

Press Conference – 19 March 2018

Approaching a New Era

Q&As

Background

The year 2017 marks the 10th anniversary of the Financial Reporting Council (“FRC”). With the introduction of the Financial Reporting Council (Amendment) Bill 2018, we are indeed entering a new era. The Amendment Bill, if passed, will transform the FRC into the independent fully-fledged auditor regulator of Hong Kong.

1. What is the current status of independent auditor oversight in Hong Kong?

As set out in our 2013 and 2016 reports on independent auditor oversight, Hong Kong did not and still does not meet the requirements for membership of International Forum of Independent Audit Regulators (“IFIAR”) and European Commission (“EC”) regulatory equivalence mainly because Hong Kong has no independent auditor regulator.

2. What is IFIAR membership?

IFIAR is a global organisation for independent auditor regulators worldwide. The organisation’s primary aim is to enable its members to share knowledge of the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms, with an aim of enhancing audit quality.

Membership of IFIAR is confined to independent regulators that are responsible for inspection of audit firms and have investigative and enforcement powers which include fines and removal of an audit licence and/or registration. Currently it has 53 members: see Appendix I.

3. What is EC regulatory equivalence?

EC regulatory equivalence is a recognition given to a country/jurisdiction that its auditor regulatory regime is equivalent to the EC requirements. To be recognised by the EC as having regulatory equivalence, an auditor regulator is required to have ultimate responsibility for the oversight of the following six functions - registration, inspection, investigation, enforcement (discipline), standards on professional ethics and auditing, and continuing professional education. In addition, the governing body of the auditor regulator must be comprised solely of non-practitioners (i.e. persons who have not been involved in statutory audits or been a partner of or employed by or otherwise associated with an audit firm in the previous three years).

EC regulatory equivalence is regarded internationally as an endorsement of the competence of an auditor regulator across core aspects of its oversight ambit, i.e. the six functions mentioned above. A total of 53 jurisdictions worldwide (see Appendix I), including China, the UK and the US, currently meet the EC regulatory equivalence requirements.

4. What are the benefits of IFIAR membership and EC equivalence for Hong Kong?

Over the years, Hong Kong's capital market has grown very significantly. There are about 2,200 listed entities in Hong Kong and market capitalisation has risen to over HK\$30 trillion. To maintain its competitiveness, Hong Kong needs to continue to attract new listings. In addition, Hong Kong needs to meet the expectations of the global investing public of having an auditor regulatory regime which is independent of the audit profession.

Achieving dual recognition with IFIAR and the EC is an international norm which will:

- bring Hong Kong in line with 45 other jurisdictions including major capital markets worldwide (see Appendix I);

- enhance audit quality and investor protection;
- further entrench Hong Kong’s status and reputation as a major international financial centre.

In particular, since EC regulatory equivalence status is regarded internationally as an endorsement of the competence of an auditor regulator across core aspects of its oversight ambit, obtaining EC regulatory equivalence status would lead to enhanced global confidence in Hong Kong’s auditor regulatory regime. It will also facilitate future regulatory collaboration between Hong Kong and the wider global network of independent auditor regulators, and attract better trade opportunities and cross-border investment.

5. What benefits will the Amendment Bill bring?

The FRC welcomes and supports the Amendment Bill which will transform the FRC into Hong Kong’s fully-fledged independent auditor regulator, vested with direct powers of inspection, investigation, as well as discipline concerning auditors of listed entities. The FRC will also be overseeing the performance of the Hong Kong Institute of Certified Public Accountants of their functions in relation to auditors of listed entities including registration; standards in professional ethics, auditing and assurance; and continuing professional development requirements.

We believe the Amendment Bill is in the best interests of the investing public, and that it would migrate Hong Kong’s auditor regulatory regime from “self-regulation” to “independent oversight”. It will enable the FRC to apply for IFIAR membership, with all the benefits such membership will bring. The Amendment Bill will also provide a stable source of funding for the FRC to execute its responsibilities. It also seeks to fill the lacuna in the regulation of overseas auditors under the current regime.

6. What are the focus and major findings of the Comparative Study on Audit Oversight Functions?

The Comparative Study on Audit Oversight Functions focuses on the organisational structures, regulatory activities and operational costs of independent auditor regulators in the UK, the Netherlands, the US and Japan.

It is noted that each jurisdiction has adopted different organisational structures and has different ranges of responsibilities. The auditor regulators of the four jurisdictions have ultimate responsibility for the oversight of the following six functions - registration, inspection, investigation, enforcement (discipline), standards on professional ethics and auditing, and continuing professional education.

Based on the study, the budget for 2017/18 of the UK FRC is £35.3m (HK\$388.3m) and the budget for 2017 of the US PCAOB is US\$268.5m (HK\$2,094.3m). The Government has proposed a budget of HK\$99 million (at 2019 price level) for the FRC's operational costs at the commencement of the new regime which we believe is adequate as a modest beginning for a prudent and effective regulator.

7. How does the FRC prepare itself to take up the additional statutory responsibilities?

Over the last decade, the FRC has diligently discharged its independent investigator role in the face of a marked increase in the volume and complexity of complaints, and made numerous referrals to relevant regulatory bodies. All this has been achieved with a small but dedicated and professional staff. The FRC will need to attract and recruit high calibre staff with relevant competencies in order to execute the new mandate in respect of inspection, discipline and oversight.

