



梁繼昌議員 **Hon Kenneth Leung**

12 September 2014

Ms. Au King-chi

Permanent Secretary for Financial Services and the Treasury (Financial Services)

Financial Services and the Treasury Bureau

24/F, Central Government Offices

2 Tim Mei Avenue, Tamar, Hong Kong

Dear King Chi

### **Proposal to Improve Regulatory Regime of Listed Entity Auditors**

I write to respond to the above consultation paper (the "**Paper**") issued by the Financial Services and the Treasury Bureau ("**FSTB**") in June 2014.

The audit regulatory reform is an important step to overhaul the current regulatory system of auditors of listed entities and to bring Hong Kong in line with the regulatory culture of other major financial centres. It is important that any changes under the reform should be taken only when it is absolutely required to meet the international benchmarking.

My responses (in bold and italics) to the questions for consultation are set out in the appendix to this letter.



In upholding the professional standards of listed entity auditors through the auditor regulatory reform, the Administration should concurrently explore the idea of professional liability reform, which is essential to maintain the competitiveness, sustainability and viability of the auditing profession.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Kenneth Leung', with a long horizontal flourish extending to the right.

**Kenneth Leung**

c.c. Principal Assistant Secretary for Financial Services & the Treasury  
(Financial Services) 4

Encl.

**(A) Basic Parameters of Reform**

**Question 1**

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 believe the objective of the regulatory reform is to maintain the goodwill and reputation of Hong Kong as an international financial centre and a good global citizen by ensuring that the regulatory regime for auditors of listed entities can meet the international benchmarking.***

***The reform should take a bare minimum approach to avoid unnecessary adverse impacts upon the audit profession.***

**Question 2**

Do you agree that the new regulatory regime should only cover auditors of public interest entities, which will be defined to cover listed entity auditors?

***Since there is no universal definition of a public interest entity (“PIE”), I agree that the definition of PIE should only be confined to a listed company. Currently, there is no strong view from the investors in Hong Kong to demand an independent oversight on the auditors for PIEs which are not listed companies.***

### **Question 3**

Do you agree that the definition of public interest entities 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 agree that the definition of PIE should contain in the main body of legislation itself (rather than in any subsidiary legislation) since any change in the meaning of PIE, however small, will have dire implication on auditors who perform audit work for PIEs. Future changes of the definition, if any, by means of an amendment bill is appropriate, since that will require the bill to be passed by the Legislative Council.***

### **Question 4**

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?

***Subject to my other concerns in this consultation, I agree in principle to expand the regulatory remit of FRC so that it becomes the independent auditor oversight bodies for listed entities in Hong Kong. As such, FRC should at the same time exercise a minimal degree of intrusion in performing its overseeing role. The oversight power in this context should be a reserve power for FRC to intervene and rectify if and only if anything goes wrong. The term “oversight” when used in the Paper and this response should also be interpreted in this light throughout.***

## **(B) Registration**

### **Question 5**

- (a) Do you agree that a listed entity auditor must be a practice unit as defined under the existing PAO and a fit and proper person to be registered as a listed entity auditor?
- (b) 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 listed entity auditor, i.e. by reference to the existing fit and proper test for becoming a CPA?

***I agree that a listed entity auditor must be a practice unit as defined by the PAO. As the "fit and proper" criteria have to be met for admission to membership for the HKICPA, they should also be applied to listed entity auditors without any change.***

***I do not envisage the need to change the existing qualification and experience requirements for considering whether a person is fit and proper to be registered as a listed entity auditor. The registration criteria should only be re-confirmed as part of the annual renewal registration.***

## Question 6

- (a) Do you agree that in order for an application for registration as a listed entity auditor 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?
- (b) 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 listed entity auditor when considering whether they are fit and proper to perform those roles?

