

Press Release

FRC submits its response and key recommendations to the Government

(18 September 2014, Hong Kong) The Financial Reporting Council (**FRC**) has today submitted its response to the public consultation paper on proposals to improve the regulatory regime for listed entity auditors (**the Consultation Paper**) and invites the Financial Services and the Treasury Bureau to vigorously pursue an auditor regulatory regime for Hong Kong that is at least on par with other major international financial centres.

Commenting on FRC's submission, Dr John Poon, Chairman of the FRC, said, "The FRC is a statutory body independent of the audit profession. Our submission is prepared from a public interest perspective, having due regard to the international best practices and experience as well as our local auditor regulatory framework which have largely been covered in our published international comparative study."

The international comparative study on independent audit oversight published by the FRC in October 2013 reveals that audit regulators of major jurisdictions, such as the United Kingdom, the United States, Canada, Australia and Singapore, are independent of the profession with authority over at least auditors of listed entities.

As stated in the Consultation Paper, the existing regulatory regime for listed entity auditors is not consistent with international standards and practices in that the oversight of the regulation of listed entity auditors should be independent of the profession itself. As a result, Hong Kong is not eligible to be represented on the International Forum of Independent Audit Regulators (**IFIAR**), and Hong Kong has not achieved regulatory equivalence with the European Commission (**EC**).

The FRC believes that the reform should at a minimum enable Hong Kong to be eligible for membership in the IFIAR and to attain EC regulatory equivalence status. To achieve this, the governing body of the auditor regulator must be independent from the audit profession.

Dr Poon added, "The independence of the FRC, both in fact and in the eyes of the public, is paramount at all times. The Council of the FRC is currently

composed of a majority of lay members and in the future will be composed of a majority of non-practitioners. Moreover, future funding of the FRC must be secure, stable and free from influence by the audit profession. This ensures the FRC meets the independence requirement in accordance with international standards.”

The Reform

While there can be different approaches to meeting the reform objective, we support, subject to our submissions, the proposals set out in the Consultation Paper.

In particular, the FRC supports the proposal to enlarge its remit by empowering it, to be

- directly responsible for
 - inspection of auditors of listed entities
 - investigation of auditors of listed entities (which is currently within the scope of the FRC)
 - discipline of auditors of listed entities
- to oversee the Hong Kong Institute of Certified Public Accountants (**HKICPA**) in respect of
 - registration of listed entity auditors
 - continuing professional development (**CPD**) of listed entity auditors
 - standard-setting on professional ethics, auditing and assurance related to listed entities.

Since the government published the Consultation Paper, we note that the accounting profession has raised some concerns regarding the objectivity of the disciplinary decisions of the FRC.

Dr Poon addressed these concerns: “The FRC is committed to ensuring that the future regulatory system is fair, and all principles of natural justice will be afforded to all parties concerned. We are also committed to implementing appropriate measures to segregate the investigative and disciplinary functions.”

Key recommendations by the FRC on the Consultation Paper

Objective	In the best interests of the public, the reform should at a minimum enable Hong Kong to be eligible for membership in the IFIAR and to attain regulatory equivalence status with the EC. The enhanced auditor regulatory regime should strengthen investor protection and Hong Kong's status as an international financial centre.
Independence	
Governance of the FRC	<ul style="list-style-type: none"> ● We consider that the independence of the FRC, both in fact and in the eyes of the public, is paramount. Therefore the majority of members of the Council of the FRC should be non-practitioners.
Funding	<ul style="list-style-type: none"> ● Future funding of the FRC must be secure, stable, free from influence by the audit profession and sufficient to discharge its statutory responsibilities.
Five new functions in addition to investigation	
Oversight - Registration - CPD - Standard setting	<ul style="list-style-type: none"> ● The FRC should be equipped with the reserve powers to act itself where circumstances so warrant in respect of matters subject to its oversight. ● The FRC should also be given the power to require, at any time, information from the HKICPA.
Disciplinary system	<ul style="list-style-type: none"> ● The FRC is committed to ensuring that the future regulatory system is fair, and all principles of natural justice will be afforded to all parties concerned. We are also committed to implementing appropriate measures to segregate the investigative and disciplinary functions. ● The maximum pecuniary penalty should be referenced to a multiple of the engagement fee which is more objective and appropriate for the type of engagements performed by auditors of public interest entities (PIEs). ● The FRC considers that the individual/individuals who assume(s) ultimate responsibility for the system of quality control of a practice unit should be accountable for the absence/systemic failure of such system. This would not only be consistent with the existing obligations under local standards but would also prevent a gap in the statutory framework.
Inspection of listed entity auditors	<ul style="list-style-type: none"> ● The scope of inspection and the statutory powers of inspectors/reviewers should also cover the quality control system of listed entity auditors. ● To achieve the highest level of independence, the FRC does not consider it appropriate for it to delegate to HKICPA its functions and powers to inspect listed entity auditors in respect of their listed entity audit and assurance engagements or their quality control systems.
Scope of the Reform	
Scope of the reform	<ul style="list-style-type: none"> ● To be more in-line with international standards and practices, the FRC recommends that the new legislation should have the flexibility to amend the definition of PIEs by regulation.

Dr Poon remarked, “We are confident that the reform proposals in the Consultation Paper together with our recommendations will enhance Hong Kong’s regulatory regime for listed entity auditors and enable Hong Kong to be eligible for IFIAR membership and achieve EC regulatory equivalence status. The FRC can then enter into reciprocal arrangements with overseas regulators to facilitate cross-border regulatory cooperation.”

Conclusion

Dr Poon concluded, “We look forward to the successful implementation of an enhanced and robust auditor regulatory regime for Hong Kong which will improve the quality of financial reporting and ultimately strengthen our investor protection.”

The full submission on the Consultation Paper is available on the FRC website at www.frc.org.hk. The international comparative study on independent audit oversight published by the FRC is at [www.frc.org.hk/Report on Independent Audit Oversight.pdf](http://www.frc.org.hk/Report_on_Independent_Audit_Oversight.pdf).

- End -

About the FRC

The FRC is a statutory body established in December 2006 under the Financial Reporting Council Ordinance. The FRC is entrusted with the statutory responsibilities to conduct independent investigations into possible auditing or reporting irregularities in relation to listed entities and to enquire into possible non-compliance with accounting requirements on the part of listed entities. The FRC has 11 members with a variety of professional backgrounds and the majority of whom, including the Chairman, are lay persons. For more information, please visit www.frc.org.hk.