

ASEAN-Hong Kong, China FTA Workshop on Strengthening Regulatory Framework and Implementation for Accountancy Services

Framework for Independent Regulation of the Accounting Profession in Hong Kong, China

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Agenda

1. Evolution of Independent Regulation of the Accounting Profession
2. Regulation of Accounting Professionals serving the Capital Markets – the PIE Regime
3. In-process Reforms – Independent Regulation of the Accounting Profession in Hong Kong
4. Execution of Powers – Regulatory Values, Principles and Approach
5. Meeting the Challenges and Opportunities Facing the Accounting Profession Today



1. Evolution of Independent Regulation of the Accounting Profession



FRC established as an Independent Regulatory Body

Date	Milestone
29 June 2005	Introduction to Legislative Council of the Financial Reporting Council Bill 2005, to establish the FRC as an Independent Regulatory Body in line with the international trend towards making oversight of auditors and financial reporting of listed entities more independent from the accounting profession
13 July 2006	Passage of Financial Reporting Council Bill 2005
1 December 2006	FRC established as Independent Regulatory Body
16 July 2007	Commencement of FRC operations to: <ul style="list-style-type: none">▪ Investigate possible auditing irregularities in listed entity audits▪ Enquire into possible non-compliances in listed entity financial reports



Independent Oversight Body for the PIE Regime

Date	Milestone
24 January 2018	Introduction to Legislative Council of the FRC (Amendment) Bill 2018 to further enhance independence of the regulatory regime for PIE auditors and align with international standard and practice
30 January 2019	Passage of FRC (Amendment) Bill 2018
1 October 2019	Commencement of enhanced Regulatory Regime, with FRC as Independent Oversight Body to: <ul style="list-style-type: none"><li data-bbox="792 991 2364 1105">▪ Regulate PIE auditors through Recognition (Overseas auditors), Inspection, Investigation and Disciplinary Sanction<li data-bbox="792 1119 2410 1162">▪ Oversee specified functions of the HKICPA related to PIE auditors<li data-bbox="792 1176 2321 1219">▪ Enquire into possible non-compliances in PIE financial reports



Independent Regulator of the Accounting Profession

Date	Milestone
21 July 2021	Introduction of FRC (Amendment) Bill 2021 to enhance the independence of the regulatory regime for the accounting profession in line with international developments and to increase its coherence and efficiency
22 October 2021	Passage of FRC (Amendment) Bill 2021
On a date to be appointed by the Secretary for FSTB	Commencement of enhanced Regulatory Regime for the Accounting Profession, with FRC as the Independent Oversight Body to: <ul style="list-style-type: none">▪ Regulate Accounting Professionals (including PIE auditors) through Issuance of Practising Certificates, Registration (including Recognition), Inspection, Investigation and Disciplinary Sanction▪ Oversee the functions of the HKICPA relating to CPAs▪ Enquire into possible non-compliances in PIE financial reports



2. Regulation of Accounting Professionals serving the Capital Markets – the PIE Regime



The Capital Markets and Market for Listed Entity Audits

As a leading international financial centre:

- Hong Kong ranked as the world's No.1 IPO venue in seven of the last twelve years
- A total of 154 companies raised HK\$398 billion from IPOs in 2020, the highest amount raised in a single year since 2010
- Hong Kong plays a key role as an entrepôt for capital between the Mainland and rest of the world and has unparalleled access to Mainland capital markets
- Mainland enterprises (“MEs”) contributed over 80% of total market capitalisation of listed entities in Hong Kong
- Hong Kong witnessed a rapid growth in the size of its securities markets from 2010 to 2020:
 - Market capitalisation increased by 127% to HK\$47.5 trillion (by 217% to HK\$38.1 trillion for MEs)
 - The number of listed entities increased by 104% to 2,538 (by 123% to 1,319 for MEs)
- Hong Kong had a vibrant market for listed entity audits from 2010 to 2019:
 - Total audit fees increased by 83% to HK\$12,187 million;
 - The no. of audit firms performing listed entities audits increased by 9% to 72, comprising 41 Local and 31 Mainland and Overseas audit firms



Sources

Extracted from website of The Stock Exchange of Hong Kong and from FRC report: “Overview of the Market for Listed Entity Audits in Hong Kong”



Regulatory Focus of FRC under the PIE Regime is the Quality of PIE Financial Reports and of PIE Audits

Mission statement

To uphold the quality of financial reporting of listed entities in Hong Kong, so as to enhance protection for investors and deepen investor confidence in corporate reporting.

