

Annual Investigation and Compliance Report

20 October 2022



Dr Kelvin Wong, SBS, JP

Chairman



Mr Marek Grabowski
Chief Executive Officer



- Provide insights on common areas of misconduct in the work of listed entity auditors and financial reporting non-compliance in financial statements of listed entities

- **For auditors**
 - pay attention to the findings and observations
 - take actions to address the findings and observations so as to improve audit quality

- **For Boards, management and audit committees of listed entities**
 - emphasize their responsibilities in relation to financial reporting
 - urge them to pay attention to our findings and observations and to uphold the quality of financial reporting

- The report covers our regulatory remit in relation to listed entities and their auditors
- From 1 October 2022, the investigative powers of the AFRC were expanded to cover all practice units and CPAs (i.e. **professional persons**)
- Expanded the team of professional staff and updated our operational processes and procedures

Ms Wincey Lam

Head of Investigation and Compliance



This report includes

- Overview of operations
- Our work for the year
- Findings and observations on auditing irregularities
- Findings and observations on financial reporting non-compliance

Public confidence in the AFRC to take regulatory actions

- Significant increase in the number of complaints received about potential misconduct of auditors or potential non-compliance with financial reporting requirements by listed entities (in particular, from whistleblowers and other regulators)

Enhanced transparency on our regulatory approach

- Announcements of initiation of investigations and enquiries with significant public interest

Refined approach regarding non-compliance with financial reporting standards

- Increased numbers of enquiries initiated to ensure financial statements preparers are held accountable for financial reporting non-compliance

MOU with other regulators and enforcement agencies

- New memoranda of understanding signed with other regulators and law enforcement agencies allow the AFRC to enhance our collaboration with other regulators, in particular, to synchronise the effort of the AFRC and other regulators in handling matters with mutual interest
- A joint operation with the ICAC were conducted involving a search of the offices of a PIE auditor and the premises of other relevant parties in an investigation (November 2021)

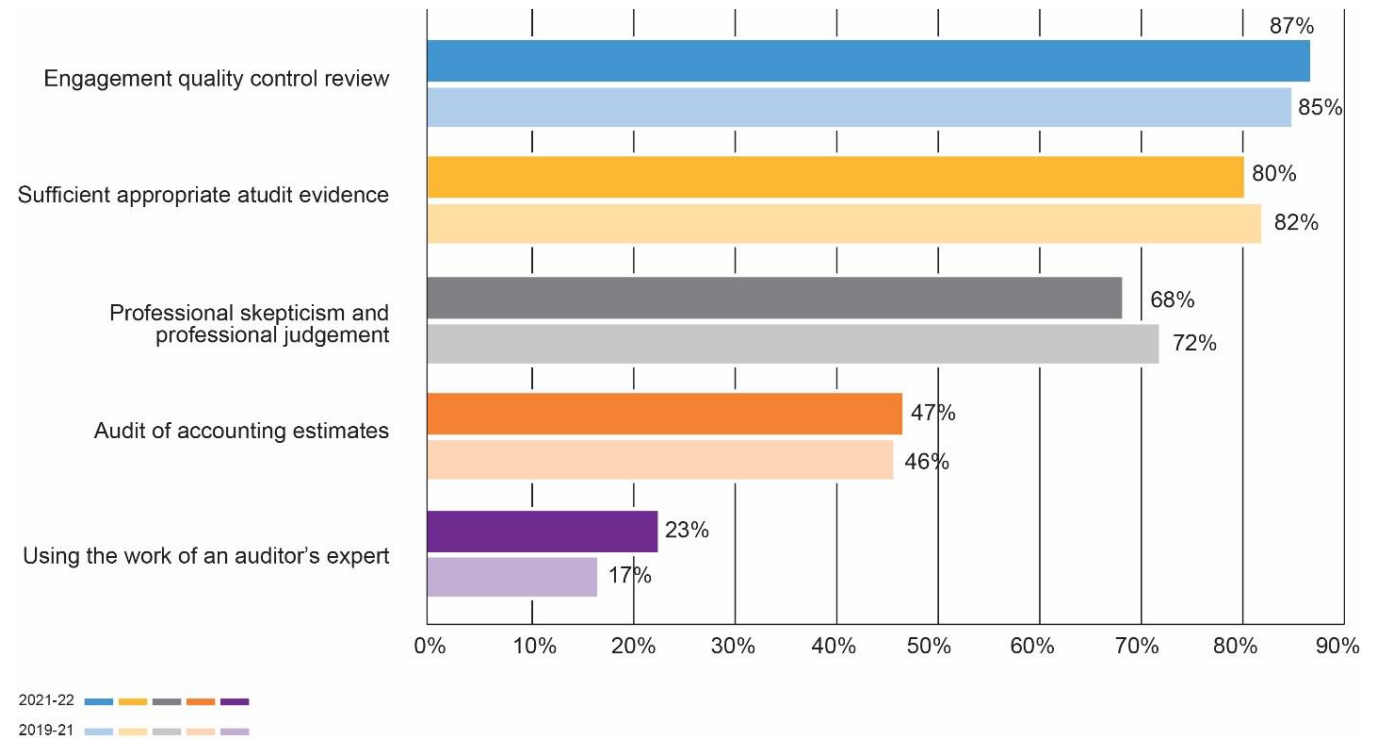
Cooperation with MOF regarding audit working papers located in the Mainland

