

Consultation on Proposals to Improve the Regulatory Regime for Listed Entity Auditors

Consultation Conclusions

BACKGROUND

On 20 June 2014, the Financial Services and the Treasury Bureau (“FSTB”) launched a three-month public consultation to solicit views on the proposals to introduce an independent oversight regime for listed entity auditors (“LEAs”). The key objective of the proposals is to further enhance the independence of the existing auditor regulatory regime from the audit profession with a view to ensuring that the regime is benchmarked against international standards and practices, which is important given the externally-oriented nature of our financial market and the need to maintain the confidence of both international and local investors in our overall financial regulatory regime with regard to the capital market.

2. The consultation paper was issued to various stakeholders, including the Hong Kong Institute of Certified Public Accountants (“HKICPA”), the Financial Reporting Council (“FRC”), professional accountancy bodies, financial regulators, audit firms, chambers of commerce and political parties, etc. To invite views from the general public, we issued a press release, organised a press briefing and posted the consultation paper onto FSTB’s website¹ on 20 June 2014. In addition, we held two public forums and attended three meetings and briefings organised by interested organisations to brief the participants on the proposals and to listen to their views during the consultation period. We also briefed the Panel on Financial Affairs of the Legislative Council (“LegCo”) on the reform proposals on 7 July 2014.

¹ The consultation paper is available at http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_rpirlea_e.pdf.

CONSULTATION FEEDBACK

3. We received 703 written submissions during the consultation period. Out of the submissions, 661 are copies of six templates of standard petitions/questionnaires. If these are counted as six submissions, there are in total 48 submissions. A list of the respondents is at **Appendix I**. A compendium of the submissions will be made available on FSTB's website.

4. An overwhelming majority of respondents are supportive of the objective and direction of the reform. Some respondents have also made specific comments on some of the proposals. A summary of the respondents' views on the proposals and the specific issues raised with our corresponding responses is set out at **Appendix II**. In light of the comments received, we have reviewed the relevant proposals. Paragraphs 5 to 34 below set out our considerations in respect of these proposals, and where applicable, the refinements to and elaborations on the proposals.

REVIEW OF RELEVANT PROPOSALS

Definition of public interest entities ("PIEs")

5. The consultation paper proposed that the new regulatory regime would cover auditors of PIEs, with PIEs to be defined to mean listed entities in Hong Kong. While most respondents supported the proposal, some respondents suggested that the scope of PIEs should be extended to cover other non-listed PIEs, e.g. major non-listed banks, clearing houses and exchanges, as it appeared to them that few overseas independent auditor regulators would only regulate auditors of listed entities.

6. We acknowledge that the comments from these other respondents are not without ground. However, since this reform will entail very substantial changes to the existing regulatory system, it would be prudent for us to adopt a step-by-step approach in proceeding with the reform. We can review the scope of PIEs after we have sufficient operating experience of the new regime.

FRC's oversight powers over HKICPA in relation to the latter's functions under the new regime

7. The consultation paper proposed that in exercising its oversight over HKICPA in relation to registration, setting of continuing professional development ("CPD") requirements and setting of standards on professional ethics, auditing and assurance with respect to LEAs under the new regime, FRC would –

- (a) receive periodic reports from HKICPA on the performance of these functions and the exercise of the relevant powers;
- (b) conduct quality review on HKICPA in respect of the performance of such functions and the exercise of such powers; and
- (c) upon being satisfied that it was in the public interest to do so, give HKICPA written directions in relation to the performance of such functions and the exercise of such powers.

8. There is general support from respondents to the proposed oversight model. On the other hand, some respondents suggested that FRC should be provided with a reserve power to act itself where circumstances so warranted and an express power to require information from HKICPA in respect of matters subject to its oversight. We agree that it will be conducive to the effective performance of FRC's oversight functions if FRC is empowered to require information from HKICPA for the purpose of exercising its oversight of the three functions by HKICPA viz. registration, setting of CPD requirements and setting of professional standards in respect of LEAs. The amendment bill will provide for this power of FRC. However, since FRC will be empowered to give written directions to HKICPA in the public interest under the new regulatory regime and it will be a statutory obligation for HKICPA to act in accordance with the written directions, we do not see strong justifications to give FRC a reserve power to act itself.

9. Some respondents were concerned that the proposal for FRC to publish the periodic reports received from HKICPA might inhibit full and frank dialogue between FRC and HKICPA. To address these concerns, we will make it a statutory requirement on FRC to publish reports in its own name periodically to inform the public of the performance of its oversight functions, instead of requiring it to publish the periodic reports received from HKICPA.

Registration of LEAs

10. The consultation paper proposed that a practice unit who wished to enter into an audit engagement with a listed entity in Hong Kong should be registered as a LEA, and in order for an application for registration as a LEA to be approved, individuals who were authorised by the LEA to perform the role of an audit engagement authorised person, an engagement quality control reviewer or a quality control system responsible person should be fit and proper persons. For the purpose of the reform, there would not be any change to the existing qualification and experience requirements for considering whether a person was fit and proper to be registered as a LEA and whether an individual was fit and proper to perform the above-mentioned roles in respect of a LEA.

11. Whilst the majority of respondents supported the proposal that a practice unit who wished to enter into an audit engagement with a listed entity in Hong Kong should be registered as a LEA, some raised concern that the proposed new registration requirement might restrict an eligible auditor who did not have any listed client yet from entering the market. To address the concern, the amendment bill will make it clear that all eligible auditors who meet the registration requirements under the new regime may apply to be registered as LEAs under the new regime before accepting any listed client.

“Responsible persons” of LEAs

12. The consultation paper proposed that a LEA must, *inter alia*, authorise individuals who were fit and proper persons to perform the role of the LEA’s quality control system responsible persons, and that these responsible persons must be registered under the new regime. The consultation paper also invited views on whether these responsible persons should be held accountable for the absence/failure of the LEA’s quality control system and be subject to disciplinary actions in such circumstances.

13. Many respondents supported the proposal to require responsible persons to be registered and a number of them also took the view that these responsible persons should be held accountable for the absence/failure of the LEA’s quality control system and be subject to disciplinary actions where circumstances so warranted. On the other hand, some respondents considered that it might not be necessary to make it a mandatory requirement for individuals who assumed ultimate responsibility for the quality control system of a practice unit to be registered under the new regime as the Hong Kong Standard on Quality Control 1 (“HKSQC 1”) already contained express provisions that the leadership of a practice unit should be responsible for establishing and maintaining a quality control system within the practice unit. They also raised concern that an audit firm’s managing board might include individuals who did not have audit background and it would not be appropriate to subject them to disciplinary actions under the new regime. Some respondents also sought clarification on the circumstances under which these responsible persons might be subject to disciplinary actions.

14. The stipulations in HKSQC 1 underline the importance of establishing and maintaining a quality control system within a practice unit. The consultation proposal is actually modelled on HKSQC 1. To ensure a proper and effective regulatory regime for LEAs, we consider it necessary for the relevant legislation to expressly provide for the registration of responsible persons and disciplinary actions against them in case of failure in their statutory duties.

15. In view of respondents' concerns, we have reviewed the details of the proposal. Since the new regime will only regulate LEAs in respect of their audit engagements with listed entities, the regulatory scope covers only one of the different lines of business in which a practice unit may engage. Therefore, we will tighten up the definition of "responsible persons" such that only persons who are responsible for the LEA's quality control system of audit engagements in respect of listed entities would be required to be registered in the new regime, and the amendment bill will also stipulate clearly the statutory duties of a responsible person and the circumstances under which he may be subject to disciplinary actions. Under the revised arrangements –

- (a) each LEA would be required to designate at least one responsible person from amongst the managing board of partners and/or its Chief Executive Officer ("CEO") (or their equivalents) to be in charge of the quality control of audit engagements in respect of listed entities;
- (b) a responsible person shall be required to use his best endeavours –
 - (i) to ensure that the LEA has established policies and procedures for maintaining a quality control system in respect of listed entity audit engagements; and
 - (ii) to secure observance with such policies and procedures within the LEA; and
- (c) a responsible person would be subject to disciplinary actions only if he has contravened the statutory requirements in (b) above.

We trust that the above revised arrangements will address the respondents' concern while ensuring the integrity of the regulatory system.

Inspection of LEAs

16. The consultation paper proposed that the statutory function to conduct recurring inspections of LEAs in respect of their listed entity audit engagements should be transferred from HKICPA to FRC. There is overwhelming support from respondents on the consultation proposal, although some respondents expressed concern about the power of FRC to enter into the business premises of the LEAs at any reasonable time. To ensure that there is proper safeguard to the exercise of such power, the amendment bill will make it clear that the power to enter into the business premises of LEAs at any reasonable time may only be exercised for ascertaining whether a LEA is complying with, has complied with, or is likely to be able to comply with the relevant legislative provisions and auditing standards.

17. Some respondents considered that it might be too onerous for a LEA to be held criminally liable if it failed to comply with the requirements in relation to FRC's inspections. It should be noted that it is already a criminal offence under the existing Financial Reporting Council Ordinance ("FRCO") (Cap. 588) for a person who fails to comply with the requirements imposed by FRC in relation to its investigations. We consider it appropriate to maintain our proposal which is in line with the existing regulatory regimes of other financial regulators in Hong Kong, under which non-compliances with the requirements in relation to the regulators' inspections are criminal offences. However, to address the concern raised by some respondents, the amendment bill will make it clear that the Court will take into account whether the person concerned has any reasonable excuse for the non-compliance before it makes a decision on the case.

18. On the other hand, the consultation paper invited views on whether FRC should be allowed to delegate to HKICPA its inspection functions and powers. Most of the respondents who commented on this question considered that such delegation was not in line with the practice of most overseas independent auditor oversight bodies and might jeopardise the independence and consistency of the inspection process. In light of the comments received, we will not provide for the delegation route in the amendment bill.

Disciplinary mechanism

19. The consultation paper proposed that FRC should be vested with direct disciplinary powers, including the powers to make decisions on disciplinary cases concerning LEAs in respect of listed entity audit and reporting accountants in respect of assurance engagements under the new regulatory regime. A number of respondents supported the proposal, whilst some others suggested that FRC's disciplinary function should be performed by a body or committee which was either independent of FRC or consisting of persons independent of FRC so as to ensure separation of disciplinary power and inspection/investigation powers.

20. We have reviewed the proposed disciplinary mechanism, with particular reference to the relevant international standards and practices as they apply to the disciplinary system governing auditors. We note that the Statutory Audit Directive of the European Union ("EU") requires that the oversight of the disciplinary system for auditors should be governed by non-practitioners, i.e. independent of the audit profession. However, there is no parallel requirement by EU or any comparable overseas jurisdictions that the disciplinary powers must be vested with a body or committee independent of the independent auditor regulator, or that any such body or committee should consist of persons independent of the regulator. In fact, in some major overseas jurisdictions (e.g. US and Canada), the inspection, investigation and disciplinary powers are all vested with their independent auditor regulators. Therefore, there is no question that for the purpose of ensuring fairness in the disciplinary mechanism, FRC must not be vested with direct disciplinary powers under the new regime.