PIE Financial Reporting

Financial reporting is a critical element of market disclosures that underpins efficient market price formation in Hong Kong's capital markets. The powers of the FRC under the amended PIE regime give it a pivotal role in Hong Kong's system of financial regulation.

Quality of PIE Financial Reports

PIE financial reports are prepared by PIE Management but are the primary responsibility of PIE Boards and overseen by PIE Audit Committees. The collective culture and financial reporting and business competence of PIE Directors and Management and the effectiveness of PIE financial reporting systems affect the quality of their financial reports. The quality of PIE Audits also affects the quality of PIE financial reports. In turn, the quality of the performance of HKICPA's functions relating to PIE auditors may affect the quality of PIE Audits.



Why PIE Audit Quality Matters

- Upholding the quality of auditing is important because a high quality audit:
 - Should deliver the principal aim of an audit, which is to obtain the necessary evidence and provide a report that is intended to enhance user confidence that the PIE's audited financial reports can be trusted
 - It therefore counters information asymmetry between shareholders and investors and the PIE's Board and Management
 - Supports good corporate governance through the interaction between the PIE auditor and the Audit Committee and Board of the PIE
 - Protects the interests of the PIE's shareholders and the investing public and the wider public interest



Regulation of Factors that Affect PIE Audit Quality

- The appointed PIE auditor and its leadership are primarily responsible for the quality of a PIE Audit, which is performed by the audit engagement team led by a registered responsible Engagement Partner (EP).
- PIE audit quality is affected by the Business and Professional Competence, Diligence and Ethical Behaviour of the PIE auditor, supported by maintaining its independence from the PIE.
- Competence, Diligence and Ethics are regulated by qualification and fit and proper tests and Standards and CPD compliance requirements.
- PIE audit quality also depends on:
 - The collective culture of the PIE auditor's leadership and staff and any other auditors involved; and
 - The effectiveness and compliance with related Standards of the PIE auditor's Quality Control System (QCS).
- A registered responsible Quality Control System Responsible Person (QCSRP), who must be appointed by the PIE auditor, is responsible for maintenance of the QCS, monitoring controls and compliance.
- A required monitoring control is an objective review of each PIE audit by a registered responsible Engagement Quality Control Reviewer (EQCR).



Current Functions and Powers of the FRC – PIE Regime

1. Recognition

- Consider approval-in-principle when overseas PIE proposes to appoint an overseas auditor, to recognise the auditor as a PIE auditor for the entity
- **Power** to grant or refuse recognition or renewal applications

6. Oversight

- Oversee HKICPA functions relating to PIE auditors
- **Power** to request information and periodic reports, conduct assessment and give written directions on performance of a specific function

2. Enquiry

- Initiate and conduct Enquiries into possible non-compliances in PIE financial reports
- **Power** to require production of relevant records or documents and the provision of information and explanations, and to secure removal of relevant non-compliances

3. Inspection

- Carry out inspections of PIE auditors for ascertaining compliance with Standards or provisions of FRCO
- **Power** to enter any business premises of the PIE auditor, inspect records or make inquiries of the auditors, require verification by statutory declaration

4. Investigation

- Investigate possible misconduct by PIE auditor or registered responsible person, or possible practice irregularity by a non-PIE auditor
- **Power** to require relevant records and documents, explanations, interviews, assistance, verification by statutory declaration

5. Disciplinary Sanction

- Consider and impose disciplinary sanctions
- **Power** to revoke or suspend PIE auditor's registration or recognition, reprimand the person publicly or privately, and impose pecuniary penalties

3. In-process Reforms – Independent Regulation of the Accounting Profession in Hong Kong



Further Reforms will deliver Independent Regulation of the Accounting Profession

Benefits	Why and How
Independent regulation & oversight	Align with international practices
Impartiality	Check and balance by 3 governance bodies (<i>Process Review Panel, Board, Committees</i>)
Reduce compliance costs	Enhance regulatory efficiency
Enhance regulatory consistency	Ensure fairness
Increase public trust and confidence	Ensure sustainable development of the accounting profession and market for audits

Code of Ethics for Professional Accountants paragraph 100.1

“A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest”



Registration and Licensing

Issuance of practising certificates and Registration of all auditors will be vested with the FRC

No change in powers

Change in powers

Power	Current arrangement		Further reform	
	HKICPA	FRC	HKICPA	FRC
▪ Registration of Certified Public Accountants (CPAs)	✓		✓	
▪ Issuing practising certificates (PCs)	✓			✓
▪ Registration of practice units	✓			✓
▪ Registration of PIE auditors	✓	✓ (Oversight)		✓
▪ Recognition of overseas PIE auditors		✓		✓

Registration criteria remain largely the same but a new fit and proper test will apply for Issuance of PCs.



