

AFRC – Remit and Powers

23 November 2022



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Director, Investigation and Compliance Department



Agenda

- Overview of AFRC

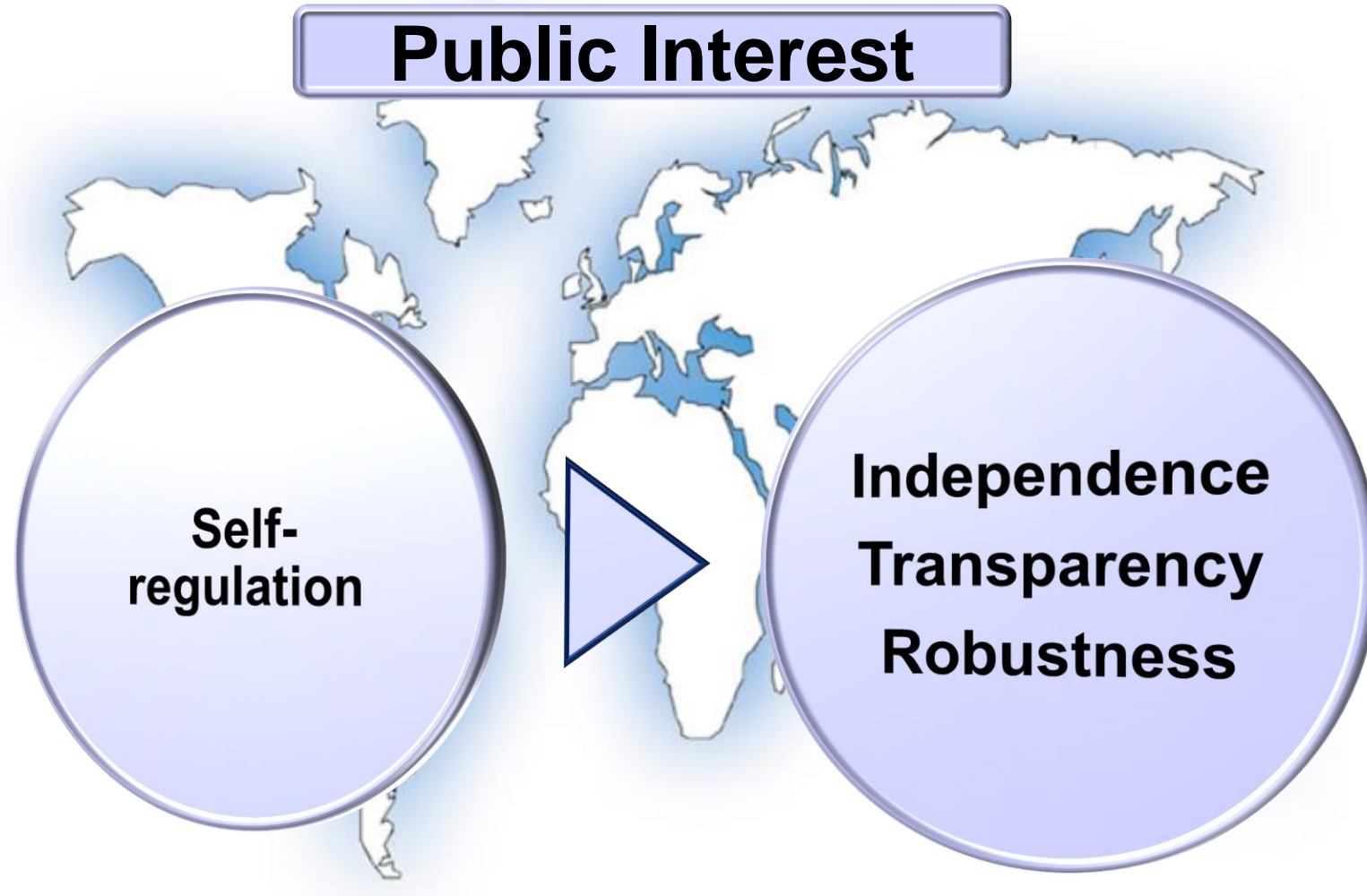
- Functions of AFRC
 - Policy, Registration and Oversight
 - Inspection
 - Investigation and Enquiry
 - Discipline