21. To ensure fairness and due process in the disciplinary mechanism, the consultation paper has proposed a system which is being practised and has been well-tested in auditor regulation in major overseas jurisdictions as well as in Hong Kong's financial market. We have also committed in the consultation paper to put in place a number of checks and balances² on FRC's exercise of the disciplinary powers. To elaborate further, under the new regime, the person subject to disciplinary proceedings will be given a fair hearing, in which he will be allowed to make written or oral representations before a disciplinary decision against him is made.

22. We will work out the details of the disciplinary mechanism within the above framework in drawing up the amendment bill. In the process, we will consider whether it would be desirable and appropriate for persons independent of FRC to be given any formal role in the disciplinary mechanism under the auspices of FRC, and if so, the arrangements for FRC to engage such persons in making disciplinary decisions.

Maximum level of pecuniary penalty

23. The consultation paper proposed to cap the amount of pecuniary penalty at \$10 million or three times the amount of the profit gained or loss avoided by the LEA as a result of the irregularity, whichever was higher. Some respondents expressed concerns that the proposed maximum level of pecuniary penalty was too high which might drive smaller audit firms out of business.

² The checks and balances include –

- (a) giving the person concerned a reasonable opportunity of being heard before exercising such disciplinary powers;
- (b) a power to establish an expert panel to provide advice to FRC in respect of the disciplinary cases on the application of audit standards, related practices of the audit profession or experiences in previous cases of similar nature;
- (c) arrangements to ensure that FRC's investigation and inspection staff will not be involved in the disciplinary process and the determination of disciplinary sanctions;
- (d) a statutory requirement on FRC to issue guidelines to indicate the manner in which it exercises the power to impose pecuniary penalty, and to have regard to the guidelines when exercising the power; and
- (e) a channel for any person who is aggrieved by a disciplinary decision made by FRC to appeal against the decision through an independent appeals mechanism, etc.

24. It should be noted that in some major overseas jurisdictions (e.g. the UK), there is indeed no statutory limit on the amount of pecuniary penalty the auditor regulator may impose on the auditors. In putting forward our proposal, we have emphasised that it is not our intention that the imposition of pecuniary penalty be used as a tool to put LEAs into financial jeopardy. Under the proposal, FRC would be required by law to publish guidelines on how it may impose a pecuniary penalty, which should include, *inter alia*, the following factors –

- (a) the nature and seriousness of the irregularity;
- (b) whether the LEA has made financial gains/avoided financial loss;
- (c) the audit fees received; and
- (d) other circumstances which would include that the penalty should not put a firm or individual into financial jeopardy.

In gist, FRC must have regard to the principles of fairness and proportionality when determining the pecuniary penalty to be imposed in individual cases. We keep an open mind on whether the guidelines to be issued by FRC in due course should include any other relevant factors. We are prepared to consider any further views from stakeholders on this matter.

25. As regards the variable element of “three times the amount of the profit gained/loss avoided”, some respondents sought clarification on whether and how the amount of profit gained or loss avoided should be calculated in each and every disciplinary case. We would like to clarify that this variable element may only come into play in determining the amount of pecuniary penalty to be imposed for a particular case if the intended amount exceeds \$10 million. In other words, it would not be necessary for FRC to make an assessment on the amount of profit gained or loss avoided in each and every disciplinary case. It should be noted that the sanction guidelines of the auditor regulators in some overseas jurisdictions (e.g. the UK) also make reference to the financial benefit derived or loss avoided by the auditor concerned as a result of an irregularity when determining the disciplinary sanction to be imposed on the regulatee. Therefore, we do not see any strong justifications to change the proposal.

Independent appeals mechanism

26. Most respondents supported the consultation proposal to set up a new independent appeals tribunal for hearing appeals against registration and disciplinary decisions under the new regime and to provide an additional avenue to appeal to the Court of Appeal against the decision of the independent appeals tribunal if leave to appeal had been granted by the Court of Appeal.

27. Some respondents expressed concern about possible premature disclosure of the identity of a LEA subject to disciplinary action as this might damage the LEA's reputation. To address the concern, the amendment bill will make it clear that the relevant disciplinary decision would not be made public until after the expiry of the period for lodging an appeal to the independent appeals tribunal or, if an appeal is lodged, until after the appeal has been determined.

28. On the other hand, some respondents suggested removing the requirement of obtaining leave from the Court of Appeal before a party could appeal to the Court, mainly on the ground that there was no such requirement under the present appeals mechanism. It should be noted that under the present appeals mechanism, a person who is aggrieved by a registration or disciplinary decision made against him may make an appeal only directly to the Court of Appeal. In contrast, under the proposed new regime, the person will have the statutory right to make an appeal to the independent appeals tribunal chaired by a person eligible for appointment as a High Court judge, and as an added protection, an appellant who is not satisfied with the determination of the independent appeals tribunal can make a further appeal to the Court. It should be noted that the independent appeals tribunal arrangement would normally be more efficient and less costly to the appellants than if the appeals are to be handled by the Court. Since the access to the court system becomes an extra tier in the independent appeals mechanism under the new regime, we consider that it is reasonable to introduce a requirement for obtaining the leave of the Court of Appeal which will take into account whether the further appeal has a reasonable prospect of success or there is some other reason in the interests of justice for the further appeal to be heard by the Court.

Funding mechanism

29. The consultation paper proposed that the future FRC should be funded by the three new levies on LEAs, listed entities and securities transactions respectively on a roughly equal basis. Apart from supportive views, we also received comments that the funding should come solely from the new levy on LEAs or solely from the new levy on securities transactions.

30. Given the key objective of the reform as explained in paragraph 1 above, we believe that our proposal is a balanced and reasonable funding model and is fair to the three key stakeholder groups. As regards the suggestion by some respondents that the Government should be one of the funding sources of FRC under the new regime, we maintain the view that the Government should not be a recurrent funding source for FRC's operation. This is consistent with the principle that the independent auditor regulator should be financially and operationally independent from the Government, and is in line with the practices in most of the other comparable overseas jurisdictions.

31. On the other hand, there are suggestions that the levy on individual LEAs should be proportionate to their audit fees instead of applying a flat rate for each listed entity audit engagement of the LEAs, on the ground that the suggested approach may better take into account the affordability of the LEAs. Noting that the flat fee per audit engagement approach has been adopted by HKICPA for the purpose of collecting contributions from relevant auditors for making annual financial contributions to FRC ever since the inception of FRC, we have sought information from HKICPA on the relevant background and are given to understand that a decision to adopt this approach, which is simple and straightforward to implement, was made after a due process of members' consultation which had also considered other basis for calculation. Against this background, it would seem appropriate to maintain the flat fee per audit engagement approach for determining the levy on individual LEAs unless new arguments which have not been considered in the past are put forward that warrant a review of this calculation basis.

Composition of FRC

32. The consultation paper proposed that FRC should in future comprise not less than seven members appointed by the Chief Executive, together with the CEO of FRC as an ex-officio member. Out of the FRC members to be appointed by the Chief Executive, there should be at least two persons who possessed knowledge of and experience in the auditing of Hong Kong listed entities. There is general support from respondents to the proposal, although some suggested that more persons with sufficient experience and knowledge of the audit profession should be included in FRC and some others suggested that the Government should be represented in FRC.

33. Given the primary considerations that FRC should be independent of the audit profession and of the Government, and since we have already proposed to relax the present requirement of a majority of “lay persons”³ within FRC to a majority of “non-practitioners”⁴, which will allow the appointment of experienced personnel from the audit profession who have passed the relevant cooling-off period to FRC, we do not see strong justifications to pursue the above suggestions.

34. On the other hand, given the much wider regulatory ambit of FRC after the reform, FRC will need to be supported by a strong executive team with the CEO underpinned by a suitable number of executive directors (“EDs”). Therefore, the amendment bill will provide for the appointment of EDs by the Chief Executive to be members of FRC, and correspondingly make it a statutory requirement that the number of executives in the Council must not exceed the number of non-executive Council members so as to ensure proper corporate governance.

³ Under the FRCO, a “lay person” means a person who is not a certified public accountant (“CPA”) within the meaning of the Professional Accountants Ordinance (Cap. 50) or a member of an accountancy body which is a member of the International Federation of Accountants.

⁴ “Non-practitioner” will be defined as a person who is not, and has not during the previous three years been, a CPA (practising) or a partner, director, agent or employee of a practice unit.

WAY FORWARD

35. Backed by majority support from the respondents for the reform exercise, we will proceed to prepare the draft amendment bill based on the consultation conclusions. We will continue to engage relevant stakeholders as we work out further details of the new regime for preparing the draft amendment bill. In order to allow reasonable time for the drafting process and further stakeholder engagement as necessary, our target is to introduce an amendment bill into LegCo in the 2016-17 legislative session.

Financial Services and the Treasury Bureau
26 June 2015

Respondents
(in alphabetical order)

1. Association of Chartered Certified Accountants, The (ACCA)
2. Accounting and Finance Committee of the Federation of Alumni Associations of Chinese Colleges and Universities in Hong Kong, The
3. Accounting Development Foundation Limited
4. Century Legend (Holdings) Limited
5. Chamber of Hong Kong Listed Companies, The
6. CHOW Kwong-fai, Edward
7. Consumer Council, The
8. CPA Australia
9. Deloitte Touche Tohmatsu
10. Ernst & Young
11. Financial Reporting Council
12. Hon CHEUNG Wah-fung, Christopher
13. Hon LEUNG, Kenneth
14. Hong Kong Association of Banks, The
15. Hong Kong Business Accountants Association
16. Hong Kong Institute of Certified Public Accountants, The
17. Hong Kong Institute of Chartered Secretaries, The
18. Hong Kong Institute of Directors
19. Hong Kong Securities Professionals Association
20. International Federation of Accountants
21. JONES, Gordon W.E.
22. KANG Shing-leung
23. KPMG
24. LAI, Bernard
25. LAM Kok-sang
26. Mabel Chan & Co. CPAs

27. Mr LAM
28. Nexia Charles Mar Fan & Co.
29. PKF Hong Kong
30. PricewaterhouseCoopers
31. PYI Corporation Limited
32. RSM Nelson Wheeler
33. Society of Chinese Accountants & Auditors, The
34. WONG Kim-man
35. 一群香港中小企執業會計師
36. Multiple entries (Version 1) [257 submissions]
37. Multiple entries (Version 2) [214 submissions]
38. Multiple entries (Version 3) [8 submissions]
39. Multiple entries (Version 4) [175 submissions]
40. Multiple entries (Version 5) [5 submissions]
41. Multiple entries (Version 6) [2 submissions]
42. A respondent who has requested that his views be kept confidential
43. A respondent who has requested that his views be kept confidential
44. A respondent who has requested that his views be kept confidential
45. A respondent who has requested that his views be kept confidential
46. A respondent who has requested that his views be kept confidential
47. A respondent who has requested that his views be kept confidential
48. A respondent who has requested that his views be kept confidential

