

Approaching A New Era 邁向新紀元



Press Conference

19 March 2018

Today's Presentation

- 2017 Annual Report
- Views on the FRC (Amendment) Bill 2018
- Independent Auditor Oversight 2017 Comparison
- Concluding Remarks
- Q&A Session

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2017 Annual Report

Mr Paul F. Winkelmann
CEO

Financial Reporting Council

A Decade of Achievements

	Since inception	2017
Pursuable complaints received	Over 400	126
Investigations completed	56	11
Enquiries completed	11	-

2017 Operations

- Handled record number of pursuable complaints
- Proactive review of financial statements for accounting non-compliances and auditing irregularities
- Confirmation of internal compliance with FRC policies and procedures by an independent Process Review Panel

See: http://www.frc.org.hk/en/prp_report.php

Most Common Issues in Completed Investigations

- Impairment of assets
- Accounting for business combinations
- Revenue recognition
- Recognition and measurement of financial instruments

FRC will ensure that continuing professional development courses will cover the most common issues.

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Views on the FRC (Amendment) Bill 2018

19 March 2018

Advocate for Independent Auditor Oversight

2017-2018
Legislative Session

LegCo

Amendment
bill
introduced
by the
Government

- Bills Committee formed
- Written submissions received

Jul 2017

FRC

Comparative
Study on
Audit
Oversight
Functions

Oct 2016

FRC

Update on
independent
audit
oversight
report

June 2015

Government

Consultation
conclusions

Jun 2014

Government

Proposals to
improve the
regulatory
regime for
listed entity
auditors

Oct 2013

FRC

Report on
independent
audit
oversight

Public Interest of Hong Kong

- Strengthen investor protection
- Enhance audit quality
- An independent and robust oversight regime for auditors of listed entities
- International recognition

FRC (Amendment) Bill 2018

- Bring Hong Kong’s auditor regulatory regime in line with major international capital markets
 - from “self-regulation” to “independent oversight”
- Enable FRC to apply for membership of International Forum of Independent Audit Regulators (IFIAR)
- Provide stable funding for FRC to execute its responsibilities under the new mandate
- Close the regulatory gap - overseas auditors

International Norm - Dual Recognition

IFIAR Membership

EC regulatory equivalence

Independent auditor oversight regime will enhance audit quality and investor protection globally

Enhance Hong Kong's status and reputation as a major international financial centre

Endorsement of the competence of an auditor regulator

Facilitate regulatory collaboration

Attract better trade and investment opportunities for Hong Kong

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
13	Dubai International Financial Centre	35	Singapore
14	Finland	36	Slovak Republic
15	France	37	Slovenia
16	Germany	38	South Africa
17	Greece	39	Spain
18	Hungary	40	Sweden
19	Indonesia	41	Switzerland
20	Ireland	42	Thailand
21	Italy	43	Turkey
22	Japan	44	United Kingdom
		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

Written submissions to LegCo (March 2018)

– EC equivalence

- HKICPA – advocating for “practitioners” in the future FRC Council; likely to result in HK being ineligible for EC equivalence
- Big 4: audit over 60% of listed entities (about 1,300) and over 60% of market capitalisation (about HK\$20 trillion) in HK
 - Advocate HK attaining EC equivalence; therefore only “non-practitioners” on future FRC Council
 - Support FRC Council to have accounting and auditing expertise

See: LegCo website

Accounting & Auditing Expertise and Non-practitioners - NOT Mutually Exclusive

- Non-practitioner - 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 3 years
- 3 years cooling off period = non-practitioners who still possess current accounting & auditing expertise through CPD
- Over 50 jurisdictions are EC equivalence
E.g. New York, London, Frankfurt, Paris, Luxembourg, Tokyo, Singapore and Sydney

Written submissions to LegCo (March 2018)

– Scope of PIE Engagements

- Overwhelming support (HKICPA + Big 4) for the expansion of the scope of PIE engagements