- Co-operation with other regulators

- Recent publications

- Questions & Answers

Evolution of Independent Regulator of Accounting Profession



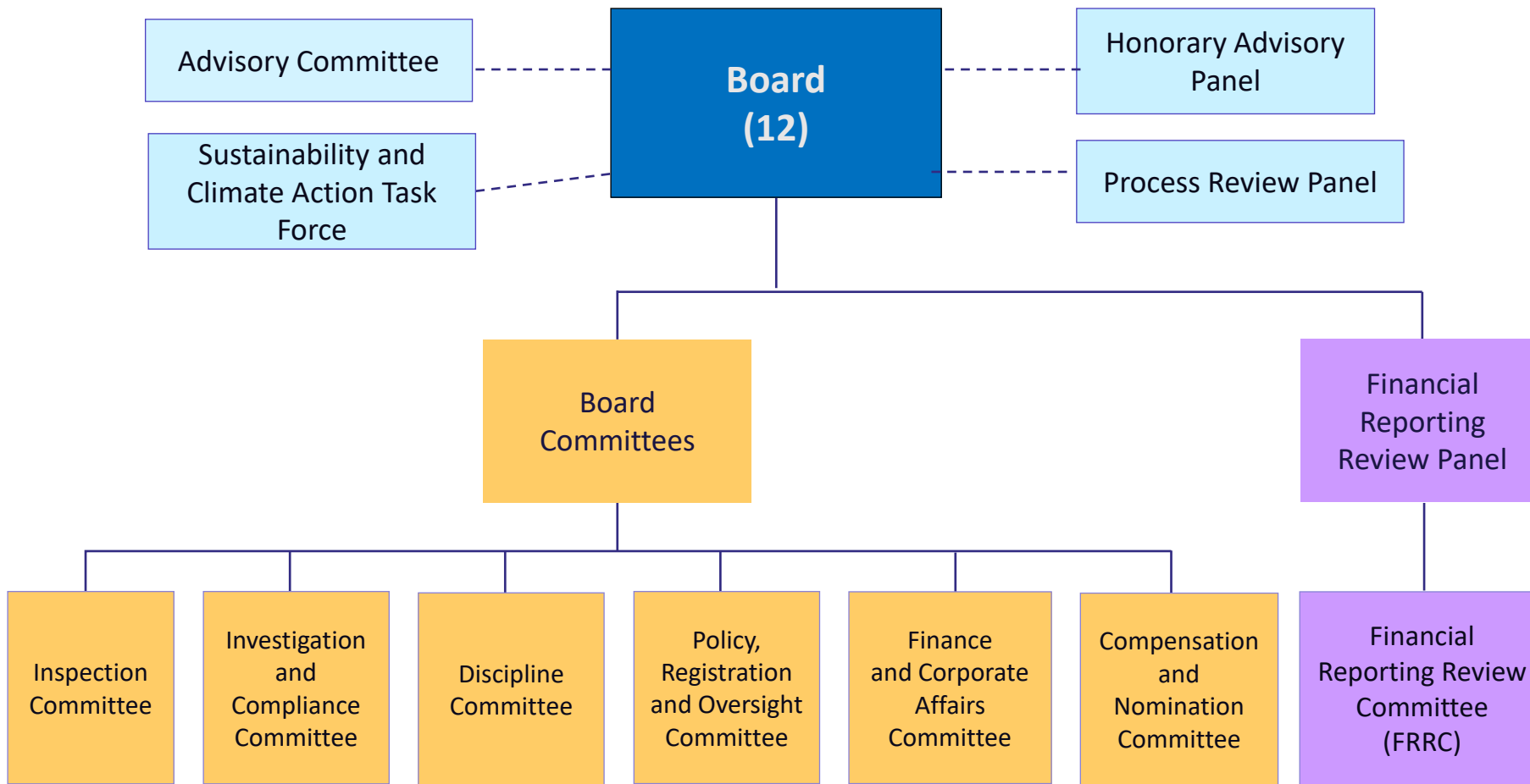
Independent Auditor Regulatory Reform in Hong Kong



