Financial Reporting Council  
29th Floor, High Block  
Queensway Government Offices  
66 Queensway  
Hong Kong  

By E-mail: reform@frc.org.hk  

Our reference: CKC/evw  

12 April 2019  

Dear Sirs  

Consultation Paper — Sanctions Guidelines  

We appreciate the opportunity to comment on the Consultation Paper from the Financial Reporting Council (FRC) on the proposed Sanctions Guidelines (“Guidelines”).  

We fully support the FRC’s development of the Guidelines to ensure that there is an effective system of sanctions to complement investigations and inspections by the FRC. We have considered all six questions in the Consultation Paper and our responses thereto are included in the Appendix to this letter.  

We also set out below our more significant comments on the Guidelines, which we believe would further enhance the transparency and aid understanding of the process which will help to ensure that it is fair to those subject to the Guidelines.  

1. **Discount for Admissions and Early Disposal**  
   
   Paragraph 66 states that “any adjustment will generally apply only to any pecuniary penalty to be imposed”. However we considered that the Guidelines have not fully articulated the rationale for only allowing adjustment to pecuniary penalty but not the “conditions to be imposed”.  

2. **Pecuniary Penalty on Individuals**  
   
   Paragraph 38(d) and 42 argues pecuniary penalty should vary positively with the financial resources and background of a responsible person in order to be a credible deterrent. Meanwhile, paragraph 44 opens to situation where pecuniary penalty imposed on responsible persons could be indemnified by insurers, a PIE auditor or employer. In our view, the possibility depicted in paragraph 44 undermines the argument in paragraph 42. Would it be simpler to take the individual financial resources out of the picture by linking pecuniary penalty solely to the relevant breaches and / or misconduct.  

3. **Maximum of Pecuniary Penalty**  
   
   Section 37D of the FRC (Amendment) Ordinance 2019 (“2019 Ordinance”) concerns sanctions for misconduct for PIE auditors and section 37E concerns sanctions for misconduct for registered responsible persons (defined to include (a) an engagement partner, (b) an EQCR; and (c) a QC system responsible person).
Under section 37D(3)(b)(iv) and 37E(3)(b)(iv) of the Amendment Ordinance, the FRC may order the PIE auditor and each of the registered responsible persons to pay a pecuniary penalty not exceeding the amount which is the greater of (A) $10 million or (B) 3 times the amount of the profit gained or loss avoided by the person as a result of the misconduct.

We are concerned that the potential combined effect of these two subsections of the 2019 Ordinance is that the FRC may impose a maximum pecuniary penalty of $40 million for a misconduct in relation to an engagement (ie. $10 million x 4 persons, being the PIE auditor, and the three registered responsible persons). This does not seem to be the general understanding of the accounting profession at the consultation and bills committee stages of the proposed Amendment Ordinance.

The FRC is asked to consider how the Guidelines may be revised to clarify the maximum level of pecuniary penalty which may be imposed by the FRC for a misconduct in relation to an engagement.

If you require any clarifications on our comments, please do not hesitate to contact Mr Clement Chan at 2218-8263 or Mr Stephen Chan at 2218-8231.

Yours faithfully

BDO Limited
BDO responses to the questions in the Consultation Paper

1. Do you agree with the FRC’s objectives of imposing sanctions as set out in paragraph 10? If not, please state the particular objective(s) that you do not agree with and the reasons for your disagreement.

   We agree.

2. Do you agree with the FRC’s approach to determining sanctions summarised in paragraph 19? If not, please explain any alternatives you would propose and the reasons therefor.

   We agree.

3. Have we included the sorts of factors (paragraphs 21 to 24) in the Sanctions Guidelines that you would expect the FRC to consider in assessing the nature and seriousness of the misconduct and determining the sanctions to be imposed? Are there any other factors you believe the FRC should take into account when determining the sanctions to be imposed?

   We agree.

4. Do you agree that the sanctions, including a pecuniary penalty, to be imposed by the FRC should act as an effective deterrent and be proportionate to the misconduct and have regard to all the circumstances of the case, including the financial resources of the regulated persons? If not, what would you propose? Please explain your rationale.

   Our comments are set out in the body of our letter.

5. Do you agree with the factors set out in paragraphs 37 to 43 that the FRC will normally take into consideration when determining the amount of a pecuniary penalty? If not, please explain any alternatives you would propose and the reasons therefor.

   Our comments are set out in the body of our letter.

6. Do you have any other comments on the Sanctions Guidelines that would help the FRC as an independent auditor regulator to protect the investing public and the public interest?

   Our comments are set out in the body of our letter.

Drafting comments

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<td>1</td>
<td>“regulated persons”, “senior management” These two terms appear throughout the Guidelines but they do not seem to be defined terms in the 2019 Ordinance nor in the Guidelines.</td>
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<td>2</td>
<td>Para 2 It would be useful to clarify: (i) who are the intended persons or body of persons other than the FRC who would discharge their respective responsibilities under the FRCO; and (ii) what are their respective responsibilities under the FRCO.</td>
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