The FRC has regular contact with international auditor regulators (e.g. the UK FRC, the PCAOB of the United States and ASEAN Audit Regulators Group) and participates in various conferences organised by audit regulators to share views and experiences in auditor oversight.

The FRC has also commissioned the Comparative Study on Audit Oversight Functions in 2017 to obtain an in-depth understanding of the organisational structures, regulatory activities and operational costs of independent regulators responsible for auditor oversight in major capital markets including the UK and the US, to plan for its future organisational structure and operational procedures which are in line with international best practice and are appropriate in the local context. The FRC will continue to play its part while communicating clearly about developments with all stakeholders.

8. How will the FRC be funded under the new regime?

The Amendment Bill aims to enable Hong Kong to achieve IFIAR membership. Under one of the IFIAR Core Principles, an independent auditor regulator should have stable funding which is sufficient to execute its responsibilities. The Government has proposed a budget of HK\$99 million (at 2019 price level) for the FRC's operational costs at the commencement of the new regime which we believe is adequate as a modest beginning for a prudent and effective regulator.

Under the Amendment Bill, the FRC will be funded by levies on the three stakeholder groups, namely, investors, listed entity and listed entities auditors :

- Levy on investors of securities transactions (50% of total contribution) @ 0.00015% of consideration (paid by each of seller and purchaser) – HK\$49.5 million for 2019
- Levy on PIEs (25% of total contribution) @ 4.2% of annual listing fee for a calendar year – HK\$24.75 million for 2019
- Levy on PIE auditors (25% of total contribution) @ HK\$12,310 for every PIE client for a calendar year – HK\$24.75 million for 2019

The FRC remains neutral on how the funding should be shared among the stakeholder groups.

EC equivalence status + IFIAR membership

1	Abu Dhabi	23	Jersey
2	Australia	24	Korea
3	Austria	25	Liechtenstein
4	Belgium	26	Lithuania
5	Brazil	27	Luxembourg
6	Bulgaria	28	Malaysia
7	Canada	29	Mauritius
8	Chinese Taipei	30	The Netherlands
9	Croatia	31	New Zealand
10	Cyprus	32	Norway
11	Czech Republic	33	Poland
12	Denmark	34	Portugal
	Dubai International	35	Singapore
13	Financial Centre	36	Slovak Republic
14	Finland	37	Slovenia
15	France	38	South Africa
16	Germany	39	Spain
17	Greece	40	Sweden
18	Hungary	41	Switzerland
19	Indonesia	42	Thailand
20	Ireland	43	Turkey
21	Italy	44	United Kingdom
22	Japan	45	United States

Total: 45

EC equivalence status only

1	China
2	Estonia
3	Guernsey
4	Iceland
5	Isle of Man
6	Latvia
7	Malta
8	Romania

IFIAR membership only

1	Albania
2	Botswana
3	Cayman Islands
4	Egypt
5	Georgia
6	Gibraltar
7	Russia
8	Sri Lanka

Hong Kong

Key features of the Financial Reporting Council (Amendment) Bill 2018

Who is Affected?

- The new regulatory regime will cover auditors of public interest entities (PIEs) which is limited to corporations with issued shares listed in Hong Kong or collective investment schemes with interests listed in Hong Kong. (About 2,200 entities, approximately 50 audit firms/practices, together with those registered responsible persons – engagement partners; engagement quality control reviewers and quality control system responsible persons)

FRC's Mandate

- The FRC will become the independent auditor regulator with ultimate responsibility for the following six functions:
 - directly responsible for:
 - inspection of auditors of PIEs
 - investigation of auditors of PIEs (which is currently within the scope of the FRC)
 - discipline of auditors of PIEs
 - conduct independent oversight over Hong Kong Institute of Certified Public Accountants (HKICPA) in respect of
 - registration of auditors of PIEs
 - setting of continuing professional development requirements for auditors of PIEs
 - standard-setting on professional ethics, auditing and assurance for PIE auditors.

Regulation of Overseas Auditors

- FRC will also be empowered to decide on applications for recognising overseas auditors to audit specific overseas entities listed in Hong Kong.

Future Composition of the FRC Council

- FRC will comprise not less than nine members, with at least two persons who possess knowledge of and experience in PIE engagements. The Chairman will be a non-executive director and a non-practitioner. The number of non-executive directors must exceed the number of executive directors.

Appeal from FRC's Decisions

- A new independent review tribunal will be set up to make determinations on any review against registration and disciplinary decisions under the new regime. In addition, an aggrieved person may appeal to the Court of Appeal against the decision of the independent review tribunal if leave to appeal has been granted by the Court of Appeal.

Funding

- FRC will be funded by levies on the three stakeholder groups, namely, investors, listed entities and listed entity auditors :
 - Levy on investors of securities transactions (50% of total contribution) @ 0.00015% of consideration (paid by each of seller and purchaser) – HK\$49.5 million for 2019
 - Levy on PIEs (25% of total contribution) @ 4.2% of annual listing fee for a calendar year – HK\$24.75 million for 2019
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