Enquiry

There is no change in powers

No change in powers
 Change in powers

Power	Current arrangement		Further reform	
	HKICPA	FRC	HKICPA	FRC
<ul style="list-style-type: none"> Initiating and conducting Enquiry concerning relevant accounting non-compliances 		✓		✓
<ul style="list-style-type: none"> Secure removal of relevant accounting non-compliances 		✓		✓



Inspection

FRC's inspection power will be extended to cover all practice units

No change in powers
 Change in powers

Power	Current arrangement		Further reform	
	HKICPA	FRC	HKICPA	FRC
Carry out Inspections in relation to				
<ul style="list-style-type: none"> PIE auditors – Inspections of PIE Engagements 		✓		✓
<ul style="list-style-type: none"> Practice units (including PIE auditors) – Inspections of all engagements other than PIE Engagements and AML compliance reviews 	✓			✓

Inspection approach (e.g. cycle and standards) will largely follow HKICPA practice for engagements other than PIE engagements.



Investigation and Disciplinary Sanctions

Powers to investigate and impose disciplinary sanctions on CPAs and practice units to be transferred from HKICPA to FRC

No change in powers

Change in powers

Power	Current arrangement		Further reform	
	HKICPA	FRC	HKICPA	FRC
Carry out investigations and impose disciplinary sanctions on				
<ul style="list-style-type: none"> PIE auditors and registered responsible persons in relation to misconduct related to a PIE Engagement 		✓		✓
<ul style="list-style-type: none"> CPAs 	✓			✓
<ul style="list-style-type: none"> Practice units (including PIE auditors) in relation to misconduct not related to a PIE Engagement 	✓			✓

Scope of powers (including investigable and sanctionable misconducts and powers of investigators) as well as types and levels of penalties will remain largely unchanged after the transfer from HKICPA to FRC.



Oversight of HKICPA performance of Functions

Scope of oversight to be extended to all remaining HKICPA functions relating to CPAs

No change in powers
 Change in powers

Power	Current arrangement		Further reform
	CPAs, CPA(P)s and practice units	PIE auditors	CPAs, CPA(P)s and practice units (including PIE auditors)
FRC's oversight of HKICPA performance of:			
<ul style="list-style-type: none"> ▪ Provision of training for qualifying as CPAs and for CPD of CPAs 			✓
<ul style="list-style-type: none"> ▪ Qualification through CPA exam and reciprocal recognition of accountants from outside Hong Kong 			✓
<ul style="list-style-type: none"> ▪ Registration and licensing 		✓	✓
<ul style="list-style-type: none"> ▪ Setting Continuing Professional Development (CPD) requirements 		✓	✓
<ul style="list-style-type: none"> ▪ Setting Auditing and ethical standards 		✓	✓
<ul style="list-style-type: none"> ▪ Setting Accounting standards 			✓

CPD requirements and professional standards follow converged international standards.



New Function to Promote and Support the Development of the Accountancy Profession

- Entrusted with the duty to promote the development of the accounting profession, such as:
 - Nurturing the development of more accounting professionals
 - Strengthening the effectiveness of CPD to enhance relevant skills
 - Enhancing accessibility by all CPAs of information on professional business opportunities
 - Reinforcing the need for competitiveness and high quality professional standards

- Facilitating accounting professionals to work and expand provision of accounting services in the Greater Bay Area



4. Execution of Powers – Regulatory Values, Principles and Approach



FRC Core Values and Principles

■ Integrity

- Maintain highest integrity by adhering to high ethical standards
- To protect public interest and maintain public confidence

■ Proficiency

- Enhance operational proficiency by identifying and taking opportunities to further enhance the efficiency of our processes
- To ensure effective utilisation of public resources

■ Independence and impartiality

- Perform our functions fairly, impartially and consistently as an independent body
- To ensure the FRC operates independently, and free from interference by the auditing profession and listed entities, and from political pressure



