

## Completed enquiry and investigations

On 8 November 2018, the FRC adopted an enquiry report on the consolidated financial statements of a listed entity for the years ended 31 March 2009 to 31 March 2014 (**the Relevant Financial Statements**). The enquiry concerns the possible non-compliance with accounting requirements in respect of (i) the recognition and measurement of the preferred shares issued by a subsidiary of the listed entity; and (ii) the accounting for the remaining interest in the subsidiary after the issuance of the preferred shares.

In relation to the above accounting issues, the FRC had also adopted three investigation reports on the respective audits of the Relevant Financial Statements by three auditors on 1 February and 12 July 2018.

The details of the enquiry and the investigations are set out below:

### Background

In 2009, a wholly-owned subsidiary of the listed entity issued a number of preferred shares which reduced the listed entity's interest in it to less than 50%. The remaining interest in the investee was continuously accounted for as a subsidiary in the Relevant Financial Statements. Pursuant to the terms of the preferred shares, certain operating or financial decisions in relation to the subsidiary would require consent from the holders of the preferred shares. In addition, there were specified events that would cause the subsidiary to repay the preferred shares and all the accrued but unpaid dividends, whether or not declared. The preferred shares, including the conversion feature attached thereto, were recognised as equity instruments in the Relevant Financial Statements.

### Non-compliance with accounting requirements

As a result of the enquiry, it was found that:

- The preferred shares and the related dividends should have been accounted for as financial liabilities, rather than equity instruments, of the subsidiary in accordance with Hong Kong Accounting Standard (**HKAS**) 32 *Financial Instruments: Presentation* (**HKAS 32**).
- There is insufficient information available for Council to determine whether (i) the classification of the conversion feature in the preferred shares as an equity instrument complied with HKAS 32; and (ii) the accounting for the remaining interest in the subsidiary complied with HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 27 (Revised) *Consolidated and Separate Financial Statements* and Hong Kong Financial Reporting Standard 10 *Consolidated Financial Statements*, as appropriate.

Since the subsidiary had been deconsolidated from the listed entity's consolidated financial statements for the year ended 31 March 2016, there would be no future financial impact arising from the above issues. The FRC resolved not to require the listed entity to retrospectively correct the non-compliance identified above.

### Auditing irregularities

As a result of the investigations, it was found that the auditors failed to

- evaluate or properly evaluate the terms of the preferred shares issued by the subsidiary and whether the preferred shares and the related dividends had been appropriately accounted for in the Relevant Financial Statements; and
- evaluate whether the specific events as set out in the relevant agreements would affect the power of the listed entity to control the subsidiary and whether the accounting for the remaining interest in the investee as a subsidiary was appropriate.

The investigation reports have been referred to the HKICPA to determine if any disciplinary actions are warranted. Names of the relevant parties are withheld because of the potential disciplinary proceedings.

— End —

## **Note to editors**

### **About the FRC**

The FRC is a statutory body established in December 2006 under the Financial Reporting Council Ordinance. The FRC is entrusted with the statutory responsibilities to conduct independent investigations into possible auditing or reporting irregularities by auditors of listed entities and to enquire into possible non-compliance with accounting requirements by listed entities. The FRC has 11 members with a variety of professional backgrounds and the majority of whom, including the Chairman, are lay persons. For more information, please visit [www.frc.org.hk](http://www.frc.org.hk).

### **For media enquiries:**

Celian Cheung  
Corporate Communications Manager  
Financial Reporting Council  
Tel: (852) 2236 6025  
Fax: (852) 2810 6320  
Email: [celiancheung@frc.org.hk](mailto:celiancheung@frc.org.hk)