- Collection of the second batch of audit working papers took more than one year which imposed inefficiency in the investigation process
- AFRC continues working with the MOF to enhance the efficiency of the process and to further strengthen the cross-boundary cooperation and collaboration with MOF and other Mainland authorities

Findings and observations on auditing irregularities

Common areas where potential or actual auditing irregularities were identified in the completed and ongoing investigations:

- Failure to perform the engagement quality control review adequately in respect of significant judgements made and conclusions reached by the engagement team
- Failure to obtain sufficient appropriate audit evidence on which to base the audit opinion
- Failure to exercise appropriate professional skepticism and professional judgement
- Failure to properly evaluate the reasonableness of accounting estimates and the adequacy of the work of the auditor's expert



Findings and observations on auditing irregularities

Examples of auditing irregularities in each of the common areas are:

- **Sufficient appropriate audit evidence**

- Auditor only relied on information provided in the discussion with management and did not obtain details and supporting evidence

- **Professional skepticism and professional judgement**

- Auditor did not maintain a questioning mind and perform a critical assessment of evidence needed to properly consider the presence of possible misstatements or fraud in the financial statements

- **Audit of accounting estimates**

- Auditor did not question the high annual growth rate assumed in the cash flow forecast provided by management

Findings and observations on auditing irregularities

- **Using the work of an auditor's expert**

- Auditor did not properly evaluate the work of the expert they engaged to evaluate the complex valuation process and the assumptions used in the valuation

- **Engagement quality control review**

- Engagement quality control reviewers failed their role as a “gate-keeper” to identify significant auditing issues before the audit opinions were issued

Findings and observations on financial reporting non-compliance

Examples of financial reporting non-compliances identified in completed and ongoing enquiries are:

- **Financial instruments**

- Credit losses of receivables were not properly estimated using the expected credit loss model required by the relevant accounting standards

- **Impairment of assets and fair value measurement**

- Valuation of the forestry operating rights did not take into account the adverse physical conditions of the relevant plantation areas

- **Going concern assessment and reporting**

- Failure to make explicit disclosures as to whether events and conditions that may cast significant doubt on the entity's ability to continue as a going concern existed

Auditors

- Consider the findings and observations and take actions to improve the performance of audits
- Ensure a robust audit approach to deliver high-quality audits, in particular, the application of HKSQM

Boards and Management of listed entities

- Primary responsibility for high-quality financial reporting
- Make sure there are sufficient and appropriately competent financial reporting resources and consider consulting appropriate experts

Audit committees

- Crucial role to hold management and auditors accountable for their respective roles in ensuring high-quality financial reporting and audits
- Proper oversight of the financial reporting process by challenging management's judgements made on significant financial reporting matters
- Sufficient and timely communication with the auditor on key issues of the audit

Q&A

