the FRC is envisaged to have higher capacity to expedite the case handling process and clear existing backlogs over time.

4.14 Besides, in preparation for the commencement of the new regulatory regime of the accounting profession, the FRC is developing guidelines on the class or description of interests which are required to be disclosed by relevant parties including its staff as potentially giving rise to conflicts of interests in the course of performing the functions of the FRC. Under the new legislation, the FRC will have the power to harmonise the different conflict of interest rules for cases under the PIE and non-PIE regimes, which is expected to significantly reduce the incidence of staff conflict. The FRC is also continuing to review the processes and procedures for handling complaints and investigation and enquiry cases

with a view to identifying further ways to simplify or expedite the performance of procedures, for example by further delegation of power to the executive team in handling more straight-forward cases.

Chapter 5 : Way Forward

5.1 The PRP recognises the FRC’s efforts in effectively discharging its statutory functions under the PIE auditor regulatory regime. Going forward, the Financial Reporting Council (Amendment) Ordinance 2021 will commence on 1 October 2022 under which the FRC will become a full-fledged independent regulator of the accounting profession and be renamed as the Accounting and Financial Reporting Council (“AFRC”). The AFRC will be vested with expanded powers of registration of PIE auditors, issue of practising certificates, inspection of practice units³, and investigation and discipline against practice units and certified public accountants (“CPA”). Its oversight function will also be expanded to cover the various statutory professional functions of the HKICPA, including, among other things, the registration of CPAs. The PRP’s terms of reference will be duly reviewed and expanded where necessary, such that it may advise the AFRC on its procedures and guidelines for the expanded functions under the new regime.

5.2 The PRP welcomes and attaches great importance to the views from stakeholders and the public. Comments on the work of the PRP can be referred to the Secretariat of the PRP for the FRC through the following channels⁴ –

By post : Secretariat of the Process Review Panel for the
Financial Reporting Council
Financial Services and the Treasury Bureau
15th Floor, Queensway Government Offices,
66 Queensway, Hong Kong

By email : frcprp@fstb.gov.hk

³ A “practice unit” refers to (i) a certified public accountant (practising)(“CPA (practising)”) who practises accountancy on his/her own account under his/her own name; (ii) a CPA (practising) who practises accountancy on his/her own account under a firm name; (iii) a firm of CPAs (practising); or (iv) a corporate practice.

⁴ For enquiries or complaints not relating to the process review work of the FRC, they should be made to the FRC directly –

By post : 24th Floor, Hopewell Centre, 183 Queen’s Road East, Hong Kong
By telephone : (852) 2810 6321
By fax : (852) 2810 6320
By email : general@frc.org.hk or complaints@frc.org.hk

Chapter 6 : Acknowledgement

6.1 The PRP would like to express its gratitude towards the FRC for its assistance in facilitating the review work, and its cooperation in responding to the PRP's enquiries and recommendations in the past year.

**Secretariat of the Process Review Panel
for the Financial Reporting Council
July 2022**