

By mail and email: rpirrlea@fstb.gov.hk

19 September 2014

Division 4, Financial Services Branch
Financial Services and the Treasury Bureau
15/F, Queensway Government Offices
66 Queensway
Hong Kong

Dear Sirs,

**Proposals to Improve the Regulatory Regime for Listed Entity Auditors –
Consultation Paper**

The Hong Kong Business Accountants Association (HKBAA) agrees in principle with the proposed objective of the reform and believes that the reform will maintain Hong Kong's position and reputation as a major international capital market.

In this letter, we only comment on the areas that may impact Business Accountants and do not provide responses to the specific consultation questions. Detailed below are our suggestion and disagreement on the governance structure, funding mechanism and composition of Financial Reporting Council (FRC) proposed in the Consultation Paper for your further consideration:

1. Independent listed entity auditor oversight body

The consultation paper proposes that the new regulatory regime would cover only the auditors of public interest entities, which is defined to cover “listed entity auditors” only. This scope of authority is much narrower than in



the scope of equivalent regulatory bodies in other major jurisdictions, many of which also cover auditors of unlisted public interest entities.

Furthermore, the Securities and Futures Commission (SFC) is the statutory body responsible for regulating the securities and futures market in Hong Kong. As the auditors of listed entities are just one of the market participants, we believe that synergy and efficiency could be better achieved if the regulation of listed entity auditors is parked with SFC which already has the effective governance structure in place. To provide additional regulatory powers to the FRC will not only create another layer of oversight body, but also add unnecessary burden to the listed entities and their business accountants.

2. Proposed funding mechanism

We do not agree with the funding mechanism proposed in the consultation paper. The consultation paper proposes that listed entities (through a statutory levy), investors (through a levy on securities transactions based on the modus operandi for the existing levy charged by the SFC) and listed entity auditors (through a levy on the listed entity auditors) should share the costs equally for the future operation of the independent oversight body. This will have the effects that the listed entities will bear the bulk of the additional regulatory costs – (i) the stock exchange levy and (ii) indirectly the levy on auditors as it is highly likely that the auditors would pass the additional costs on to the listed entities. In our view, under the users-pay principle, only the investors should bear these costs.

Although the consultation paper does not provide any indication of the likely annual operating costs of the oversight body, we expect that it will be significantly higher than the \$20 million currently incurred by FRC. As listed entities' compliance costs are already very high, we are of the view that the regulatory reform should not increase the burden of these entities. We note that as of 31 March 2014, the end of its last financial year, SFC had an



accumulated surplus of close to \$7.3 billion. This level of surplus, which has been built up mainly from transaction levies paid by investors, is sufficient to cover some five years of its gross overheads. We are aware that the transaction levy rate has been reduced from 0.003% to 0.0027% for securities transactions with effect from 1 April 2014, resulting in a reduction in levies of some \$102 million per annum assuming the value of transactions is the same as that recorded in 2013. We believe that the effect of this reduction in transaction levy rate will likely be offset by additional transaction levies from the Shanghai-Hong Kong Stock Connect, which is expected to be launched very soon.

We believe that the SFC, as the regulator of market participants, should be made solely responsible for the funding of the operation of the new regulatory regime, even if the new roles are to be assumed by FRC. This suggestion is based on the view that SFC is in essence sub-contracting its responsibility to regulate listed entity auditors to FRC.

3. Proposed composition and structure of the FRC

The consultation paper proposes that the new composition of FRC membership comprises not less than seven members appointed by the Chief Executive of the HKSAR Government plus the Chief Executive Officer. If it is decided that FRC will take up the new regulatory roles, we are of the view that the number of members should be more than the current number of 11, including the Chief Executive Officer, to cope with the heavier workload resulting from the significant increase in activities.

In the deliberation of cases, conflicted members are required to be excused. To ensure that there are sufficient non-conflicted members who possess knowledge of and experience in the auditing of Hong Kong listed entities, we would suggest that at least one quarter of the FRC members should have such



knowledge and experience, instead of two members as proposed in the consultation document. We also suggest that a further one quarter of the members should be drawn from business accountants who are experienced in risk management and the application of financial reporting standards. Business accountants are able to look at accounting, auditing and other issues from a business perspective and would help to facilitate the work of the FRC in discharging its new regulatory functions.

If you require clarification or additional information, please contact me at hkbaa2014@gmail.com.

Yours sincerely,

Wilson Fung

President HKBAA

About the Hong Kong Business Accountants Association

Founded in Hong Kong in early June 2014, the Hong Kong Business Accountants Association (HKBAA) is a professional group which focuses on serving accountants working in commercial and public organisations. It aims to advance the interest of business accountants and raise the concerns of its members to related authorities. The Association also provides a unique platform for members to enhance their professionalism and facilitate an exchange of views and information aimed at broadening their vision and strengthening their understanding of the Mainland market. Members of the Association work in various industries or in the public sector. Their organizations are operated by interests from Hong Kong, Mainland or overseas.

HKBAA is operated by Hong Kong Business Accountants Association Limited.