Mission of the AFRC

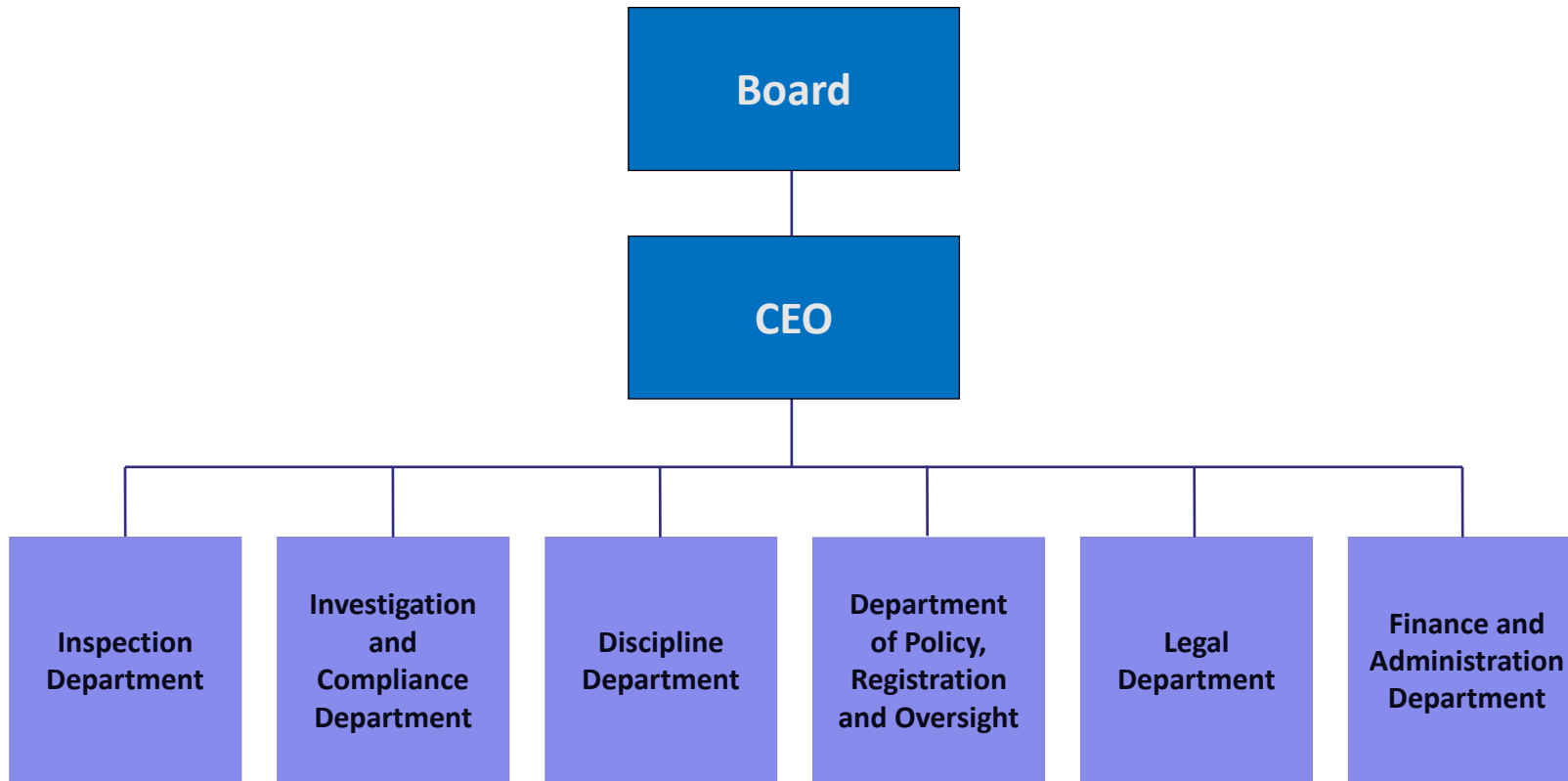
- Discharge our statutory duties as an effective regulator
- Enhance the quality of financial reporting in Hong Kong
- Promote healthy development of the profession and Hong Kong's position as a competitive international financial centre

Governance structure



- **The Board** - ultimate governing body
 - Comprises 12 members including the Chairman who is non-executive, 10 non-executive directors and 1 executive director
- All directors must be non-practitioners
- The number of non-executive directors must exceed executive directors

Organisation structure



Note : Management comprises heads of departments and General Counsel

Functions of AFRC

Functions of AFRC	Scope of Regulation
Enquiry	PIE (financial statements)
Licensing (Recognition) Registration Registration & Licensing (PCs)	PIE Auditor (Overseas) PIE Auditor (all) CPA (Practising), Practice Units (all)
Inspection, Investigation, Discipline Inspection, Investigation, Discipline Investigation, Discipline	PIE Auditor (all – PIE engagements) Practice Units (all – audit & assurance) CPAs
Oversight (Qualification and Registration, CPD requirements, Standards (audit, assurance and accounting))	HKICPA performance of functions

2006 | 2019 | 2022



Department of Policy, Registration and Oversight



Major functions

Three major functions:

- Policy and Governance initiatives
- Registration and Licensing
- Oversight of the HKICPA's performance of specified functions

Policy and Governance initiatives

- Conduct policy research that is conducive to enhancing the quality of financial reporting and audit quality
- Protect investors and the public interest
- Completed projects:
 - Overview of the Market for Listed Entity Audits in Hong Kong (Mar 2021)
 - Collaboration with the IFEC (Sept and Dec 2021)
 - Audit Committee Guidelines on Selection, Appointment and Reappointment of Auditors (Dec 2021)