Summary of Respondents' Views with the Government's Responses

Questions	Summary of Respondents' Views	Government's Responses
Chapter 2 - Basic Parameters of Reform		
1	<i>Do you agree with the proposed objective of the reform, i.e. to enhance the independence of the regulatory regime for auditors of listed entities from the profession itself with a view to ensuring that the regime is benchmarked against international standards and practices and continues to be appropriate in the local context?</i>	
	<p>(a) An overwhelming majority of respondents agreed or did not express negative view on the proposed objective of the reform, although a respondent considered that there was no urgent need for the reform.</p> <p>(b) Specific comments raised in some submissions include –</p> <p>(i) A respondent considered that the reform should at a minimum enable Hong Kong to be eligible for membership in the International Forum of Independent Audit Regulators (IFIAR) and to attain regulatory equivalence status with the European Commission.</p> <p>(ii) A respondent commented that the reform should take a bare minimum approach to avoid unnecessary adverse impacts upon the audit profession.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the objective of the reform.</p> <p>(b)</p> <p>(i) Noted. We have set out in the consultation paper the importance of enabling Hong Kong to be eligible for being represented in IFIAR and making reference to the relevant principles of the European Union (EU) in designing the new regulatory regime.</p> <p>(ii) Noted. We have all along been engaging the audit profession and will take into account their views and comments as well as other stakeholders' comments in taking forward the reform.</p>
2	<i>Do you agree that the new regulatory regime should only cover auditors of public interest entities (PIEs), which will be defined to cover LEAs?</i>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that the new regime should only cover auditors of PIEs, with PIEs to be defined to cover listed entities only.</p> <p>(b) Some respondents suggested that consideration should be given to expand the scope of PIEs from listed entities to cover non-listed entities such as non-listed banks, clearing houses, exchanges, subsidiaries of listed entities, as well as entities over a certain size that took money from the public, e.g. charities and those that held money and assets in a fiduciary capacity, and a respondent suggested that the reform should also extend the public oversight over all of the regulatory activities of Hong Kong Institute of Certified Public Accountants (HKICPA), including those in relation to auditors of entities other than PIEs, noting that public oversight of professional audit regulatory body as a whole was an established requirement of the EU that was increasingly recognised as best practice internationally.</p> <p>(c) A respondent pointed out that some larger capital markets defined PIEs more broadly and that the EU Statutory Audit Directive had also included credit institutions and insurance undertakings as PIEs in addition to listed entities. The</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b) Noted. Since the reform will entail very substantial changes to the existing regulatory system, it would be prudent for us to adopt a step-by-step approach in proceeding with the reform. We can review the scope of PIEs after we have sufficient operating experience of the new regime.</p> <p>(c) Noted. The definition of PIEs can be amended through an amendment bill in future after due consultation with relevant stakeholders.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>respondent therefore suggested that the new legislation should provide for flexibility to amend the definitions of PIEs as and when necessary.</p>	
<p>3</p>	<p><i>Do you agree that the definition of PIEs should be set out in the main legislation such that any change in future could only be made by way of an amendment bill?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal to set out the definition of PIEs in the main legislation.</p> <p>(b) A respondent suggested that the new legislation should provide flexibility to amend the definition of PIEs by regulation.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b) Noted. As a change to the definition of PIEs would mean increasing or reducing the types of auditors to be regulated by the Financial Reporting Council (FRC) under the new regime, it is more appropriate for any such amendment to be pursued through an amendment bill after due consultation with relevant stakeholders.</p>
<p>4</p>	<p><i>Do you agree that FRC should become the independent auditor oversight body with respect to listed entities in Hong Kong by enlarging its regulatory remit?</i></p>	
	<p>An overwhelming majority of respondents supported or did not express negative view on the proposal for FRC to become the independent auditor oversight body with respect to listed entities in Hong Kong, although a respondent opposed to the proposal on the ground that FRC members were not elected but appointed by</p>	<p>We are pleased to note the respondents' overwhelming support for the proposal, which is consistent with the key objective of the reform that the governing body of the regulator for LEAs in Hong Kong must be independent from the audit profession.</p>

Questions	Summary of Respondents' Views	Government's Responses
	the Government and another respondent considered that the regulation of LEAs should be placed under the Securities and Futures Commission (SFC).	
Chapter 3 - Registration		
5	<p>A. <i>Do you agree that a LEA must be a practice unit as defined under the existing Professional Accountants Ordinance (Cap.50) (PAO) and a fit and proper person to be registered as a LEA?</i></p> <p>B. <i>If yes, do you agree that for the purpose of the reform, there should be no change to the existing qualification and experience requirements for considering whether a person is fit and proper to be registered as a LEA, i.e. by reference to the existing fit and proper test for becoming a certified public accountant (CPA)?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that a LEA must be a practice unit as defined under the existing PAO and a fit and proper person to be registered as a LEA.</p> <p>(b) Specific comments raised in some submissions include –</p> <p>(i) A respondent considered that the meaning of “fit and proper” should be defined and explained, and that the meaning of “fit and proper” would be different depending on the type of practice unit (whether it was an individual, firm, or a corporate practice).</p>	<p>(a) We are pleased to note the respondents’ overwhelming support for the proposal.</p> <p>(b)</p> <p>(i) We do not consider it necessary to define “fit and proper” in the legislation as our proposal is to make reference to the prevailing fit and proper test for becoming a CPA. Relevant details are already in the public domain vide the HKICPA website (http://www.hkicpa.org.hk/en/registration-and-licensing/register-as-cpa/registration-requirements/fit-person/)</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(ii) A respondent suggested that similar fit and proper criteria should be applied when registering an overseas based auditor.</p>	<p>(ii) Same as the case in the present regime, the qualification requirements as well as the fit and proper criteria for local LEAs and LEAs from overseas respectively will not be identical under the new regime. At present, the fit and proper criteria for becoming a CPA do not apply to overseas auditors of specific overseas entities listed in Hong Kong, who are subject to different criteria as explained in paragraph 3.15 of the consultation paper. Our proposal for overseas auditors is that under the new regime, they must meet the criteria as set out in paragraph 3.30¹ of the consultation paper before they would be recognized by FRC as overseas auditors of specific overseas entities listed in Hong Kong.</p>
<p>6</p>	<p>A. <i>Do you agree that in order for an application for registration as a LEA to be approved, the individuals who are authorised by the auditor to perform the roles of an audit engagement authorised person, an engagement quality control reviewer or a quality control system responsible person should be fit and proper persons to perform such roles?</i></p> <p>B. <i>If so, do you agree that for the purpose of the reform, there should be no change to the existing qualification and experience requirements for individuals taking up such roles with respect to a registered LEA when considering whether they are fit and proper to perform those roles?</i></p>	

¹ The criteria are – (a) the overseas auditor is a member of a body of accountants recognised by FRC; (b) there is in force an agreement of mutual or reciprocal cooperation arrangement between the home regulator of the overseas auditor and FRC; and (c) the overseas auditor must demonstrate to the satisfaction of FRC that he has adequate resources and possesses the capability to perform the audit of the relevant overseas entity listed in Hong Kong.

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) A majority of respondents supported or did not express negative view on the proposals that the individuals who were authorised by the auditor to perform the roles of an audit engagement authorised person, an engagement quality control reviewer or a quality control system responsible person should be fit and proper persons to perform such roles in order for the application for registration as a LEA to be approved, and there should be no change to the existing qualification and experience requirements for individuals taking up such roles.</p> <p>(b) A few respondents questioned the rationale for requiring the registration of the individual or individuals responsible for the firm's quality control system as those individuals would normally not be directly involved in the audit engagement and the existing Hong Kong Standard on Quality Control 1 (HKSQC 1) had already required such individual(s) to assume ultimate responsibility.</p>	<p>(a) We are pleased to note the respondents' support for the proposal.</p> <p>(b) Our proposal is actually modelled on the HKSQC 1 which underlines the importance of establishing and maintaining a quality control system within a practice unit. To ensure a proper and effective regulatory regime for LEAs, we consider it necessary for the relevant legislation to expressly provide for the registration of individuals who assume ultimate responsibility for the LEA's quality control system.</p> <p>It is not our intention to require all members of the managing board of partners and the Chief Executive Officer (CEO) (or their equivalents) to be registered as responsible persons. In view of respondents' concerns,</p>