The Bill includes	The Bill excludes
<ul style="list-style-type: none">■ Annual financial statements■ Listing documents■ Accountant's report for a reverse takeover or a very substantial acquisition	<p>Most common examples:</p> <ul style="list-style-type: none">■ Interim financial statements■ Accountant's report for a very substantial disposal or major acquisition■ Letter on profit forecast

- All PIE audit and assurance engagements required under Listing Rules should be under the remit of FRC

Funding

- HK\$90 million (2016 price level) / HK\$99 million (2019 price level)
- Levies on investors, PIEs and PIE auditors

Investors of securities transactions	PIEs	PIE auditors
<ul style="list-style-type: none">■ 50% of total contribution■ HK\$49.5 million■ 0.00015% of consideration	<ul style="list-style-type: none">■ 25% of total contribution■ HK\$24.75 million■ 4.2% of annual listing fee for a calendar year	<ul style="list-style-type: none">■ 25% of total contribution■ HK\$24.75 million■ HK\$12,310 for every PIE client for a calendar year

- FRC remains neutral on the funding formulae



Independent Auditor Oversight 2017 Comparison
Hong Kong Financial Reporting Council

Background

Deloitte research

Deloitte UK was engaged by the Hong Kong (HK) Financial Reporting Council (FRC) to undertake the following studies:

- *Report on Independent Audit Oversight (2013)*: an assessment of the requirements to achieve the International Forum of Independent Audit Regulators (IFIAR) membership and/or European Commission (EC) equivalence and identification of the gaps in HK's system in meeting those requirements
- *Update on Independent Audit Oversight (2016)*: an update on the 2013 report, providing an assessment of new requirements to achieve IFIAR membership and/or EC equivalence, including a major new EC requirement introduced in 2016 requiring the Council of the FRC to be fully governed by non-practitioners
- *Comparative Study on Audit Oversight Functions (2017)*: a study on how the regulators in the UK, the Netherlands, the US and Japan operate under IFIAR and EC equivalence requirements