Registration and Licensing

- Ensure the professional ethics, integrity and competency of the auditing profession

Registration Power	Before 1 Oct 2022		From 1 Oct 2022	
	HKICPA	FRC	HKICPA	AFRC
▪ Recognition of overseas auditors		✓		✓
▪ Registration of CPA	✓		✓	
▪ Registration of audit practice units	✓			✓
▪ Registration of PIE auditors	✓			✓
▪ Issuing practising certificates to CPAs	✓			✓

Recognition of overseas PIE auditors

- It is an offence for an overseas auditor to undertake or carry out a PIE engagement for an overseas entity unless the overseas auditor has been recognised
- The listed entity must apply to the AFRC for the audit firm to be recognised as a PIE auditor
- If a particular overseas audit firm carries out PIE engagements for more than one listed entity, each listed entity concerned must apply for recognition of the same overseas firm
- Recognition of an overseas auditor attaches to the specific listed entity that applied for recognition
- Recognition is valid to 31 December and renewed annually
- Mainland auditors
 - under a mutual recognition agreement between the Mainland and the HKSAR, endorsed as being qualified to act as an auditor for Mainland corporations listed in Hong Kong (apply ASBE and Mainland auditing standards)
 - 11 Mainland audit firms have been endorsed

Registration and Renewal of Firms, CPs and PIE auditors

For firms and CPs

Key registration/renewal criteria	Firms	CPs
1. Composition of firms / CPs <ul style="list-style-type: none"> a. All partners / directors are CPA b. At least a proportion of partners / directors are CPA (practising) 	No change <i>(Proportion is specified by AFRC)</i>	
2. Requirements on articles of association and professional indemnity	N/A	No change <i>(Requirements are set by HKICPA)</i>

For PIE auditors

Key registration/renewal criteria	
1. Every partner (for firms), director (for CPs), and responsible person is a fit and proper person to be a CPA	No change
2. Quality control system responsible person is the CEO/a member of the managing board of partners	
3. Every responsible person is a fit and proper person to be a CPA	

Issuance and Renewal of PC

Key issuance/renewal criteria	
1. Satisfies the fit and proper requirement to be a CPA	New
2. Specific amount of full time approved accounting experience	No change <i>(Accounting experience is approved by HKICPA)</i>
3. Local experience and knowledge of local law and practice (may include completion of HKICPA's PC examinations and having no less than 1 year of full time approved accounting experience in Hong Kong)	No change <i>(Requirements are set by HKICPA)</i>
4. CPD requirements	
5. Ordinarily resident in Hong Kong	
6. Not bankrupt or has not entered into a voluntary arrangement with the creditors	
7. Not subject to sanction/disciplinary order of AFRC/HKICPA that prevents the person from being issued with a PC	No change
8. Intends to practice as a CPA (practising)	



Oversight of the HKICPA's performance of the specified functions

- Oversight of the HKICPA's performance of the following specified functions:
 - Registration of CPA
 - Arranging mutual/reciprocal recognition of accountants
 - Setting of requirements for continuing professional development (CPD) for all CPAs
 - Setting standards on professional ethics, accounting, auditing and assurance practices, all CPAs
 - Providing training for qualification and CPD of CPAs

- Oversight through the following means:
 - Request information and periodic reports
 - Conduct assessment
 - If satisfied that it is in the public interests to do so, give written directions
 - HKICPA must comply with any direction given by the AFRC

- “Revised Statement of Protocol” between the two parties signed on 16 Aug 2022 (available on the AFRC's website)

Inspection Department



Objective and Focus of Inspection

■ Objectives

- Monitoring and promoting audit quality

■ Focus of Inspection

- Effectiveness of internal quality control systems
- Compliance with applicable professional standards and legal and regulatory requirements

Scope of Inspection

1. AFRC inspection covers inspections of all practice units in Hong Kong
2. Practice units including:
 - a. A CPA (practising) who practises accountancy under the accountant's own name;
 - b. A CPA firm*; and
 - c. A corporate practice
3. AFRC inspection covers two elements:
 - a. Firm-level – review policies and procedures of firm-wide system of quality control to assess compliance with HKSQC 1 or HKSQM 1 and AML Guidelines**
 - b. Engagement-level – review selected engagements to assess compliance with professional standards and legal and regulatory requirements

* Under section 2 of the AFRCO, CPA firm means – (a) a certified public accountant (practising) who practises accountancy on the accountant's own account under a firm name registered under Division 2 of Part 2A of the AFRCO; or (b) a firm of certified public accountants (practising) that – (i) practises accountancy in partnership; and (ii) is registered under Division 2 of Part 2A of the AFRCO.