FRC Core Values and Principles

■ Proportionality

- No “one size fits all’ approach – our regulatory approach recognizes both:
 - The relative significance of our potential impact on regulatees whose operations and resources are on a small or even micro scale relative to some of the largest PIE auditors; and
 - The relative significance of their potential to harm the public interest
- Deployment of resources to areas where they will have the most significant regulatory impact on potential harm to the public interest based on risk assessment
- To avoid undue compliance burdens on smaller and non-complex businesses or auditors, subject to risk assessment

■ Transparency and accountability

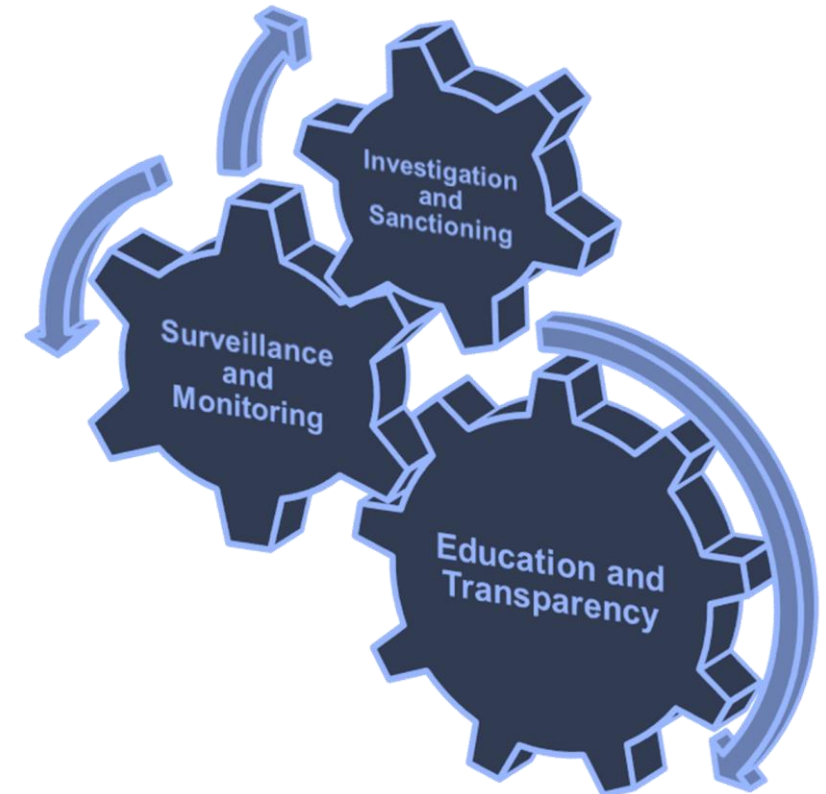
- Allow the public to understand our operations and facilitate judgement of our performance, by publication of operational statistics, information on investigations and enquiries, and other reports
- Increase market education and enhance public confidence in the regulatory system



FRC's Regulatory Approach

To drive a combination of regulatory outcomes:

- **Prevention:** Prevent occurrence and recurrence of public interest harm through a combination of education and transparency, through influencing the behaviours of our regulatees and other stakeholders
- **Detection:** Detect potential harm through proactive monitoring (Inspection and Financial Statement Reviews based on risk assessment) and surveillance activities, including reacting to referrals from other regulators, the public and whistleblowers
- **Remediation:** Driving remediation of past failures and system weaknesses that create opportunities for future harm
- **Deterrence:** Sanctioning more serious harm to the public interest, with a focus on both corporate and individual responsibilities and credit for co-operation



Education and Transparency

Stakeholder(s)	Education
<p>The investing and wider public, including but not limited to:</p> <ul style="list-style-type: none">• Shareholders and investors, including retail investors• The board of directors, audit committees, managements and professionally qualified accountants of listed entities (Preparers) and their staff• Auditors (from leadership to staff)	<ul style="list-style-type: none">• Periodic regulatory reports• Press releases• E-newsletters• Media briefings• Policy and governance reports• Meetings with key stakeholder representative bodies• Collaboration with other bodies, such as the Hong Kong Institute of Directors and The Investor and Financial Education Council (IFEC)



Recent Publications

- Annual Investigation and Compliance Report (November 2021)
- Interim Inspection Report (November 2021)
- eNews (November 2021)
- Annual Inspection Report (June 2021)
- FRC Annual Report (June 2021)
- Overview of the Market for Listed Entity Audits in Hong Kong (11 March 2021)
- Report on the FRC's Assessment of the HKICPA's Performance of the Specified Functions (11 December 2020)