International recognition

IFIAR and EC equivalence

IFIAR

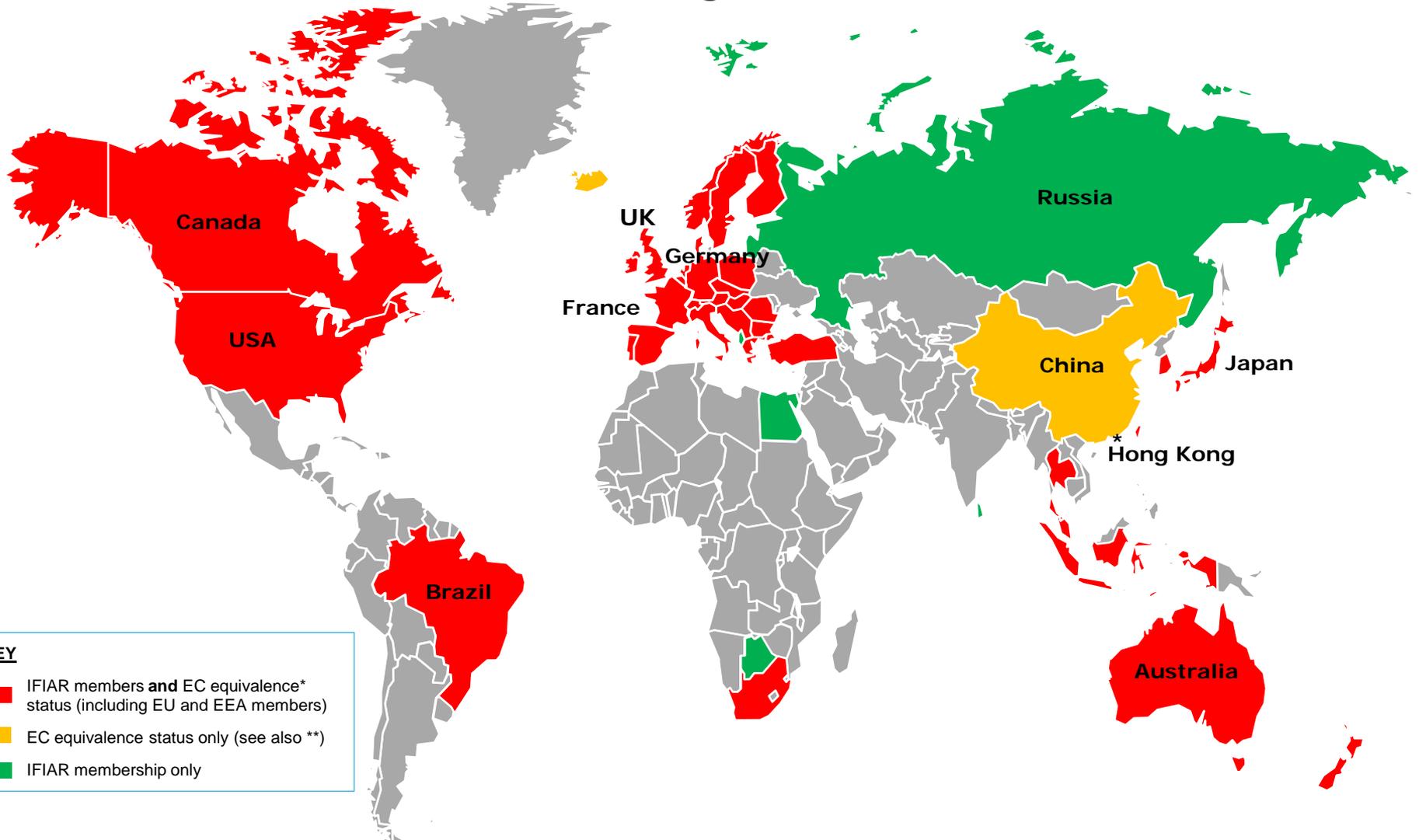
- IFIAR is an international forum which independent audit regulators around the world can apply to join. It provides a forum where members can share their regulatory experiences and inspection findings with the aim of enhancing audit quality globally
- Members should have stable funding sufficient to execute their responsibilities

EC equivalence

- EC equivalence exempts non-European Union (EU) auditors of entities incorporated/listed in the European Economic Area (EEA) from some registration and inspection requirements that would otherwise apply
- Benefits of EC equivalence for HK include:
 - Facilitate cross-border investment and trade
 - Align with other major capital markets worldwide
 - Enhance HK's reputation as a financial centre
 - Support financial markets and the public interest via a regulatory regime comprising independent oversight of the audit profession
 - Streamline cross-border regulation and reduce associated costs

The global picture

Countries with international recognition



Key attributes

Independence

- Both IFIAR and the EC require the applicant to provide evidence that it complies with their respective requirements for the independence of the regulatory audit regime, including the relevant legislation
- EC equivalence notably requires independence in:
 - *Governance*: no practitioner (defined as including a three year cooling off period) is permitted to be involved in the governance structure – i.e. the Council of the FRC
 - *Quality assurance reviews*: former audit practitioners acting as quality assurance reviewers have a three year cooling off period
 - *Sources of funding*: a levy can be imposed on the audit profession as long as the law clearly stipulates that it is a statutory obligation for Listed Entity Auditors to pay the levy
 - *Inspection*: the inspection division and its operation and governance are suitably independent from the reviewed firms and auditors, are not controlled by a professional body and conflicts of interest are avoided
 - *Disciplinary mechanism*: experts engaged for specific assignments cannot be conflicted; mechanism in place for ensuring findings are addressed within a reasonable period; adequate complaints procedures / whistleblowing arrangements are adopted

Key attributes (continued)