***The requirement for making registration of individuals who assume the ultimate responsibility of an audit engagement and the quality control system could be superfluous given that:***

- ***the registration of a firm of certified public accountants (practising) is governed by sections 28A to 28C of the Professional Accountants Ordinance and Professional Accountants By-laws 28 and 29;***
- ***the firm has already been requested to meet the requirements of Standard of Quality Control (SQC) 1 where the company Board and their chief executive officer (“CEO”) are accountable for the quality control of each and every audit engagements; and***
- ***no other major jurisdictions are imposing similar regulatory requirements.***

***Strong justifications are considered required to justify why registration of firm alone is not adequate to uphold audit quality standards since the practice unit’s CEO (or equivalent) and/or members of the managing board of partners (or equivalent) will have the ultimate accountability on the quality of their audit engagements anyway.***

### **Question 7**

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 listed entity auditor, and that it shall be a criminal offence if an unregistered person entered into an audit engagement with a listed entity?

***I agree with the above proposal. This is the proper way to protect the interests and quality of the audit profession in Hong Kong.***

### **Question 8**

(a) Do you agree that HKICPA Registrar should be assigned the role of Registrar of Listed Entity Auditors and be vested with the registration functions and powers as outlined in paragraph 3.23, and FRC should exercise oversight through arrangements as proposed in paragraph 3.24?

(b) Do you agree that FRC should publish the periodic reports received by the HKICPA Registrar as mentioned in paragraph 3.24(a) 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 agree that the HKICPA should continue to be assigned the role of Registrar of Listed Entity Auditors and be vested with the registration functions and powers as outlined in paragraph 3.23 of the Paper, and FRC should exercise oversight through arrangements as proposed in paragraph 3.24.***

***I agree to adopt the proposed measures mentioned in paragraphs 3.24(a) and 3.24(b) of the Paper as the regular means of oversight to be exercised by FRC.***

### **Question 9**

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 agree to set up an appeal mechanism independent from both the HKICPA Registrar and FRC in regard to a registration decision made by the HKICPA Registrar as an effective check-and-balance measure for enhancing independence of the registration process.***

### **Question 10**

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 support the proposed arrangement.***

### **Question 11**

Do you agree that the register of listed entity auditors should include the types of information on each registered listed entity auditor as proposed in paragraph 3.27?

***I support the arrangement as proposed in paragraph 3.27.***



## **Question 12**

Do you agree 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 have been approved for listing in Hong Kong on a case-by-case basis?

***Being the regulatory body for listed entity auditors registered in Hong Kong, FRC should be vested with statutory powers to receive and approve applications for recognising overseas auditors of specific overseas entities which have been approved for listing in Hong Kong on a case-by-case basis.***

## **Question 13**

Do you agree that an applicant must meet the criteria as proposed in paragraph 3.30 for being recognised as an overseas auditor of the overseas entity listed in Hong Kong as set out in its application?

***I accept the proposed criteria for recognition as an overseas auditor of a specific overseas entity listed in Hong Kong as set out in paragraph 3.30. The Government should rigorously review any existing mutual or reciprocal cooperation with other jurisdictions including the Mainland authorities.***

## **Question 14**

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 agree with the proposed arrangement.***

### Question 15

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?

***It is necessary and important for the HKICPA Registrar to maintain a complete and updated list of local and overseas auditors who are eligible for entering into audit engagements for listed entities in Hong Kong and to make such list available for public inspection.***

### (C) Setting of CPD Requirements

### Question 16

(a) Do you agree that HKICPA should continue to perform its statutory functions and exercise its statutory powers with regard to setting CPD requirements for listed entity auditors, subject to independent oversight by FRC in accordance with paragraph 4.6?

(b) Do you agree that FRC should publish the periodic reports received by it as mentioned in paragraph 4.6(a) 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 agree that the Institute should remain the body designing and running CPD for its practising and non-practising members as set out in parts (a) and (b). Oversight from the independent body should take the least intrusive approach.***

## **(D) Setting of Standards on Professional Ethics, Auditing and Assurance**

### **Question 17**

- (a) 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 listed entity auditors as proposed in the arrangements set out in paragraph 5.8?
- (b) Do you agree that FRC should publish the periodic reports received by it as mentioned in paragraph 5.8(a) 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 agree that the Institute should remain the standard setting body with oversight from the independent oversight body, as set out in parts (a) and (b).***

### **Question 18**

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 listed entity auditors?