FRC Financial Reporting Council
財務匯報局



Interim Inspection Report

FRC Financial Reporting Council
財務匯報局

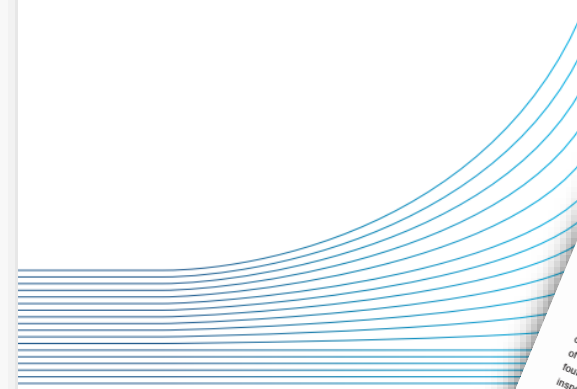
Investigation & Compliance



Annual Investigation and Compliance Report

3 November 2021

FRC Financial Reporting Council
財務匯報局



ANNUAL REPORT
年報 2019-21

FRC Financial Reporting Council
財務匯報局

November 2021

e-NEWS

Introductory message from the CEO
It has been an eventful few months since our last edition of e-News was published on 28 July 2021 and I am pleased to introduce some of the key developments since then.

Regulatory reforms passed by LegCo
The further regulatory reforms of the accounting profession which will see the FRC evolve into the independent regulator of the accounting profession in Hong Kong, renamed as the Accounting and Financial Reporting Council, were passed by the Legislative Council on 22 October 2021.

We are now looking forward to working closely with the Government as the secondary legislation is developed to provide for the transitional arrangements and other technical details of the new regime, and with the HKICPA to ensure a smooth transfer of functions to the FRC. We will also continue our stakeholder engagement while devoting our efforts to preparing for the implementation.

Latest departmental progress reports published
On 3 November, we published the first report of our Investigation and Compliance Department, covering the period from 1 October 2019 to 31 March 2021. On the same day, we published the second Interim report of our Inspection Department. The purpose of these reports is to share information about the most common matters that we have found or are looking into in our investigations and enquiries and about our most common inspection findings.



Market Monitoring Activities

Respond to matters without delay, when identified through our:

■ Proactive risk-based market monitoring activities:

- Through inspections
- FRC's own financial statements review programme

■ Reactive detection activities:

- Complaints from the public
- Whistleblowers
- Referrals from other regulators



Cooperation With Other Hong Kong Regulators and Enforcement Agencies

- Increased cooperation with local regulatory partners
- Memorandum of understanding (MoU)
 - Independent Commission Against Corruption (ICAC)
 - The Securities and Futures Commission (SFC)
 - The Stock Exchange of Hong Kong Limited (HKEX)
 - The Hong Kong Institute of Certified Public Accountants (HKICPA)
 - The Hong Kong Monetary Authority
 - The Insurance Authority
- Close working relationship with local regulators and enforcement authorities including SFC, HKEX, ICAC, Commercial Crime Bureau and HKICPA



Cooperation with Regulators and Other Bodies in Mainland China and Overseas Jurisdictions

- MoU with the Supervision and Evaluation Bureau (SEB) of the PRC Ministry of Finance
- To enhance international cooperation and collaboration, the FRC has:
 - Affiliate membership of the International Organization of Securities Commissions (IOSCO)
 - Applied for membership of the International Forum of Independent Audit Regulators (IFIAR) as the independent audit regulator in Hong Kong.
- Building relationships with overseas Independent Audit Regulators with a view to enabling closer co-operation and collaboration



5. Meeting the Challenges and Opportunities Facing the Accounting Profession Today



Meeting the Challenges and Opportunities Facing the Accounting Profession

1	Maintaining a sustainable accounting profession
2	Changes in accounting profession practice imposed by the COVID-19 pandemic (business, practice, education)
3	Challenges in attracting and retaining talent in the profession
4	Economic uncertainty (geopolitics)
5	Changing expectations of the public and consumers of accounting services
6	Embracing regulatory change
7	Technology and cybersecurity
8	New business opportunities: Greater Bay Area, Sustainable Finance, ESG and Business Valuations



Thank you