** AML Guidelines refer to “Guidelines on Anti-Money Laundering and Counter-Terrorist Financing for Professional Accountants” contain in the “Code of Ethics for Professional Accountants”.

Powers

- To require an auditor to give certain information to determine the frequency of inspection or the scope of an inspection (for FR Inspector)
- To enter any business premises of a regulatee (for FR Inspector)
- To apply for search warrant (for FR Inspector)
- To require answer to be verified by statutory declaration (for FR Inspector)
- To inspect, and make copies or record details of any record or document, and to require answers to inquiries (for FR Inspector and CPA Inspector)

Inspection report and outcome (PIE auditors)

Reporting

- Inspection findings and any follow-up actions, results of inspection will be reported as:
 - Good (rating 1)
 - Limited improvement (rating 2)
 - Improvements required (rating 3)
 - Significant improvement (rating 4)

- Provide a dated draft of the report to the PIE auditor and anyone named in the report, to give them an opportunity to be heard

Outcome

- Decide no follow-up action is required
- Require the PIE auditors to take a measure or corrective action
- Carry out a further inspection
- Refer to the Investigation and Compliance Department
- Take any other follow-up action that the AFRC considers appropriate

Inspection report and outcome (Practice units other than PIE auditors)

Reporting

- Inspection findings and any follow-up actions, results of inspection will be reported as:
 - No findings
 - Findings (other points to note)
 - Significant findings

- Provide a dated draft of the report to the practice unit and anyone named in the report, to give them an opportunity to be heard

Outcome

- Decide no follow-up action is required
- Require the practice unit to take a measure or corrective action
- Carry out a further inspection
- Refer to the Investigation and Compliance Department

Key operations statistics

	2021	2020
PIE audit firms inspected (quality controls system)	17	18
PIE engagements inspected	51	37
Special focus inspections initiated	4	2

Investigation and Compliance Department



Source of work and outcome

- Sources of work
 - Reactive
 - Complaints from the public
 - Whistleblower reports
 - Referrals from other regulators
 - Proactive
 - Financial statements review programme
 - Internal referrals arising from inspections
- Outcome of complaint assessments
 - Initiate investigations or enquiries
 - Refer to other regulators
 - Not pursue further



Major functions

Two major functions:

■ Investigation

- Relevant irregularities – auditing or reporting irregularities
- FR Misconduct
- Professional irregularities

■ Enquiry

- Relevant non-compliance in relation to a listed entity – non-compliance with accounting requirements

Investigation

Relevant date	Regulatees	Matters [conducted by]
Engagement completed before 1 October 2019 (Pre-amended FRCO)	Auditor or reporting accountant of listed entity -> Professional person under AFRCO	Relevant irregularity (auditing or reporting) -> Professional irregularity under AFRCO [conducted by Board of AFRC or AIB]
After 1 October 2019 (AFRCO)	PIE auditor, Registered Responsible Person of PIE auditor (RRP)	FR Misconduct (including practice irregularity) [conducted by AIB or FR Investigator*]
	Non-PIE auditor	Practice irregularity [conducted by AIB or FR Investigator*]
After 1 October 2022 (AFRCO)	Professional person - CPA; or - Practice unit	Professional irregularity [conducted by CPA Investigator]

* FR Investigator – Employee of AFRC or any person appointed with the consent of the Financial Secretary

Investigation (Pre-amended FRCO)

Relevant irregularity (s4 Pre-amended FRCO) -> Professional irregularity (AFRCO)

- falsified or caused to be falsified a document;
- made a statement, in respect of a document, that was material and knew to be false or did not believe to be true;
- negligent in the conduct of the auditor or reporting accountant's profession;
- guilty of professional misconduct; or
- dishonourable conduct;
- failed or neglected to observe, maintain or otherwise apply a professional standard; or
- refused or neglected to comply with the provisions of any bylaw or rule made or any direction lawfully given by the Council of the HKICPA.

Investigation (Pre-amended FRCO)

Powers	Circumstances suggesting – auditing irregularity (s23(1))	Circumstances suggesting – reporting irregularity (s23(2))	Reasonable cause to believe (s23(3))
To produce records or documents		✓	✓
To explain regarding records or documents produced		✓	
To attend interviews and answer questions (no right to silence but may claim protection in criminal proceedings)			✓
To respond to written questions, to explain or give further particulars			✓
To verify (by a statutory declaration) a statement made, the whereabouts of any missing records or documents or info required is not within their knowledge or possession		✓	✓
To give all other assistance in connection with the investigation			✓
To apply for a search warrant (enter the premises within 7 days)		✓	✓



Investigation (AFRCO – FR Misconduct)

PIE auditor (s23)

- has reasonable cause to believe that a PIE auditor has carried out a PIE engagement in a way that is not in the interest of the investing public or in the public interest;
- has reasonable cause to believe that a provision of the Ordinance may have been contravened; or
- has reason to inquire into whether a FR misconduct has been committed.