***Such procedures will not be necessary. I believe it will work out better if any standard setting committee of the HKICPA should contain a council member of FRC so that views of FRC can be heard.***

## **(E) Inspection**

### **Question 19**

Do you agree with the proposal to transfer statutory functions for conducting recurring inspections of listed entity auditors 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 (which are similar to the powers which HKICPA is equipped with under its practice review programme)?

***I agree to transfer the inspection functions of listed entity auditors in respect of their listed entity audit engagements from HKICPA to FRC in order to reinforce the independence of the listed entity auditor regulatory regime. However, there may be justification for the actual inspection work to be sub-contracted back to HKICPA to save costs and time.***

### **Question 20**

Do you agree that FRC's inspection programme should adopt the statutory procedures as set out in paragraph 6.14 with reference to the existing arrangements for HKICPA's practice review programme?

***I support the proposed arrangement.***

### **Question 21**

Do you agree that FRC may delegate its inspection functions and relevant powers to committees formed under its auspices?

***I have no strong view against the proposal for FRC to delegate some of its inspection functions and relevant powers to committees formed under its auspices, though it remains to be ultimately responsible and liable for any such functions or work delegated.***

### **Question 22**

What are your views on whether FRC should be allowed to delegate to HKICPA its functions and powers to inspect listed entity auditors 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?

***Please refer to the answers to Question 19 and Question 21.***

### **Question 23**

Do you agree that FRC reviewers should be given the proposed statutory powers as set out in paragraph 6.17 in relation to their inspections?

***I agree with the proposed inspection powers be given to FRC reviewers (and its delegated parties) the inspection powers set out on paragraph 6.17.***

#### **Question 24**

(a) 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?

(b) If so, do you agree that the provisions on such criminal offences should be modelled on the existing provisions in the FRCO concerning failure to comply with requirements in relation to an investigation into relevant irregularities?

***(a) Criminal offences should only confine to cases of persistent non-compliance.***

***(b) I agree to adopt the approach under the FRCO but I will definitely like to review and fine-tune such provision when the draft legislation is in place.***

#### **Question 25**

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 agree with the arrangement for HKICPA and FRC to share their inspection results with each other to facilitate better coordination of their inspection activities.***

## **(F) Investigation and Disciplinary Proceedings**

### **Question 26**

Do you agree that FRC should continue to be responsible for conducting independent investigations into relevant irregularities by listed entity auditors?

***I agree with the proposed arrangement.***

### **Question 27**

Do you agree that a disciplinary action may be imposed on a listed entity auditor, a person approved to be its audit engagement authorised person and/or a person approved to be its engagement quality control reviewer if the listed entity auditor and/or the person concerned (as the case maybe) is proved to have committed an irregularity in relation to an audit engagement?

***Please refer to the answer to Question 6.***

### **Question 28**

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 listed entity auditors with listed entities as required under the Listing Rules?

***I generally agree with this approach.***

## Question 29

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 chief executive officer (or equivalent) or, if appropriate, members of the practice unit's managing board of partners (or equivalent)?

***I do not agree that any liability would be extended to anyone other than the file engagement partner. I would like to know the justification for the Government to make such proposal. Please refer to the answer to Question 6.***

## Question 30

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 listed entity auditors, subject to the requirements for ensuring fairness and a due process as proposed in paragraphs 7.21 to 7.24?

***This is the crucial part of the regulatory reform. It is absolutely critical to have an independent tribunal to hear any cases brought by the independent oversight body, i.e. FRC.***

***The disciplinary process should be independent and also be seen to be so. Regulation of other service providers in the financial services industry and auditors of listed companies are two totally different concepts. It is inconceivable that there could be one model which can fit all.***

***The tribunal, completely independent from FRC, should maintain a small secretariat and employ experienced and legally qualified persons to be its chairman and deputy chairman.***



***For hearings to be dealt with effectively and efficiently, I would suggest that a disciplinary panel should comprise a chairman (who can be the chairman or deputy chairman of the tribunal) and two other members. The qualifications and background of the other two members can be decided at a later stage but should at least include one (or even two) accountants.***

***A panel of technical advisers from overseas should also be shortlisted to provide technical backup to the tribunal when required. The drawing of expertise from overseas can avoid potential conflict of interest.***

***Any appeal from the decision of the independent tribunal should be on a point of law and should go directly to the Court of Appeal.***

***The quantum of any fine which can be imposed by the tribunal will need to be looked into objectively and scientifically at a later stage.***

### **Question 31**

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?