Questions	Summary of Respondents' Views	Government's Responses
		<p>we will tighten up the definition of “responsible persons” such that only persons who are responsible for the quality control system of audit engagements in respect of listed entities of the LEA would be required to be registered, taking into account that the new regime will regulate LEAs only in respect of their audit engagements with listed entities. Under the revised arrangements, each LEA would be required to designate at least one responsible person from amongst the managing board of partners and/or its CEO (or their equivalents) to be in charge of the quality control of audit engagements in respect of listed entities, and such persons should be fit and proper persons to take up the role of responsible persons.</p>
<p>7</p>	<p><i>Do you agree that an individual, partnership or body corporate who wishes to enter into an audit engagement with a listed entity in Hong Kong should be required to register as a LEA, and that it shall be a criminal offence if an unregistered person entered into an audit engagement with a listed entity?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that an individual, partnership or body corporate who wished to enter into an audit engagement with a listed entity in Hong Kong should be required to register as a LEA.</p>	<p>(a) We are pleased to note the respondents’ overwhelming support for the proposal.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(b) A respondent expressed concern that small and medium sized practitioners (SMPs) who did not have listed client now might be restricted from entering the market.</p> <p>(c) While a number of respondents supported that it should be a criminal offence if an unregistered person entered into an audit engagement with a listed entity, some respondents did not consider it necessary to make it a criminal offence if an unregistered person entered into an audit engagement with a listed entity. The latter group of respondents suggested that such non-compliances should be dealt with under the disciplinary mechanism, and pointing out that it was already a criminal offence for non-certified public accountants providing or offering to provide audit services under section 42 of the PAO.</p>	<p>(b) We have no intention to introduce any new restrictions on eligible auditors taking up listed entity audit engagements. The amendment bill will make it clear that all eligible auditors who meet the registration requirements under the new regime may apply to be registered as LEAs before accepting any listed client.</p> <p>(c) This requirement is to protect the interests of the LEAs, the listed entities and investors, and is in line with other financial regulatory regimes in Hong Kong under which it is a criminal offence if a person carries on or holds out to carry on a regulated activity without properly licensed or registered under the respective regimes. The clarification in (b) above regarding the registration of eligible auditors who do not have listed clients yet should have addressed the concern that an auditor might inadvertently commit a criminal offence by entering into a listed entity audit engagement without prior registration under the new regime.</p>
8	<p>A. <i>Do you agree that HKICPA Registrar should be assigned the role of Registrar of LEAs and be vested with the registration functions and powers as outlined in paragraph 3.23 of the consultation paper, and FRC should exercise oversight through arrangements as proposed in paragraph 3.24 of the consultation paper?</i></p> <p>B. <i>Do you agree that FRC should publish the periodic reports received by the HKICPA Registrar as mentioned in paragraph</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<i>3.24(a) of the consultation paper on its website, and provide information on the results of its quality review and the written directions given by it in its annual report?</i>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that the HKICPA Registrar should be assigned the role of Registrar of LEAs and be vested with the registration functions and powers as outlined in paragraph 3.23 of the consultation paper, and FRC should exercise oversight through arrangements as proposed in paragraph 3.24 of the consultation paper, while a respondent opposed to the proposal on the ground that such proposal would diminish the power of HKICPA.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) A respondent considered that when FRC exercised its oversight power over the performance of registration of LEAs by HKICPA, apart from the three proposed arrangements in the consultation paper, FRC should be given the power to require information from HKICPA, as well as a reserve power to act itself where circumstances so warranted.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b)</p> <p>(i) We agree that it will be conducive to the effective performance of FRC's oversight functions if FRC is empowered to require information from HKICPA for the purpose of exercising its oversight functions. We will provide for this power of FRC in the amendment bill. However, since FRC will be empowered to give written directions to HKICPA in the public interest under the new regulatory regime and it will be a statutory obligation for HKICPA to act in accordance with the written directions, we do not see any strong justifications to give FRC a reserve power to act itself.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(ii) A respondent suggested that the directions issued by FRC to HKICPA should only be made to protect the public interest and not to circumvent exercise of due process by HKICPA. In the event that FRC needed to issue directions, FRC should be required to give full reasons for its actions to HKICPA and the Government.</p> <p>(c) A majority of respondents supported our proposal that FRC should publish HKICPA's periodic reports submitted to it. However, some respondents considered that periodic reports received by FRC from HKICPA should not be published as this might inhibit co-operation and full and frank dialogue between FRC and HKICPA.</p>	<p>(ii) Noted. We have made it clear in the consultation paper that the written directions given by FRC to HKICPA in relation to the latter's performance of such functions and exercise of such powers should only be made when FRC is satisfied that it is in the public interest to do so. We believe that FRC will set out the relevant considerations in giving any written directions to HKICPA.</p> <p>(c) To address the respondents' concern, we will make it a statutory requirement on FRC to publish reports in its own name periodically to inform the public of the performance of its oversight functions, instead of requiring it to publish the periodic reports received from HKICPA.</p>
<p>9</p>	<p><i>Do you agree that any person subject to a registration decision by the HKICPA Registrar may appeal against the decision, and any such appeal should be handled by an appeal mechanism which is independent of both the HKICPA Registrar and FRC?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that any person subject to a registration decision by the HKICPA Registrar might appeal against the decision, and any such appeal should be handled by an appeal mechanism which is</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>independent of both the HKICPA Registrar and FRC.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) Two respondents considered that the appeal mechanism should also apply to registration decisions made by the FRC.</p> <p>(ii) Two respondents were of the view that any refusal of registration as LEAs and subsequent appeal should not be made public since the activities of an auditor were not a matter of public interest until they had been registered as LEAs. Publicity about refusal of registration could unduly affect an auditor's reputation in other aspects of its professional activities and might influence the outcome of future registration applications.</p>	<p>(b)</p> <p>(i) Yes. Appeals against FRC's decisions on applications for recognising overseas auditors of specific overseas entities listed in Hong Kong will be handled by the same mechanism.</p> <p>(ii) We note that there is no provision for making public a refusal of registration under the existing regime. We do not intend to adopt a different approach under the new regime.</p>
10	<p><i>Do you agree with the proposal that registration shall remain in force until 1 January in the year following the year in which the auditor was so registered, and each registration is subject to annual renewal?</i></p>	
	<p>An overwhelming majority of respondents supported or did not express negative view on the proposal that the registration should remain in force until 1 January in the year following the year in which the auditor was so registered, and each registration should</p>	<p>We are pleased to note the respondents' overwhelming support for the proposal. Since the qualification requirements to be registered as a LEA would be the same as those for registration as a CPA, it would be more consistent and appropriate to have a</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>be subject to annual renewal, although some respondents suggested that since many listed companies in Hong Kong had a financial year ending on 31 December, the validity of the registration should run from 1 July to 30 June so that the renewal of registration would not be in the middle of the audit process.</p>	<p>coterminous registration cycle for LEAs and CPAs, whose registration will remain in force until 1 January in the year following the year in which he was so registered as currently stipulated under the PAO.</p>
<p>11</p>	<p><i>Do you agree that the register of LEAs should include the types of information on each registered LEA as proposed in paragraph 3.27 of the consultation paper?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that the register of LEAs should include the types of information on each registered LEA as proposed in paragraph 3.27 of the consultation paper.</p> <p>(b) A respondent commented that only relevant and essential information should be disclosed under “the personal particulars of the audit engagement authorised person(s), the engagement quality control reviewer(s) and the quality control system responsible person(s)”.</p>	<p>(a) We are pleased to note the respondents’ overwhelming support for the proposal.</p> <p>(b) Noted. We will consider the details of the relevant particulars to be included as we prepare the amendment bill.</p>
<p>12</p>	<p><i>Do you agree that FRC should be vested with statutory powers to take over SFC/Hong Kong Exchanges and Clearing Limited (HKEx)’s existing roles in receiving and making decisions on applications for recognising overseas auditors of specific overseas entities which have been approved for listing in Hong Kong on a case-by-case basis?</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>An overwhelming majority of respondents supported or did not express negative view on the proposal that FRC should be vested with statutory powers to take over SFC/HKEx's existing roles in receiving and making decisions on applications for recognising overseas auditors of specific overseas entities which had been approved for listing in Hong Kong on a case-by-case basis.</p>	<p>We are pleased to note the respondents' overwhelming support for the proposal.</p>
<p>13</p>	<p><i>Do you agree that an applicant must meet the criteria as proposed in paragraph 3.30 of the consultation paper for being recognised as an overseas auditor of the overseas entity listed in Hong Kong as set out in its application?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that an applicant must meet the criteria as proposed in paragraph 3.30 of the consultation paper for being recognised as an overseas auditor of the overseas entity listed in Hong Kong as set out in its application.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) A respondent suggested that the agreement of mutual or reciprocal cooperation arrangement between the overseas regulator of the auditor and FRC should include an explicit requirement for FRC to communicate with the overseas regulators to confirm that there would be equivalent regulation of non-Hong Kong auditors.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b)</p> <p>(i) Noted. FRC will take into account the regulatory regime of the overseas regulator before entering into such agreement with the latter.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(ii) Two respondents considered that there should be elaboration on the factors that FRC would take into account in considering whether an overseas auditor could demonstrate that he had adequate resources and possesses the capability to perform the audit of the relevant overseas entity listed in Hong Kong.</p> <p>(iii) A respondent suggested that FRC should seek a reference from the audit regulator in the overseas jurisdiction where the auditor was based and only recognise the auditor if the reference received was considered satisfactory.</p>	<p>(ii) Noted. We envisage that FRC will issue guidance notes on what would be taken into account in considering an application for recognition from overseas auditor.</p> <p>(iii) Noted. We are not aware of any comparable overseas justifications adopting the proposed practice. On the other hand, the proposed recognition criteria as set out in paragraph 3.30 of the consultation paper will ensure that FRC will take into account the quality of the overseas auditors before making a decision on their applications for recognition.</p>
<p>14</p>	<p><i>Do you agree that the recognition of an overseas auditor of an overseas entity listed in Hong Kong should remain in force until the following 1 January or the time when the overseas auditor ceases to be the auditor of the listed entity in question, whichever is earlier, subject to renewal of the recognition?</i></p>	
	<p>An overwhelming majority of respondents supported or did not express negative view on the proposal that the recognition of an overseas auditor of an overseas entity listed in Hong Kong should remain in force until the following 1 January or the time when the overseas auditor ceased to be the auditor of the listed</p>	<p>We are pleased to note the respondents' overwhelming support for the proposal. With reference to our response to respondents' views on Question 10, the recognition of an overseas auditor of an overseas entity listed in Hong Kong will remain in force until the following 1 January or the time when</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>entity in question, whichever was earlier, subject to renewal of the recognition, although some respondents suggested that since many listed companies in Hong Kong had a financial year ending on 31 December, the validity of the registration should run from 1 July to 30 June so that the renewal of registration would not be in the middle of the audit process.</p>	<p>the overseas auditor ceases to be the auditor of the listed entity concerned, whichever is earlier.</p>
<p>15</p>	<p><i>Do you agree that the HKICPA Registrar shall maintain and update a list of overseas auditors who were recognised by FRC for entering into audit engagements with specific overseas entities listed in Hong Kong, and make available for public inspection/publish on HKICPA's website the list?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that the HKICPA Registrar should maintain and update a list of overseas auditors who were recognised by FRC for entering into audit engagements with specific overseas entities listed in Hong Kong, and make the list available for public inspection/publish the list on HKICPA's website.</p> <p>(b) Two respondents considered that details of the overseas auditors recognised by FRC should be kept on the same register of local LEAs registered by HKICPA, which should also cover Mainland audit firms qualified to audit Mainland companies listed in Hong Kong.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b) We agree that the register of LEAs to be maintained by the HKICPA Registrar should contain relevant information of local LEAs registered by HKICPA as well as that of relevant overseas auditors (including Mainland auditors).</p>