Non-PIE auditor (s23A)

- has a reasonable cause to believe that a non-PIE auditor has committed a practice irregularity.

Investigation (AFRCO – FR Misconduct)

Investigation - “FR Misconduct” (AFRCO s37A - PIE auditor / s37B - RRP)

- “Practice irregularity” (AFRCO, sec 4), examples:
 - Falsifying a document
 - Making a statement in respect of a document which is material, knowing the statement to be false or not believing it to be true
 - Negligence in the conduct of his profession
 - Guilty of professional misconduct
 - Act or omission which would reasonably be regarded as bringing or likely to bring discredit on the auditor, the HKICPA or the accountancy profession
 - Failing or neglecting to observe, maintain or otherwise apply a professional standard
- Contravention of a provision of the AFRCO
- Contravention of a condition imposed in relation to the registration or recognition of the PIE auditor
- Contravention of a requirement imposed on a PIE auditor or registered responsible person
- Conduct in relation to a PIE engagement which, in the opinion of the AFRC, is or is likely to be prejudicial to the interest of the investing public or the public interest

Powers (s25(1))

- to produce any record or document specified by the FR investigator that is or may be relevant to the investigation; and is in the person's possession;
- to give an explanation or further particulars in relation to a record or document produced;
- to attend before the FR investigator to answer a question relating to any matter under investigation that may be raised by the FR investigator;
- to answer in writing a written question relating to any matter under investigation that may be raised by the FR investigator; and
- to give the FR investigator all other assistance in connection with the investigation that the person is reasonably able to give.

Investigation – (AFRCO - Professional irregularity)

Investigation - “Professional Irregularity” (AFRCO s3B)

■ Examples:

- Falsifying a document
- Making a statement in respect of a document which is material, knowing the statement to be false or not believing it to be true
- Failing or neglecting to observe, maintain or otherwise apply a PAO professional standard
- Failing to comply with an AML/CTF requirement
- Failing, without reasonable excuse, to comply with a requirement issued by a CPA investigator
- Negligence in the conduct of his profession
- Guilty of professional misconduct

Investigation (AFRCO – Professional irregularity)

Powers (s20ZZJ)

- to produce or to allow access any specified document in the person's possession, or under the person's control relevant to the investigation;
- to give explanation or further particulars in respect of a required document;
and
- to give all assistance in connection with the investigation that the person is reasonably able to give.

Investigation report

- Contains the investigation findings
- Provide a dated draft of the report to the following parties and give them an opportunity to be heard:
 - PIE auditor, non-PIE auditor or RRP, and any other person named (s31A);
 - The person investigated, and any other person named (s20ZZN)
- Where there is sufficient evidence, the investigation report will be referred to the AFRC's Discipline Department to consider disciplinary sanction

Enquiry

Enquiry (AFRCO, s40)

- Directed at a listed entity's relevant financial reports
- Enquirer [conducted by AFRC (delegated to staff) or FRRC]
- Relevant non-compliance, an accounting requirement as to the matters or information to be included in the relevant financial report as provided in:
 - The Companies Ordinance
 - Standards of accounting practices under section 18A of the Professional Accountants Ordinance (Cap 50)
 - The International Financial Reporting Standards
 - The Listing Rules
 - Any GAAP allowed under the Listing Rules

Powers

- Require the production of any record or document or giving of any information or explanation by
 - The listed entity or its relevant undertaking
 - The auditor of the listed entity
 - Officer or employee of the listed entity or relevant undertaking

Enquiry report

- Provide a draft of the report to anyone named in the report and give them an opportunity to be heard
- Follow-up actions, where there is sufficient evidence of relevant non-compliance, the AFRC may:
 - Send a notice to the directors or manager of the PIE specifying how the relevant non-compliance should be revised or otherwise remedied with a deadline
 - If the directors have not taken action before the deadline to explain, rectify or otherwise remedy the relevant non-compliance, the AFRC may make a court application to require revision or other remedy

Key operations statistics

	Apr 2021 to Mar 2022	Oct 2019 to Mar 2021	Jan to Sep 2019	2018	2017
Pursuable complaints received*	101	67	48	35	25
Investigations completed	8	7	12	16	11
Enquiries completed	1	0	3	1	0

* Excluded 163, 50 and 101 pursuable complaints of a vexatious, abusive or unreasonably persistent nature for the years 2021-22, 2018 and 2017 respectively which were not taken further.