***With reference to the answer to Question 30, the proposed independent tribunal should be empowered to exercise the range of disciplinary powers on a person subject to disciplinary action outlined in paragraph 7.27.***

### **Question 32**

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?

***No, the tribunal should be an independent judicial body and it should have the discretion to make decisions on cases prosecuted by FRC.***

### **Question 33**

Do you agree that any pecuniary penalty paid to or recovered by FRC would be paid by FRC into the Government general revenue?

***I agree that any pecuniary penalty imposed by FRC or the independent tribunal should go to the Government general revenue account.***

### **Question 34**

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 agree that FRC should be given the power to offer a resolution/settlement in order to rationalise the workload of the tribunal and to provide a chance for the auditor to avoid a full trial at the tribunal for less serious misconduct or offences.***

***If such resolution/settlement is accepted by the auditor, then there will not be any tribunal hearing. The settlement procedures and the range of resolution/settlement offers which can be made by FRC must be specified in the main body of legislation.***

### **Question 35**

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 agree with this approach.***

## **(G) Appeal Mechanism**

### **Question 36**

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?

***One of the objectives of establishing an independent tribunal which is independent from FRC is to enhance the independence of our audit regulatory regime. An independent tribunal should mitigate any chance of future appeal other than on a point of law.***

***In case of any disagreement with the decision of the independent tribunal, the parties to the appeal may make an application within the statutory time limit to state the case on a question of law and should go directly to the Court of Appeal, i.e. a new independent appeals tribunal is not required.***

***The proposed independent tribunal can also be vested with the authority for hearing appeals in respect of registration decisions by the HKICPA Registrar.***

**Question 37**

- (a) 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?
- (b) 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?

***Please refer to the answer to Question 36.***

**Question 38**

Do you agree with the composition of the independent appeals tribunal as proposed in paragraph 8.6, 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?

***Please refer to the answer to Question 30.***

**Question 39**

*Do you agree that the independent appeals tribunal may exercise the proposed powers as outlined in paragraph 8.7 in the review proceedings?*

***Please refer to the answer for Question 30.***

**Question 40**

Do you agree that sittings of the independent appeals tribunal should be held in public unless in the interests of justice it determines otherwise?

***Please refer to the answer to Question 30.***

**Question 41**

- (a) 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?
- (b) 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?

***Please see the answer to Question 30. The person to the appeal will make their appeal to the Court of Appeal direct in the first instance.***

## **(H) Funding Mechanism**

### **Question 42**

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) listed entity auditors 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 listed entity auditors?

***The Government should continue to contribute to the funding of FRC. If the Government is a contributing party, the budget of FRC should be approved by the Financial Secretary and the Finance Committee of the Legislative Council.***

***I agree that the annual costs of FRC can be shared by the various funding parties on a just and equitable basis. Any such allocation of the funding cost should be discussed in further detail by the various stakeholders.***

### **Question 43**

Do you agree that –

- (a) 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;
- (b) 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
- (c) the levy on listed entity auditors should be directly proportional to the number of listed entity audit engagements entered into by the listed entity auditors, and that the levy should be collected by the HKICPA Registrar on behalf of FRC?

***Please refer to the answer to Question 42.***

### **Question 44**

Do you agree that the three levies should be stipulated in subsidiary legislation subject to negative vetting by the Legislative Council?

***I agree with the proposed arrangement provided that the multi-level checks-and-balances measures described in the answer to Question 42 are put in place.***



#### **Question 45**

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 agree with the proposed arrangement.***

#### **(I) Governance of the Financial Reporting Council**

#### **Question 46**

*(a) 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 Chief Executive Officer 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?*

*(b) 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 agree with the proposed arrangement.***

#### **Question 47**

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 agree with the proposed arrangement.***