CFA Society Hong Kong

By email (bc_12_20@legco.gov.hk)

2 September 2021

Clerk to Bills Committee on
Financial Reporting Council (Amendment) Bill 2021
Legislative Council Secretariat
Legislative Council Complex 1
Legislative Council Road Central,
Hong Kong

Dear Sir,

Financial Reporting Council (Amendment) Bill 2021

The CFA Society Hong Kong has reviewed the Bill and supports the new legislation to move the self-regulatory regime currently operating under Hong Kong Institute of Certified Public Accountants (HKICPA) purview to an independent public oversight regime that will be operating under the purview of the Financial Reporting Council (FRC) for non-Public Interest Entities (PIE) engagements. The proposed regulatory regime could help further strengthen Hong Kong as an international financial hub if it is implemented properly. Our comments in more details are summarized below for your consideration.

1. Background of the audit regulatory reform

Hong Kong did not meet the requirements for membership of the International Forum of Audit Regulators (IFIAR) and the EC equivalence where the membership and the EC equivalence status are important to the Hong Kong auditing profession. With the recognition as EC equivalence, Hong Kong auditors would not be necessarily regulated by EU and European Economic Area (EEA) audit regulators separately in order to audit companies incorporated outside the EEA (e.g., in Hong Kong) with securities admitted to trading on an EEA regulated market.

The transfer of powers to regulate auditors with PIE engagements from HKICPA to the FRC in 2019 marked the important first step of regulatory reform to move the self-regulatory regime to a public oversight regime for auditors on PIE engagements such that Hong Kong could meet the requirements for IFIAR membership and the EC equivalence.

The proposed reform on auditors who engage in non-PIE engagements can help to raise the standards of the audit profession in Hong Kong. Implementing elevated standards can give higher assurance level to the investor community which is important to Hong Kong as an international financial hub. The proposed reform is in line with the international development in establishing independent regulators for the audit profession to help ensure the integrity of the industry.

2. ***Funding of the FRC operation***

It is stated in the "Funding and levies" section of the FRC website that

> *The HKSAR Government has granted a seed capital of HK$400 million to facilitate the smooth migration of the FRC to the new auditor regulatory regime, to cushion the FRC against short-term fluctuations in the levy income, to fund one-off capital and non-recurrent expenses, to allow the FRC to gradually expand its staff complement taking into account its actual operational needs, and to provide a buffer for other exigencies of circumstances. Starting from 1 January 2022, the FRC will be self-financing with funding from levies payable by sellers and purchasers of securities, PIEs and PIE auditors.*

It is also stated in paragraph 24 of the briefing of the Legislative Council Brief of the bill (the Briefing) that

> *In the long run, the FRC, which will be the authority for issue of practising certificates and registration of CFA firms and corporate practices, will collect fees for practising certificates and registration applications. The fees will be a new source of income to fund its expanded regulatory functions. We will review the FRC's funding arrangement and consider the appropriate fee mechanism in due course. Pending the conclusion of the review, the FRC will not impose fees for issue of practising certificates and registration of CPA firms and corporate practices.*

Under the proposed initial funding model of the FRC, which will waive the fees for issue of practising certificates (PC) and registration of CPA firms and corporate practices before the conclusion of the review, the Hong Kong taxpayers will foot the bill of the expanded regulatory functions on non-PIE engagements of the FRC temporarily.

To follow the user pays principle, the Government should consider allowing the FRC to inherit the fee charging scale from HKICPA initially; and revise the fee charging scale upon conclusion of the review.

3. ***Details and clarity of the legislation***

Clarity of the legislation is important to the successful implementation of the proposed reform. We note that the Legal Service Division of the Legislative Council Secretariat sent a list of questions to the Financial Services and Treasury Bureau (FSTB) in its letter dated 11 August 2021 seeking clarifications of the bill. We believe it will improve the clarity if the Legislative Council can share with the public the reply from FSTB in due course.

4. ***Transitional arrangements***

4.1 Transfer of the live investigation cases

Paragraph 18 of the Briefing states that

For the practices review, investigation and disciplinary functions, any proceedings carried out under PAO (i.e., Professional Accountants Ordinance) which have not been completed on the commencement date of the reformed new regime will continue to be conducted in accordance with the PAO mechanism. The result of a practice review or investigation conducted in accordance with the PAO mechanism under the transitional arrangement will then be referred to the FRC for follow-up action.

We note that the investigation process in accordance with the PAO mechanism could last over 10 years. To name a few cases, one of the HKICPA investigation on their members was only concluded in May 2018 but the investigation commenced in 2006; and another case dragged on from 2008 to June 2021.

In view of the above, there should be a clear mechanism on the transfer of the live cases from HKICPA to the FRC. Otherwise, the transition process may take years to complete and all relevant parties will suffer.

4.2 Potential inconsistencies with the existing requirements under PAO

Some requirements stipulated in the bill appear to be inconsistent with those of the PAO and this may lead to fundamental changes to the existing regime. A few examples are quoted below for reference.

- Section 20AAL(1)(d) requires PC holder to be ordinary resident in Hong Kong. It appears that an applicant has to comply with the physical presence test to conform with the ordinary resident requirement. However, many HKICPA members are based out in the PRC and practising audit. This becomes more the case with Hong Kong further integration into the PRC economy under the GBA initiative. And hence, these HKICPA members may not be able to meet the physical presence test for ordinary resident. HKICPA actually provides other avenues to the applicants, as summarized in Section 2 of the HKICPA PC application form, to fulfil the ordinary resident requirement.
- Section 41 of the PAO sets out the appeal mechanism for the unsuccessful applicants for PC. However, the appeal mechanism does not appear to exist in the bill.
- Sections 28D(2)(b)(iii) and 51 of the PAO set out the responsibility of HKICPA on professional indemnity insurance (PII). Sections 20AAZY and 20AAZX(5) in the bill set out the responsibility of the FRC on the PII arrangements. Under which, HKICPA Council would still be responsible to set rules for PII and likewise, the Corporate Practice (Registration) Rules under the current section 51 of the PAO. As the FRC will be taking over all the registration matters for the practice units, it could be more efficient to have clean cut transfer of all registration matters in relation to the practice units to the FRC from HKICPA.

We hope that all the inconsistencies will be dealt with in the subsidiary legislation to be tabled to the Legislative Council.

5. The standard setting functions

Under the proposed regulatory reform, the standard setting functions will stay with HKICPA. However, it is worth noting that a lot of the quality assurance and investigation engagements are related to the interpretation of accounting and auditing standards. It would be rather inefficient for the FRC to keep making enquiries or discussing with HKICPA on the applications of the relevant accounting and auditing standards. The fact that the FRC will likely be bounded by the confidentiality requirements on quality assurance and investigation cases would induce further inefficiency. It is therefore worthwhile to consider transferring the standard setting functions to the FRC as an integral part of the regulatory reform.

Should you have any questions on our above comments, please contact Eric Chiang, our Managing Director, at eric.chiang@cfahk.org or 2530 9200 for clarifications.

Yours faithfully,
For and on behalf of
CFA Society Hong Kong

Richard Mak
President