Questions	Summary of Respondents' Views	Government's Responses
Chapter 4 - Setting of continuing professional development (CPD) requirements		
16	<p>A. <i>Do you agree that HKICPA should continue to perform its statutory functions and exercise its statutory powers with regard to setting CPD requirements for LEAs, subject to independent oversight by FRC in accordance with paragraph 4.6 of the consultation paper?</i></p> <p>B. <i>Do you agree that FRC should publish the periodic reports received by it as mentioned in paragraph 4.6(a) of the consultation paper on its website, and provide information on the results of its quality review and the written directions given by it in its annual report?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that HKICPA should continue to perform its statutory functions and exercise its statutory powers with regard to setting CPD requirements for LEAs, subject to independent oversight by FRC in accordance with paragraph 4.6 of the consultation paper.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) A respondent considered that when FRC exercised its oversight power over the performance of setting of CPD requirements in relation to LEAs by HKICPA, apart from the three proposed arrangements in the consultation paper, FRC should be given the power to require information from HKICPA, as well as a reserve power to act itself where circumstances so warranted.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b)</p> <p>(i) Same as our response at item (b)(i) to respondents' comments on Question 8.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(ii) A respondent suggested that the directions issued by FRC to HKICPA should only be made to protect the public interest and not to circumvent exercise of due process by HKICPA. In the event that FRC needed to issue directions, FRC should be required to give full reasons for its actions to HKICPA and the Government.</p> <p>(c) A majority of respondents supported that FRC should publish HKICPA's periodic reports. However, some respondents considered that periodic reports received by FRC from HKICPA should not be published as to do so might inhibit co-operation and full and frank dialogue between FRC and HKICPA.</p>	<p>(ii) Same as our response at item (b)(ii) to respondents' comments on Question 8.</p> <p>(c) Same as our response at item (c) to respondents' comments on Question 8.</p>
Chapter 5 - Setting of Standards on Professional Ethics, Auditing and Assurance		
17	<p>A. <i>Do you agree that HKICPA should continue to perform its statutory functions and exercise its statutory powers in specifying standards on professional ethics, auditing and assurance to be observed, maintained or otherwise applied by CPAs (practising), and FRC should exercise oversight of the performance of such functions and the exercise of such powers by HKICPA which are applicable to LEAs as proposed in the arrangements set out in paragraph 5.8 of the consultation paper?</i></p> <p>B. <i>Do you agree that FRC should publish the periodic reports received by it as mentioned in paragraph 5.8(a) of the consultation paper on its website, and provide information on the results of its quality review and the written instructions given by it in its annual report?</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that HKICPA should continue to perform its statutory functions and exercise its statutory powers in specifying standards on professional ethics, auditing and assurance to be observed, maintained or otherwise applied by CPAs (practising), and FRC should exercise oversight of the performance of such functions and the exercise of such powers by HKICPA which were applicable to LEAs as proposed in the arrangements set out in paragraph 5.8 of the consultation paper.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) A respondent considered that when FRC exercised its oversight power over the performance of setting professional standards in relation to LEAs by HKICPA, apart from the three proposed arrangements in the consultation paper, FRC should be given the power to require information from HKICPA, as well as a reserve power to act itself where circumstances so warranted.</p> <p>(ii) A respondent suggested that the directions issued by FRC to HKICPA should only be made to protect the public interest and not to circumvent exercise of due</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b)</p> <p>(i) Same as our response at item (b)(i) to respondents' comments on Question 8.</p> <p>(ii) Same as our response at item (b)(ii) to respondents' comments on Question 8.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>process by HKICPA. In the event that FRC needed to issue directions, FRC should be required to give full reasons for its actions to HKICPA and the Government.</p> <p>(c) A majority of respondents supported that FRC should publish HKICPA's periodic reports. However, some respondents considered that periodic reports received by FRC from HKICPA should not be published as to do so might inhibit co-operation and full and frank dialogue between FRC and HKICPA.</p>	<p>(c) Same as our response at item (c) to respondents' comments on Question 8.</p>
<p>18</p>	<p><i>Do you agree that HKICPA and FRC should establish procedures to ensure that the HKICPA Council would duly take into account FRC's views before it makes any decision on the setting of standards on professional ethics, auditing and assurance in relation to LEAs?</i></p>	
	<p>(a) A number of respondents supported or did not express negative view on the proposal that HKICPA and FRC should establish procedures to ensure that the HKICPA Council would duly take into account FRC's views before making any decision on the setting of standards on professional ethics, auditing and assurance in relation to LEAs, while some respondents have the following comments –</p> <p>(i) A respondent raised concerns that the written directions</p>	<p>(a) We are pleased to note the respondents' support for the proposal.</p> <p>(i) We would like to clarify that FRC's oversight of HKICPA's functions and powers in the setting of standards on professional ethics, auditing and assurance would cover those in relation to LEAs only.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>given by FRC to HKICPA over the setting of standards might have impact on non-LEAs.</p> <p>(ii) A respondent suggested that FRC and HKICPA should enter into a Memorandum of Understanding (MoU) to ensure that the HKICPA Council would duly take into account FRC's views before the Institute made any decision on the setting of standards on professional ethics, auditing and assurance in relation to LEAs.</p> <p>(iii) Two respondents suggested that the procedures established between HKICPA and FRC should make reference to the International Auditing and Assurance Standards Board (IAASB) model where the Public Interest Oversight Board (PIOB) could influence the standard setting agenda but could not dictate the conclusion.</p> <p>(iv) A respondent, while supporting FRC to take part in the standard setting committees of HKICPA, considered that FRC should avoid raising separate concerns at the Council level of HKICPA as this might amount to another layer of approval or a right to veto, which in turn would prolong the process.</p>	<p>(ii) - (vii) We envisage that FRC and HKICPA will take into account all relevant views in working out the MoU that they would enter into in due course for the purpose of the new regime.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(v) In the situation where the standards set by HKICPA departed from the international standards, a respondent considered that HKICPA should discuss and explain the reasons for the departures with FRC before the standards were promulgated and that the departures would be discussed in the reports issued by FRC.</p> <p>(vi) A respondent was of the view that accountants should not dominate the committees or bodies that were responsible for setting standards on ethics and auditing. These committees should contain a mix of accountants and non-accountants and be free from influence by the HKICPA Council.</p> <p>(vii) A respondent was concerned that such procedures might cause confusion to the market and stakeholders, and another respondent considered that it would work out better if any standard setting committee of HKICPA contained a Council member of FRC so that views of FRC could be heard.</p>	

Questions	Summary of Respondents' Views	Government's Responses
Chapter 6 – Inspection		
19	<i>Do you agree with the proposal to transfer statutory functions for conducting recurring inspections of LEAs in respect of their listed entity audit engagements from HKICPA to FRC, with FRC being given the necessary powers as set out in paragraph 6.13 of the consultation paper (which are similar to the powers which HKICPA is equipped with under its practice review programme)?</i>	
20	<p><i>Do you agree that FRC's inspection programme should adopt the statutory procedures as set out in paragraph 6.14 of the consultation paper with reference to the existing arrangements for HKICPA's practice review programme?</i></p> <p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposals that HKICPA should transfer to FRC the statutory functions for conducting recurring inspections of LEAs in respect of their listed entity audit engagements, that FRC should be given the necessary powers as set out in paragraph 6.13 of the consultation paper, and that FRC's inspection programme should adopt the statutory procedures as set out in paragraph 6.14 of the consultation paper with reference to the existing arrangements for HKICPA's practice review programme.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) Noting that a comprehensive review on LEAs should cover the quality control system of the LEAs, a respondent would like to seek clarification if the scope</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposals.</p> <p>(b)</p> <p>(i) Yes. The scope of FRC's inspection will cover the quality control system of LEAs in respect of their listed entity audit engagements.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>of FRC's inspection covered the quality control system of the auditor concerned.</p> <p>(ii) A respondent pointed out that in many cases, the holding company (which is the listed entity) and its subsidiaries were not audited by the same auditor, and asked which auditors would be subject to FRC's inspection.</p> <p>(iii) A respondent sought clarification on whether under the proposed regime, there would be instances where the inspection results would be sufficient to support an initiation of disciplinary process, without having to go through the investigation process.</p> <p>(iv) A respondent pointed out that FRC should adopt all the requirements set out in the Statement of Membership Obligation (SMO) No 1 Quality Assurance of the International Federation of Accountants (IFAC), which was internationally recognised as best practice, in</p>	<p>(ii) FRC's inspection function will cover only those who are auditors of listed entities.</p> <p>(iii) We note that under the existing regime, HKICPA may initiate a disciplinary process on the basis of, <i>inter alia</i>, a decision of its practice review committee after an inspection even if it has not conducted an investigation on the case concerned. (s32D(v) of the PAO). Similarly, under the new regime, FRC may initiate a disciplinary process if a suspected irregularity is identified during the inspection or in handling complaints or referrals from other regulators.</p> <p>(iv) In conducting inspections to ensure LEAs follow applicable professional standards in performing listed entity audit engagements, FRC will follow SMO No 1, and it may also make reference to other standards followed by IFIAR members where appropriate.</p>

Questions	Summary of Respondents' Views	Government's Responses
	performing inspections.	
21	<i>Do you agree that FRC may delegate its inspection functions and relevant powers to committees formed under its auspices?</i>	
	An overwhelming majority of respondents supported or did not express negative view on the proposal that FRC might delegate its inspection functions and relevant powers to committees formed under its auspices.	We are pleased to note the respondents' overwhelming support for the proposal.
22	<i>What are your views on whether FRC should be allowed to delegate to HKICPA its functions and powers to inspect LEAs in respect of their listed entity audit engagements; and if so, what checks-and-balances measures should be introduced to ensure proper delegation and accountability for the quality of the work so delegated to HKICPA?</i>	
	A majority of respondents who commented on this proposal considered that FRC should not be allowed to delegate to HKICPA its functions and powers to inspect LEAs in respect of their listed entity audit engagements, though there were a few respondents who supported the proposal. The main concerns of the majority of respondents who objected to the proposal were that most independent auditor oversight bodies of overseas jurisdictions were directly responsible for conducting inspections and such delegation might jeopardise the independence and consistency of the inspection process.	In light of the comments received, we will not provide for the delegation route in the amendment bill.
23	<i>Do you agree that FRC reviewers should be given the proposed statutory powers as set out in paragraph 6.17 of the consultation paper in relation to their inspections?</i>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) A majority of respondents supported or did not express negative view on the proposal that FRC reviewers should be given the proposed statutory powers as set out in paragraph 6.17 of the consultation paper in relation to their inspections. On the other hand, some respondents did not agree that FRC should have the power to enter any business premises of the LEA at any reasonable time (paragraph 6.17(a) of the consultation paper refers) as such power should be more relevant to conducting an investigation, and some suggested that FRC should be required to obtain a court warrant before entering and searching the premises of a LEA.</p> <p>(b) Noting that a comprehensive review on LEAs should cover the quality control system of the LEAs, a respondent would like to seek confirmation if the powers of FRC reviewers under paragraph 6.17 of the consultation paper applied to the inspection of the quality control system of the auditor concerned.</p>	<p>(a) We are pleased to note the respondents' support for the proposal. In light of the specific comments received, the amendment bill will make it clear that the power of FRC to enter into the business premises of the LEAs at any reasonable time in inspections could only be exercised for ascertaining whether a LEA is complying with, has complied with, or is likely to be able to comply with the relevant legislative provisions and auditing standards. This will provide appropriate safeguard to the exercise of such power by FRC, and is in line with the arrangement for other financial regulators in Hong Kong.</p> <p>(b) Yes. The powers of FRC reviewers would also apply to the inspection of the quality control system of the LEA.</p>
<p>24</p>	<p>A. <i>Do you agree with the proposal to provide for criminal offences against a person who fails to comply with the requirements in relation to FRC's inspections?</i></p> <p>B. <i>If so, do you agree that the provisions on such criminal offences should be modelled on the existing provisions in the Financial Reporting Council Ordinance (FRCO) (Cap. 588) concerning failure to comply with requirements in relation to an investigation</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<i>into relevant irregularities?</i>	
	<p>A number of the respondents supported or did not express negative view on the proposal to provide for criminal offences against a person who failed to comply with the requirements in relation to FRC's inspections, of whom a respondent considered that criminal offences should be confined to cases of persistent non-compliance only. On the other hand, a number of other respondents did not agree with the proposal on the ground that the non-compliance with FRC's inspection requirements should be dealt with under the disciplinary mechanism instead, and that it was too onerous for auditors to be held criminally liable for a failure to provide audit working papers for FRC's inspection, and a statutory defence should be provided for the auditors.</p>	<p>It should be noted that it is already a criminal offence under the existing FRCO for failure to comply with requirements in relation to an investigation by FRC. We consider it appropriate to maintain our proposal, which is in line with the existing regulatory regimes of other financial regulators in Hong Kong, under which non-compliances with the requirements in relation to the regulators' inspections are criminal offences.</p> <p>On the other hand, to address the concerns raised by some respondents, we will make it clear in the amendment bill that the Court will take into account whether the person concerned has any reasonable excuse for the non-compliance before it makes a decision on the case.</p>
25	<i>Do you agree that the secrecy provisions in the PAO and the FRCO should be suitably amended to provide that both HKICPA and FRC could share their inspection results with each other to facilitate them to coordinate their inspection activities?</i>	
	<p>An overwhelming majority of respondents supported or did not express negative view on the proposal that the secrecy provisions in the PAO and the FRCO should be suitably amended to provide that both HKICPA and FRC could share their inspection results with each other to facilitate them to coordinate their inspection activities.</p>	<p>We are pleased to note the respondents' overwhelming support for the proposal. Nevertheless, upon further review of the existing secrecy provisions in the PAO and FRCO, we are satisfied that they should be wide enough to enable HKICPA and FRC to share their inspection results with each other after implementation of the new regime. Therefore, it would not be necessary to introduce any amendments to these provisions.</p>