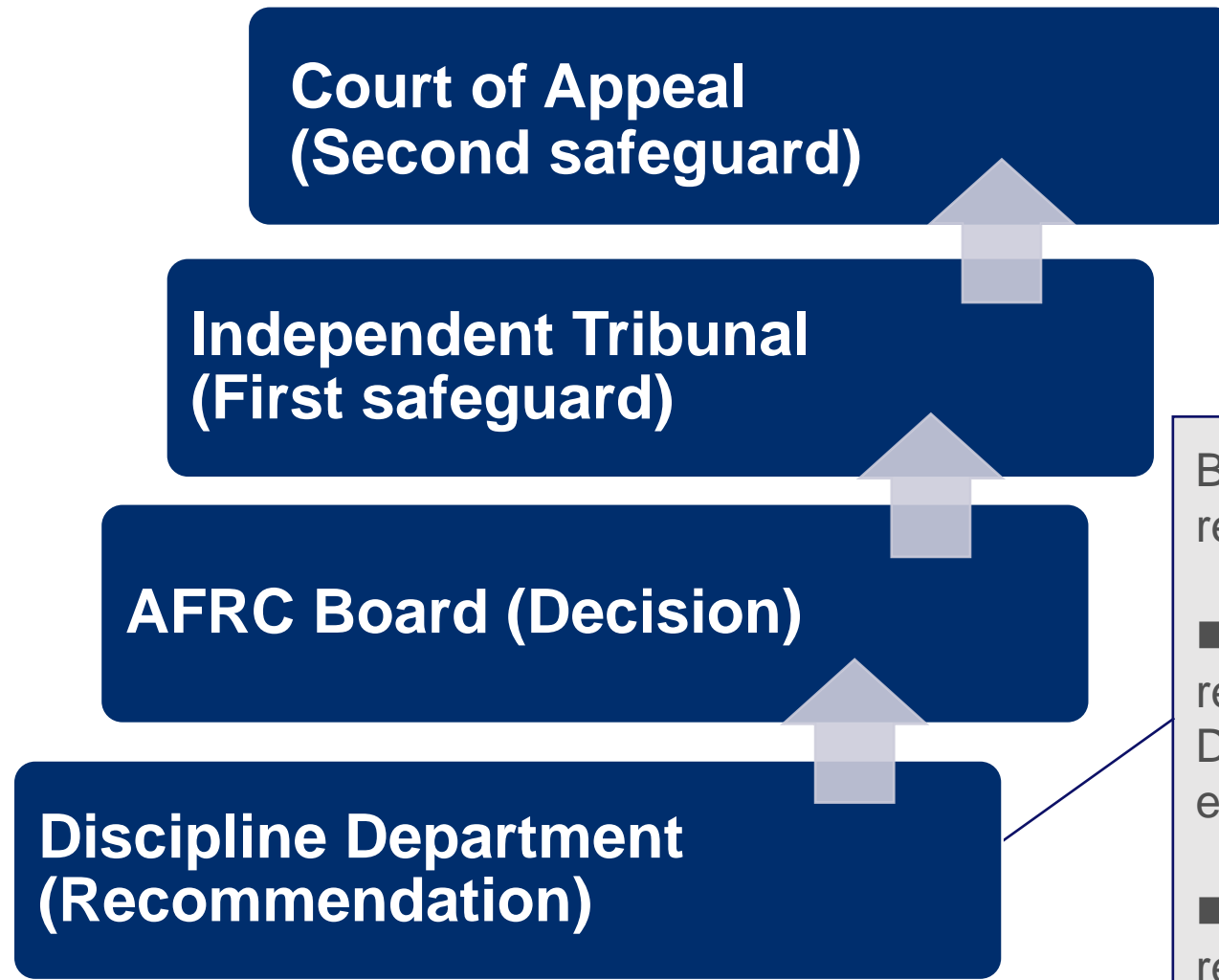
Discipline Department



Disciplinary Function

- Take appropriate and timely disciplinary action in cases of misconduct by imposing commensurate sanctions for the purposes of deterrence, investor protection, maintaining market confidence in the quality of financial reporting and audits, and upholding the standards of conduct among regulatees

Disciplinary Process – Independent, Fair and Efficient



Before a recommendation is made, rights of regulatees are properly **protected** by:

- **disclosure** of the AFRC's analysis of all relevant issues in the Notice of Proposed Disciplinary Action (NPDA) and all relevant evidence in the List of Documents
- **reasonable opportunity** to make representations in response to the NPDA

