17 April 2019

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

Dear Sirs

Financial Reporting Council Consultation Paper on Sanctions Guidelines
("Consultation Paper")

We appreciate the FRC's efforts in providing this sort of transparency about the proposed new sanctions regime. We believe that having comprehensive Sanctions Guidelines will prove helpful in practice for the FRC and PIE auditors in navigating disciplinary cases. In turn, this will help to build confidence in the process.

Our responses to the six questions in the Consultation Paper are set out in the Appendix to this letter.

If you have any questions, please do not hesitate to contact our Richard George at richgeorge@deloitte.com.hk.

Yours faithfully

[Signature]
Appendix

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 with the objectives of imposing sanctions as set out in paragraph 10. We also support the FRC in making clear in paragraph 11 that the primary purpose of imposing sanctions is not to punish, but to protect the public and the wider public interest.

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 that the approach set out in paragraph 19 for determining sanctions is appropriate. The sort of transparency in its decisions that the FRC contemplates in paragraph 20 is to be welcomed and should help to build confidence in the process.

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 are of the view that the factors in paragraphs 21-24 to be considered by the FRC in assessing the nature and seriousness of the misconduct and for determining the type of sanctions are comprehensive and generally appropriate.

Paragraph 22(c) gives examples of financial benefits derived or intended to be derived from the misconduct. We consider that, in practice, determination of penalties based on profit or loss will be difficult to reliably measure. The example given that "fees received by the regulated person" could equate to loss avoided or intended to be avoided seems flawed in that it does not take into account associated costs. Moreover, in the overwhelming majority of cases, we would expect that the irregularity would stem from an "honest mistake" where the auditor was not seeking to and did not gain any advantage. In these cases, the notion of profit gained or loss avoided does not seem meaningful.
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.

We do not disagree that sanctions including pecuniary penalties could act as a deterrent (subject to the comments set out in 5(i) below) and be proportionate to the misconduct. In our view, however, the greater deterrent effect will relate to the negative reputational effects of public sanction rather than the quantum of financial penalty.

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.

We consider that the factors that the FRC will normally take into account when assessing the amount of a pecuniary penalty are generally appropriate. We do, however, have the following comments:

(i) Paragraph 37 states that in determining the amount of a pecuniary penalty, the FRC aims for the penalty to be both proportionate to the misconduct and to act as a deterrent to future misconduct. Paragraph 61 further explains that the intention of sanction is not only to deter the regulated person who committed the misconduct but also the regulated person or other regulated persons from committing similar misconduct in future. Might circumstances arise where there is tension between these two aims? In the interest of fairness, in the first instance, should the aim of deterrence be subordinate to the aim of proportionality?

(ii) Paragraph 38(c) and (d) indicate that when assessing the amount of a pecuniary penalty, the FRC will take into consideration the size/financial resources and financial strength in the case of a PIE auditor, and financial resources and annual income, etc. in the case of a registered responsible person. Fairness would seem to dictate that, all things being equal, two equivalent cases of misconduct should attract the same level of penalty. It would seem to us that the reference to financial resources etc. should be to ensure that penalties do not result in financial hardship and not to try to calibrate penalties based on presumed ability to pay.
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?

Paragraph 19(e) refers to considering whether a "discount" for admissions or early disposal is appropriate. The FRC may want to revisit whether the terminology "discount" is used by other international regulators.