Questions	Summary of Respondents' Views	Government's Responses
Chapter 7 - Investigation and disciplinary proceedings		
26	<i>Do you agree that FRC should continue to be responsible for conducting independent investigations into relevant irregularities by LEAs?</i>	
	All respondents supported or did not express negative view on the proposal that FRC should continue to be responsible for conducting independent investigations into relevant irregularities by LEAs.	We are pleased to note the support from all respondents for the proposal.
27	<i>Do you agree that a disciplinary action may be imposed on a LEA, a person approved to be its audit engagement authorised person and/or a person approved to be its engagement quality control reviewer if the LEA and/or the person concerned (as the case maybe) is proved to have committed an irregularity in relation to an audit engagement?</i>	
	An overwhelming majority of respondents supported or did not express negative view on the proposal that a disciplinary action might be imposed on a LEA, a person approved to be its audit engagement authorised person and/or a person approved to be its engagement quality control reviewer if the LEA and/or the person concerned (as the case maybe) was proved to have committed an irregularity in relation to an audit engagement. A respondent remarked that the engagement quality control reviewer was not primarily responsible for controlling the audit engagement but normally acted in a consultative capacity; another respondent commented that disciplinary actions should be directed at the appropriate person and the nature of the disciplinary action would vary depending on the circumstances	We are pleased to note the respondents' overwhelming support for the proposal. As an engagement quality control review is required for all audits of financial statements of listed entities, and given the important role of the reviewers to help ensure the quality of the audits of listed entities' financial statements, it is necessary to bring engagement quality control reviewers within the regulatory net under the new regime. It would depend on the facts of each individual case in determining who the disciplinary action should be directed at for the relevant irregularities in that case.

Questions	Summary of Respondents' Views	Government's Responses
	and the seriousness of the offence.	
28	<i>Do you agree that the definition of “irregularity” under the new regulatory regime should be refined to cover irregularities in respect of all audit and assurance engagements undertaken by LEAs with listed entities as required under the Listing Rules?</i>	
	<p>(a) A majority of respondents supported or did not express negative view on the proposal that the definition of “irregularity” under the new regulatory regime should be refined to cover irregularities in respect of all audit and assurance engagements undertaken by LEAs with listed entities as required under the Listing Rules.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) A respondent commented that further details should be given on the scope of “all audit and assurance engagements undertaken by LEAs with listed entities” while some respondents considered that the definition of “irregularity” should be reviewed to cater for the expanded scope of work of FRC, eliminate any duplication with the continuing statutory responsibilities of HKICPA, etc.</p> <p>(ii) A respondent considered that the definition should also cover all audit and assurance engagements undertaken as a result of requirements of a statutory body or</p>	<p>(a) We are pleased to note the respondents’ support for the proposal.</p> <p>(b)</p> <p>(i) Noted. We will consider the further details as we prepare the amendment bill.</p> <p>(ii) As the scope of the new regime will cover auditors of listed entities only, it is not appropriate to expand the definition of “irregularity” as suggested.</p>

Questions	Summary of Respondents' Views	Government's Responses
	legislation, instead of only the Listing Rules.	
29	<p><i>What is your view on whether the new regime should specifically provide that the individual/individuals who assume(s) ultimate responsibility for the system of quality control of a practice unit would be held accountable for the absence/systemic failure of such system, and whether it should stipulate expressly that such responsible person(s) shall be the practice unit's CEO (or equivalent) or, if appropriate, members of the practice unit's managing board of partners (or equivalent)?</i></p>	
	<p>A number of respondents supported or did not express negative view on the idea that the legislation should specifically provide that individuals who assumed ultimate responsibility for the quality control system of a practice unit should be held accountable for the absence/systemic failure of such system, and that such responsible person should be the CEO/members of the managing board of partners of a practice unit. Some pointed out that since the HKSQC 1 had already stipulated that the firm's CEO or managing board of partners should assume ultimate responsibility for the firm's quality control system, expressly providing for such a requirement in the legislation was not only consistent with the existing obligations under the local standard, but would also fill a potential gap in the regulatory framework.</p> <p>On the other hand, a number of other respondents did not agree with such an express provision. While all of these respondents acknowledged that this was in line with the existing requirement under HKSQC 1, they did not think that it was reasonable to hold</p>	<p>As set out in our response at item (b) to respondents' comments on Question 6, each LEA would be required to designate at least one responsible person from amongst the managing board of partners and/or its CEO (or their equivalents) to be in charge of the quality control of audit engagements in respect of listed entities. The amendment bill will set out clearly the statutory duties of a responsible person and the circumstances under which he may be subject to disciplinary actions along the following lines –</p> <p>(a) a responsible person shall be required to use his best endeavours –</p> <p>(i) to ensure that the LEA has established policies and procedures for maintaining a quality control system in respect of listed entity audit engagements; and</p> <p>(ii) to secure observance with such policies and procedures within the LEA; and</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>individual/individuals of a firm accountable for a systemic failure. Specifically, some respondents considered that different persons within a firm might have responsibilities for different activities that fell within a firm's quality control system. A firm's managing board might include individuals who did not have audit background, or who had no involvement in the day-to-day operations of the firm's quality control system. Some respondents also sought clarification on the circumstances under which such responsible persons would be subject to disciplinary actions.</p>	<p>(b) a responsible person will be subject to disciplinary actions only if he has contravened the statutory requirements in (a) above.</p> <p>We trust that the above revised arrangements will address the respondents' concern while ensuring the integrity of the regulatory system.</p>
<p>30</p>	<p><i>Do you agree that FRC, as the future independent auditor oversight body, should be vested with disciplinary powers, including powers to make decisions on disciplinary cases, concerning LEAs, subject to the requirements for ensuring fairness and a due process as proposed in paragraphs 7.21 to 7.24 of the consultation paper?</i></p>	
	<p>A number of respondents supported or did not express negative view on our proposal that FRC should be vested with disciplinary powers. Amongst these respondents, one considered that there was no need to require FRC's inspection/investigative staff not to be involved in the disciplinary process; and some respondents suggested that the disciplinary cases should be heard and decided upon by a disciplinary committee/panel established under the auspices of FRC, and that the committee/panel should comprise persons who were independent of FRC and possessed audit experience and</p>	<p>We note that the major issue concerned is whether the disciplinary decisions should be made by a body/committee or persons independent of FRC. We have reviewed the matter, with particular reference to the relevant international standards and practices as they apply to the disciplinary system governing auditors. We note that the EU Statutory Audit Directive requires that the oversight of the disciplinary system for auditors should be governed by non-practitioners, i.e. independent of the audit profession. However, there is no parallel requirement by EU or any comparable overseas</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>expertise.</p> <p>On the other hand, some other respondents did not agree with the proposal and suggested that the disciplinary function should be performed by a body or committee independent of FRC so as to ensure separation of disciplinary power and inspection/investigation powers.</p>	<p>jurisdictions that the disciplinary powers must be vested with a body or committee independent of the independent auditor regulator, or that such body or committee should consist of persons independent of the regulator. In fact, in some major overseas jurisdictions (e.g. US and Canada), the inspection, investigation and disciplinary powers are all vested with their independent auditor regulators. Therefore, there is no question that for the purpose of ensuring fairness in the disciplinary mechanism, FRC must not be vested with direct disciplinary powers under the new regime.</p> <p>The proposed disciplinary mechanism is being practised and has been well-tested in auditor regulation in major overseas jurisdictions as well as in Hong Kong's financial market. It will address the major deficiencies in the existing disciplinary mechanism, especially the lack of independence from the audit profession and the long time taken to complete disciplinary cases.</p> <p>To ensure fairness and due process in the disciplinary mechanism, we have committed in the consultation paper to put in place a number of checks and balances to ensure that the fairness of the system can be safeguarded. These include a fair hearing for the person(s) concerned, an option of establishing an</p>

Questions	Summary of Respondents' Views	Government's Responses
		<p>expert panel to provide advice during the disciplinary process, an independent appeals mechanism and appropriate arrangements to separate FRC's inspection/investigative staff from the relevant disciplinary process. To elaborate further, the person subject to disciplinary proceedings will be given a reasonable opportunity of being heard, in which he will be allowed to make written or oral representations before a disciplinary decision against him is made.</p> <p>On the basis that FRC will be vested with direct disciplinary powers under the new regime and that the disciplinary mechanism is to be independent of the audit profession, we will work out the details of the disciplinary mechanism in drawing up the amendment bill. In the process, we will consider whether it would be desirable and appropriate for persons independent of FRC to be given any formal role in the disciplinary mechanism under the auspices of FRC, and if so, the arrangements for FRC to engage such persons in making disciplinary decisions.</p>
31	<i>Do you agree that FRC should be empowered to exercise the range of disciplinary powers on a person subject to disciplinary action outlined in paragraph 7.27 of the consultation paper?</i>	
	A majority of respondents supported or did not express negative view on the proposal that FRC should be empowered to exercise	We are pleased to note the respondents' general support for the proposal. As regards the proposed maximum level of

Questions	Summary of Respondents' Views	Government's Responses
	<p>a range of disciplinary powers on a person subject to disciplinary action as outlined in paragraph 7.27 of the consultation paper. On the other hand, a number of respondents made specific comments on the proposed maximum level of pecuniary penalty of \$10 million or three times of the “profit gained or loss avoided” (whichever is higher) –</p> <p>(a) Some respondents suggested reducing the fixed-sum cap to \$5 million and removed the variable element of “three times of the profit gained or loss avoided”, on ground that the original proposal would drive SMPs out of the market.</p> <p>(b) Some respondents suggested removing the fixed-sum cap and modifying the variable element of “three times of the profit gained or loss avoided” to “three times of the audit fees received”.</p> <p>(c) A respondent also suggested modifying the variable element of “three times of the profit gained or loss avoided” to “three times of the audit fees received”, whilst supporting the proposed fixed-sum cap of \$10 million.</p> <p>(d) A respondent suggested that the maximum penalty should</p>	<p>pecuniary penalty, it is set having regard to, <i>inter alia</i>, the fact that the new regime would cover practice units of vastly different sizes. It should be noted that there are major overseas jurisdictions (e.g. the UK) which do not set any statutory limit on the amount of pecuniary penalty the independent auditor regulator may impose on the auditors. Nonetheless, we would like to reiterate that it is not our intention that the pecuniary penalty be used as a tool to put LEAs into financial jeopardy. Under our proposal, in determining the level of pecuniary penalty to be imposed, FRC must have regard to the principles of fairness and proportionality taking into account the circumstances of each case. FRC would be required by law to issue guidelines on how it may impose a pecuniary penalty, which should include –</p> <ul style="list-style-type: none"> ➤ the nature and seriousness of the irregularity; ➤ the amount of profits accrued or loss avoided as a result of the irregularity; ➤ the audit fees earned by the LEA; and ➤ other circumstances of the regulated person, which would include the size and financial resources of the firm or individual and that the penalty should not have the likely effect of putting a firm or individual in financial jeopardy.