Types of Sanctions

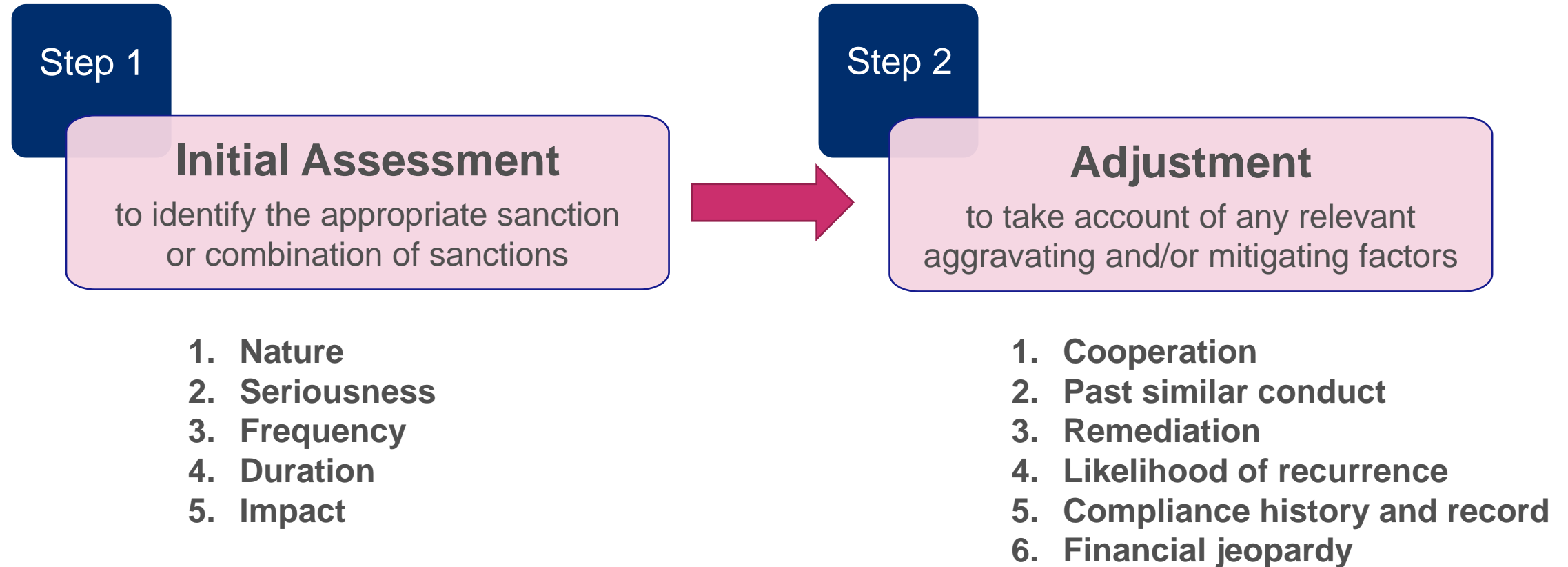
PIE Auditors and RRP	Professional Persons
<ul style="list-style-type: none">■ Remedial action■ Reprimand (private / public)■ Pecuniary penalty (not exceeding HK\$10m or 3 x profit / loss, whichever is higher)■ Registration or recognition<ul style="list-style-type: none">➤ Imposition of a condition➤ Suspension➤ Revocation➤ Prohibition from application■ Removal of name from the list of RRP	<ul style="list-style-type: none">■ Reprimand (private / public)■ Pecuniary penalty (not exceeding HK\$0.5m)■ Registration<ul style="list-style-type: none">➤ Suspension➤ Revocation■ Practising certificate<ul style="list-style-type: none">➤ Cancellation➤ Non-issuance

Approach of Sanctions – Proportionate and Fair

- 1 Principle-based
- 2 Proportionality
- 3 Transparency



Approach of Sanctions



Cooperation with other regulators

- Memorandum of understanding
 - The Supervision and Evaluation Bureau of the PRC Ministry of Finance
 - The Securities and Futures Commission
 - The Stock Exchange of Hong Kong Limited
 - The Hong Kong Institute of Certified Public Accountants
 - The Hong Kong Monetary Authority
 - The Hong Kong Police
 - The Independent Commission Against Corruption
 - The Insurance Authority

- Liaison meetings

Recent publications

- Interim Inspection Report (15 Nov 2022)
- Assessment of HKICPA's Performance of the Specified Functions (15 Nov 2022)
- New & revised quality management standards follow-up survey (10 Nov 2022)
- Annual Investigation and Compliance Report (20 Oct 2022)
- Quarterly Report (5 Oct 2022)
- Annual Inspection Report (23 Jun 2022)
- Annual Report (16 Jun 2022)



Questions & Answers