Natural justice and appeals process

- The concept of natural justice is another important consideration - the regulator is not both the prosecutor and the jury. Therefore, a right of appeal regarding regulatory decisions is crucial
- There is a right of appeal in all jurisdictions considered as part of our comparative study, although limited by comparison to the proposals for HK – a robust 2-tier appeal process including a review hearing by an independent Review Tribunal and appeal to the Court of Appeal
- In all jurisdictions a certain degree of segregation of duties between inspection, investigation and enforcement is achieved
- *In the UK:*
 - decisions to investigate and sanctions are taken by different parts of the same regulatory body to safeguard the concept of ‘natural justice’
 - respondents may appeal a final decision notice by the Disciplinary Tribunal to the Appeal Tribunal (a separate tribunal within the UK FRC). A further appeal is only possible by Judicial Review
- *In the Netherlands:*
 - the same department undertakes inspections and investigations of the audit firms. However, the Executive Board of the Authority for the Financial Markets (AFM) decides whether a respondent is liable for a fine and an independent Penal Fines Officer is responsible for setting the fines
 - appeals by the audit firms against orders from administrative authorities is only possible by a Judicial Review although individual auditors can appeal to an independent body
- *In the US:* appeal of the Public Company Accounting Oversight Board’s (PCAOB’s) decision can be made to the Securities and Exchange Commission (SEC). An additional appeal to the US Court of Appeals for the District of Columbia Circuit is also available following a decision by the SEC

Funding

Comparative metrics

Metrics	Hong Kong (estimates for 2019/2020) ⁶	UK	US
Number of public interest entities (PIEs)	2,118 ¹	About 1,900 ²	8,780
Number of firms undertaking audits of PIEs	51	About 50	532
Number of audit firms with only 1 PIE audit client	14	18	350 ³
Frequency of inspection	Big 4 plus 2 – annual review Others – twice every three years ⁴	Big 4 plus 2 – annual review Others – triennial review	Firms that audit more than 100 issuers – annual review (2016: 10 firms) Firms that audit less than 100 issuers – triennially review (2016: 188 firms)
Number of PIE engagements to be inspected	Big 4 plus 2 – 5% of PIE audits undertaken with a minimum of 5 engagements Others – 3	Big 4 – average of 20 inspections per audit firm Others – average 5-8 per audit firm	No publicly available information
Staff requirement for inspection	20 professional and 3 support staff	35 professional and support staff	60% of the 856 staff work in the Division of Registration & Inspection
Cost of function – Inspection	To be allocated within the budget	£9m (HK\$97m)	US\$141m (HK\$1,098m)
Staff requirement for enforcement/ disciplinary	1 professional and 1 support staff	20 professional and support staff ⁵	More than 60 staff work in the Division of Enforcement & Investigations
Cost of function – enforcement/ disciplinary	To be allocated within the budget	£7m (HK\$75m)	US\$22m (HK\$172m)
Total budget	HK\$99m (at 2019 price level)	£35m (HK\$388m)	US\$269m (HK\$2,094m)

Notes:

¹ Represents listed equity issuers (1,794 Main Board issuers and 324 GEM issuers) as at 31 December 2017

² Includes entities with securities admitted to trading on an EEA regulated market, banks, building societies and insurance companies

³ Includes audit firms that audit between 1-5 issuers. Data on auditors with only 1 PIE audit client is not available publicly

⁴ HK FRC's estimates reflect the activity level at inception

⁵ This information was obtained by HK FRC through direct conversations with the UK FRC and reported to Deloitte

⁶ The metrics for Hong Kong are proposed by HK FRC and have not been reviewed by Deloitte



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Concluding Remarks

Dr John Poon

Chairman

Financial Reporting Council

Concluding Remarks

- We welcome the Bill as we have advocated all along that the auditor regulatory reform is in the best interests of the investing public
- EC regulatory equivalence - the governing body of an independent auditor regulator must be comprised solely of non-practitioners
- For better investor protection - expansion of scope of public interest entity engagements
- IFIAR Core Principle - members must have stable funding sufficient to execute their responsibilities