Questions	Summary of Respondents' Views	Government's Responses
	<p>not exceed the amount whichever was the lower of \$5 million or three times of the audit fees received.</p>	<p>On the basis of the above considerations, we keep an open mind on whether the guidelines to be issued by FRC in due course should include any other relevant factors. We are prepared to consider any further views from stakeholders on this matter.</p> <p>As regards the variable element of “three times the amount of the profit gained or loss avoided”, we would like to clarify that it would only come into play in determining the amount of pecuniary penalty to be imposed for a particular case if the intended amount exceeds \$10 million. In other words, it would not be necessary for FRC to make an assessment on the amount of profit gained or loss avoided in each and every disciplinary case. Furthermore, the sanction guidelines of the independent auditor regulators in some overseas jurisdictions (e.g. the UK) also make reference to the financial benefit derived or loss avoided by the auditor concerned as a result of an irregularity when determining the disciplinary sanction to be imposed on him. Therefore, we do not see any strong justifications to change our proposal.</p>
<p>32</p>	<p><i>Do you agree that FRC should be required by law to issue guidelines to indicate the manner in which it exercises its power to order a person subject to disciplinary action to pay a pecuniary penalty, and to have regard to the issued guidelines when exercising such power?</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) An overwhelming majority of respondents supported or did not express negative views on the proposal that FRC should be required to issue guidelines to indicate the manner in which it would exercise its power to order a person subject to disciplinary action to pay a pecuniary penalty.</p> <p>(b) Additional comments raised in some submissions include –</p> <p>(i) Two respondents considered that in determining the appropriate level of pecuniary penalty to be imposed, the scale or severity of the auditing irregularity should weigh more than the size of the audit firm.</p> <p>(ii) The pecuniary penalty should seek to reflect the seriousness of the damage or potential damage to society that resulted or might have resulted from the auditing irregularity, which depended on the nature of the audit engagement than the financial gain of the LEA.</p> <p>(iii) A respondent suggested that the amount of audit fees received by the LEA should be limited to only those fees earned by that registered LEA concerned but not all audit fees earned by its network firms.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b) Noted. Same as our response to respondents' comments on Question 31.</p>

Questions	Summary of Respondents' Views	Government's Responses
33	<i>Do you agree that any pecuniary penalty paid to or recovered by FRC would be paid by FRC into the Government general revenue?</i>	
	An overwhelming majority of respondents supported or did not express negative views on the proposal that any pecuniary penalty paid to or recovered by FRC would be paid by FRC into the Government general revenue. Some respondents did not agree with the proposal, pointing out that since the Government was not one of the funding parties, FRC should keep the pecuniary penalty it received in a separate reserve account instead.	We are pleased to note the respondents' overwhelming support for the proposal. It is not appropriate for FRC to keep the pecuniary penalty paid to or recovered by it (even as its reserve fund) because this may, and may be seen to, compromise the impartiality of FRC in performing its disciplinary function.
34	<i>Do you agree that FRC may enter into a resolution with the person subject to disciplinary action at any time it is contemplating exercising its disciplinary power, and in exercising such power, FRC must consider it appropriate to do so in the interest of the investing public or in the public interest?</i>	
	An overwhelming majority of respondents supported or did not express negative view on the proposal that FRC might enter into a resolution with the person subject to disciplinary action at any time it was contemplating exercising its disciplinary power, and FRC might exercise such power so long as it was in the public interest to do so.	We are pleased to note the respondents' overwhelming support for the proposal.
35	<i>Do you agree that any amount paid to or recovered by FRC arising from a resolution would be paid by FRC into the Government general revenue?</i>	
	An overwhelming majority of respondents supported or did not express negative view on the proposal that any amount paid to or	We are pleased to note the respondents' overwhelming support for the proposal. For the same reason as stated in our response

Questions	Summary of Respondents' Views	Government's Responses
	<p>recovered by FRC arising from a resolution would be paid by FRC into the Government general revenue. Some respondents did not agree with the proposal, pointing out that since the Government was not one of the funding parties, FRC should keep the pecuniary penalty it received in a separate reserve account instead.</p>	<p>to respondents' comments in Question 33, it is not appropriate for FRC to keep the amount paid to or recovered by it arising from a resolution.</p>
Chapter 8: Appeals mechanism		
36	<p><i>Do you agree that a new independent appeals tribunal should be set up for hearing appeals in respect of registration decisions made by the HKICPA Registrar and disciplinary decisions made by FRC?</i></p>	
	<p>A majority of respondents supported or did not express negative view on the proposal that a new independent appeals tribunal should be set up for hearing appeals in respect of registration decisions made by the HKICPA Registrar and disciplinary decisions made by FRC.</p>	<p>We are pleased to note the respondents' overwhelming support for the proposal.</p>
37	<p>A. <i>Do you agree that a person who disagrees with a registration decision made in respect of him or is aggrieved by a disciplinary decision made in respect of him may apply to the new independent appeals tribunal for a review of the decision within 21 days after a notice of the relevant decision has been served upon him?</i></p> <p>B. <i>If so, do you agree that the independent appeals tribunal may, upon application by the relevant person, grant an extension to application for review of a specified decision, and that such extension should only be granted after the applicant and FRC have been given a reasonable opportunity to be heard on the proposed extension and the independent appeals tribunal is satisfied that there is a good cause for granting the extension?</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) A majority of respondents supported or did not raise negative view on the proposal that a person who disagreed with a registration decision made in respect of him or was aggrieved by a disciplinary decision made in respect of him might apply to the new independent appeals tribunal for a review of the decision within 21 days after a notice of the relevant decision had been served upon him, and that the tribunal might grant an extension to the application for review if there was a good cause for granting such an extension. Some respondents considered that more time should be allowed for applying for a review or the time allowed should be determined on a case-by-case basis.</p> <p>(b) Some respondents considered that the identity of the auditor subject to disciplinary sanction should not be made public until the appeal was determined as premature disclosure of regulatory action might damage an auditor's reputation, and that the auditor should be allowed to apply for a stay of the disciplinary sanction if the decision was subject to an appeal.</p>	<p>(a) We are pleased to note the respondents' support for the proposals.</p> <p>(b) Noted. To address respondents' concern, the amendment bill will make it clear that a disciplinary decision would be made public only after the expiry of the period allowed for making an application for appeal to the independent appeals tribunal (i.e. 21 days), or if an appeal has been made, be made public only after the appeal has been determined by the independent appeals tribunal.</p> <p>We agree that the person subject to disciplinary action should be allowed to apply for a stay of execution of the disciplinary decision. We will provide in the amendment</p>

Questions	Summary of Respondents' Views	Government's Responses
		<p>bill that the person who applies for a review of the decision may, at any time before the review of the decision is determined by the independent appeals tribunal, apply to the tribunal for a stay of execution of the disciplinary decision to which the application relates.</p>
<p>38</p>	<p><i>Do you agree with the composition of the independent appeals tribunal as proposed in paragraph 8.6 of the consultation paper, i.e. a chairman who is a person qualified for appointment as a judge of the High Court and two members who are not public officers, all to be appointed by the Chief Executive?</i></p>	
	<p>(a) An overwhelming majority of respondents supported or did not raise negative view on the proposed composition of the independent appeals tribunal.</p> <p>(b) Some respondents considered that there should be sufficient members in the independent tribunal who had the requisite auditing and accounting experience and expertise. A respondent further suggested that a panel of technical advisers from overseas should be shortlisted to provide technical backup to the tribunal when required, and avoid potential conflict of interests.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>(b) Our proposal does not exclude persons with auditing and accounting experience and expertise from being appointed as members of the tribunal, nor does it restrict the appointment of tribunal members to only persons who are based in Hong Kong.</p>
<p>39</p>	<p><i>Do you agree that the independent appeals tribunal may exercise the proposed powers as outlined in paragraph 8.7 of the consultation paper in the review proceedings?</i></p>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on that the independent appeals tribunal might exercise the proposed powers as outlined in paragraph 8.7 of the consultation paper in the review proceedings, though a respondent considered that silence or a failure to provide information should not constitute contempt in the interest of natural justice.</p> <p>(b) A respondent suggested that in addition to ordering a person to attend before the tribunal to give evidence, the tribunal should be empowered to order a person to provide documentary evidence.</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p> <p>A person will be subject to the punishment for contempt only if he, without reasonable excuse, fails to comply with an order or a requirement of the independent appeals tribunal. In exercising the relevant power, the tribunal will be required to adopt the same standard of proof as the Court of First Instance in the exercise of the same powers to punish for contempt (i.e. proof beyond reasonable doubt).</p> <p>(b) Yes. The independent appeals tribunal will be empowered to order a person to attend before it at any sitting to provide documentary evidence. In particular, the amendment bill will provide that the persons concerned might be required to produce any article, record or document in his possession or control relating to the subject matter of the review.</p>
40	<i>Do you agree that sittings of the independent appeals tribunal should be held in public unless in the interests of justice it determines otherwise?</i>	
	<p>(a) An overwhelming majority of respondents supported or did not express negative view on the proposal that the independent appeals tribunal should be held in public unless</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal.</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>in the interests of justice it determined otherwise.</p> <p>(b) A respondent, while supporting the proposal, considered that there should be guidelines in determining whether a hearing should be held in public or private.</p>	<p>(b) The independent appeals tribunal will take into account all relevant facts or particular circumstances of each case when deciding whether a hearing should be held in private. Since the relevant facts and circumstances of different cases are not the same, it is not appropriate to prescribe the conditions for holding a private hearing in guidelines.</p>
<p>41</p>	<p>A. <i>Do you agree that a party to the appeal who is dissatisfied with a determination of the independent appeals tribunal may further appeal to the Court of Appeal on a question of law, fact, or mixed law and fact?</i></p> <p>B. <i>If so, do you agree that no appeal to the Court of Appeal may be made unless leave to appeal has been granted by the same Court, and the leave may only be granted if the Court of Appeal is satisfied that the appeal has a reasonable prospect of success or there is some other reason in the interests of justice why the appeal should be heard?</i></p>	
	<p>(a) On Part (A), an overwhelming majority of respondents supported that a party to the appeal who was dissatisfied with a determination of the independent appeals tribunal might further appeal to the Court of Appeal on a question of law, fact, or mixed law and fact, though a respondent considered that it might be more desirable to restrict appeals to the Court of Appeal on points of law only.</p> <p>(b) On Part (B), some respondents considered that there should</p>	<p>(a) We are pleased to note the respondents' overwhelming support for the proposal providing for the affected party to have access to the court system on a question of law, facts, or mixed law and fact.</p> <p>(b) It should be noted that under the present regime, a person</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>not be a requirement to obtain leave from the Court of Appeal as it might limit an auditor's ability to appeal to the Court of Appeal.</p>	<p>who is aggrieved of a registration or disciplinary decision made against him may make an appeal only directly to the Court of Appeal. In contrast, under the proposed new regime, the person will have the statutory right to make an appeal to the independent appeals tribunal chaired by a person eligible for appointment as a High Court judge, and as an added protection, an appellant who is not satisfied with the determination of the independent appeals tribunal can make a further appeal to the Court. It should be noted that the independent appeals tribunal arrangement would normally be more efficient and less costly to the appellants than if the appeals are to be handled by the Court. Since the access to the court system becomes an extra tier in the appeals mechanism under the new regime, we consider that it is reasonable to introduce a requirement for obtaining the leave of the Court of Appeal which will take into account whether the further appeal has a reasonable prospect of success or there is some other reason in the interests of justice for the further appeal to be heard by the Court.</p>

Questions	Summary of Respondents' Views	Government's Responses
Chapter 9 – Funding Mechanism		
42	<i>Do you agree that under the new regulatory regime, FRC should be funded by way of introducing three new levies on (a) listed entities; (b) securities transactions; and (c) LEAs such that they will each provide roughly equal contributions to FRC i.e. one third from listed entities, one third from securities investors and one third from LEAs?</i>	
	<p>(a) A majority of respondents supported or did not express negative view that the future FRC should be funded by way of introducing new levies on (a) listed entities; (b) securities transactions; and/or (c) LEAs.</p> <p>A number of specific comments raised in the submissions include –</p> <p>(i) Some respondents from the audit profession considered that the future operation of FRC should largely be funded by securities transaction levy as investors were the beneficiaries under the new regulatory regime.</p> <p>(ii) Two respondents from the securities sector opposed to the new levy on securities transaction as they considered it amounting to double levies on investors who were already paying transaction levy to SFC. They suggested that the future FRC should be funded by listed entities and auditors of listed entities.</p> <p>(iii) Some respondents held the view that listed entities</p>	<p>(a) We are pleased to note the respondents' support that the future FRC should be funded by way of introducing new levies on (a) listed entities; (b) securities transactions; and/or (c) LEAs. With respect to the views of some respondents who preferred the funding to come solely from the new levy on LEAs or solely from the new levy on securities transactions, we believe that our proposal is a balanced and reasonable funding model and is fair to the three key stakeholder groups given the key objective of the reform viz. to further enhance the independence of the existing auditor regulatory regime from the audit profession with a view to ensuring that the regime is benchmarked against international standards and practices, which is important given the externally-oriented nature of our financial market and the need to maintain the confidence of both international and local investors in our overall financial regulatory regime with regard to the capital market.</p> <p>As regards the suggestion that the Government should be</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>should not be one of the funding parties as they were buyers of audit services who should not be required to pay for the regulation of that service at the same time.</p> <p>(iv) Some respondents suggested that the Government should be one of the funding parties.</p> <p>(b) A number of respondents requested for an indication of the quantum of costs that would be required by the future FRC.</p>	<p>one of the funding sources of FRC under the new regime, we maintain the view that the Government should not be a recurrent funding source for FRC's operation. This is consistent with the principle that the independent auditor regulator should be financially and operationally independent from the Government, and is in line with the practices in most of the other comparable jurisdictions.</p> <p>(b) Noted. We will work out the details based on the framework of the consultation conclusions and estimate the required budget in due course.</p>
<p>43</p>	<p><i>Do you agree that –</i></p> <p>A. <i>the levy on listed entities should be based on the prevailing formula under which listed entities pay their annual listing fees to HKEx, and that the levy should be collected by HKEx on behalf of FRC;</i></p> <p>B. <i>the levy on securities transactions should be based on the modus operandi for the existing levy charged by SFC under the Securities and Futures Ordinance, and that the levy should be collected by SFC on behalf of FRC; and</i></p> <p>C. <i>the levy on LEAs should be directly proportional to the number of listed entity audit engagements entered into by the LEAs, and that the levy should be collected by the HKICPA Registrar on behalf of FRC?</i></p>	
	<p>Subject to their responses to Question 42, a majority of respondents supported or did not express negative view on the proposed charging and collection mechanism of the future FRC.</p> <p>Additional comments raised in some submissions include –</p>	<p>We are pleased to note the respondents' support on the proposed charging and collection mechanism.</p> <p>(a) On the calculation basis of the levy on LEAs, since the flat fee per audit engagement approach has been adopted by</p>

Questions	Summary of Respondents' Views	Government's Responses
	<p>(a) Some respondents considered that the levy on LEAs should be proportionate to the audit fees or market capitalisation of those listed entities, instead of making reference to the number of listed clients of the auditors.</p> <p>(b) Two respondents considered that HKICPA should not be responsible for collecting the levy from LEAs as there is no transactional relationship between the Institute and the auditors.</p> <p>(c) A respondent pointed out that the existing levy charged by SFC under the Securities and Futures Ordinance (Cap. 571) was collected by HKEx but not SFC.</p>	<p>HKICPA for the purpose of collecting contributions from relevant auditors for making annual financial contributions to FRC ever since the inception of FRC and that the decision to adopt this approach, which is simple and straightforward to implement, was made after a due process of members' consultation which had also considered other basis for calculation, it would seem appropriate to maintain the flat fee per audit engagement approach for determining the levy on individual LEAs unless new arguments which have not been considered in the past are put forward that warrant a review of this calculation basis.</p> <p>(b) The proposal for the HKICPA Registrar to collect the levy on LEAs on FRC's behalf should be part and parcel of the proposal to assign the role of Registrar of LEAs to the HKICPA Registrar, who would be responsible for processing applications for registration of LEAs and annual renewal of registration. It will be reasonable for the registration authority who has direct interface with LEAs on all registration matters to be responsible for collecting the levy on FRC's behalf, which would provide for the collection of the levy on LEAs in a more cost-effective manner. We note that there is majority support from respondents to our proposal.</p>

Questions	Summary of Respondents' Views	Government's Responses
		(c) As regards the collection of the new levy on securities transactions, we will follow the existing mechanism of collecting the existing levy charged by SFC and liaise with relevant authorities in working out the details in due course.
44	<i>Do you agree that the three levies should be stipulated in subsidiary legislation subject to negative vetting by the Legislative Council (LegCo)?</i>	
	Subject to their response to Question 42, an overwhelming majority of respondents supported or did not express negative view on the proposal of stipulating the three levies in subsidiary legislation subject to negative vetting by the LegCo.	We are pleased to note the respondents' overwhelming support for the proposal.
45	<i>Do you agree that FRC should be required to review the levels of the three levies once its reserve has reached a level equivalent to 24 months of its operating expense, after deducting depreciation and all provisions?</i>	
	An overwhelming majority of respondents supported or did not express negative view on the proposal that the level of levies should be reviewed once FRC's reserve had reached a level equivalent to 24 months of its operating expense, after deducting depreciation and all provisions, although two respondents suggested that a reserve of 12 months' operating expense would be more acceptable.	We are pleased to note the respondents' overwhelming support for the proposal.

Questions	Summary of Respondents' Views	Government's Responses
Chapter 10 – Governance of FRC		
46	<p>A. <i>Do you agree with the proposed new composition of FRC membership, i.e. not fewer than seven members appointed by the Chief Executive, together with the FRC CEO as an ex-officio member, and abolishing the existing arrangements for the nomination of FRC members and for the Registrar of Companies to be an ex-officio member as set out in paragraph 10.6 of the consultation paper?</i></p> <p>B. <i>Do you agree that there should be at least two persons who possess knowledge of and experience in the auditing of Hong Kong listed entities out of the FRC members to be appointed by the Chief Executive?</i></p>	
	<p>An overwhelming majority of the respondents supported or did not express negative view on the proposed new composition of FRC. Specific comments raised in some submissions include –</p> <p>(a) Some respondents suggested that more persons with sufficient knowledge and experience of listed entity auditing should be appointed to FRC's governing board. In particular –</p> <p>(i) Two respondents considered that FRC should consist of no fewer than nine members and with at least one-third having appropriate knowledge and experience of listed entity auditing.</p>	<p>Given the primary considerations that FRC should be independent of the audit profession and of the Government, and since we have already proposed to relax the present requirement of a majority of “lay persons”² within FRC to a majority of “non-practitioners”³, which will allow the appointment of experienced personnel from the audit profession who have passed the relevant cooling-off period to FRC, we do not see strong justifications to pursue these suggestions.</p> <p>On the other hand, given the much wider regulatory ambit of FRC after the reform, FRC will need to be supported by a strong executive team with the CEO underpinned by a suitable number of executive directors (EDs). Therefore the amendment bill will also provide for the appointment of EDs by the Chief</p>

² Under the FRCO, a lay person means a person who is not a CPA within the meaning of the PAO or a member of an accountancy body which is a member of the International Federation of Accountants.

³ “Non-practitioner” will be defined as a person who is not, and has not during the previous three years been, a CPA (practising) or a partner, director, agent or employee of a practice unit.

Questions	Summary of Respondents' Views	Government's Responses
	<p>(ii) A respondent considered that on the basis of a seven-member FRC, at least three should be persons with sufficient experience and knowledge of the audit profession.</p> <p>(iii) A respondent considered that at least one quarter of the FRC members should be persons who possessed knowledge of and experience in the auditing of Hong Kong listed entities.</p> <p>(b) Some respondents considered that Government should continue to be represented in the governing board of FRC to ensure effective monitoring of FRC's operation and exercise of its power.</p>	<p>Executive to be members of FRC, and correspondingly make it a statutory requirement that the number of executives in the Council must not exceed the number of non-executive Council members to ensure proper corporate governance.</p>
<p>47</p>	<p><i>Do you agree that FRC will be required to have a chairman and a majority of members who are non-practitioners, with a non-practitioner being defined as a person who (a) is not, or has not during the previous three years been, a CPA (practising); and (b) is not, or has not during the previous three years been, a partner, director, agent or employee of a practice unit?</i></p>	<p>We are pleased to note the respondents' support for the proposal.</p> <p>With regard to the additional comments received, we need to bear in mind the importance of ensuring that the governance of the future FRC is in line with the international standard that the independent auditor oversight body should be independent of</p>
	<p>A majority of respondents supported or did not express negative view on the proposal of having a chairman and a majority of members who were non-practitioners for the future FRC, with non-practitioner to be defined as a person who (a) was not, or had not during the previous three years been, a CPA (practising); and (b) was not, or had not during the previous three years been,</p>	

Questions	Summary of Respondents' Views	Government's Responses
	<p>a partner, director, agent or employee of a practice unit.</p> <p>Additional comments raised in some submissions include –</p> <ul style="list-style-type: none"> (i) A respondent suggested that FRC should maintain a majority of non-accountants to demonstrate its independence from auditing profession. (ii) A respondent considered that to achieve independence and an appropriate mix of members for FRC, consideration should be given on a range of qualitative factors such as their relevant experience. (iii) A respondent, while acknowledging the importance of having non-practitioners in the Council, considered that a majority might not be required. 	<p>the audit profession. We have already proposed to widen the pool of potential candidates with financial and accounting/auditing expertise for appointment to FRC by relaxing the present requirement of a majority of “lay persons” within FRC to a majority of “non-practitioners”. This change will facilitate FRC to take on the wider regulatory role after the reform.</p>

Questions	Summary of Respondents' Views	Government's Responses
Others		
	<p>A respondent proposed that in order to enhance the efficiency of the investigation and enquiry functions of FRC, the Audit Investigation Board (AIB) and the Financial Reporting Review Panel (FRRP) should be abolished under the new regime and any persons authorised by the FRC would be allowed to initiate an investigation or conduct an enquiry.</p>	<p>We note that the AIB and FRRP have been in place since FRC was established. Since the suggestion is a new idea raised by one respondent, it would not be appropriate for us to commit to introducing any such change without considering the views of the other relevant stakeholders.</p>

Financial Services Branch

Financial Services and the Treasury Bureau

26 June 2015