

Press Release

18 February 2022

FRC finds that an auditor failed to identify a material misstatement and to express an appropriate audit opinion

On 17 February 2022, the FRC adopted an investigation report finding that the auditor (**the Auditor**) of a listed entity (**Listed Entity**) failed to:

- (a) identify that an impairment loss on a receivable which had been fully impaired in 2014 was duplicated in the Listed Entity's consolidated financial statements for the year ended 31 December 2016 (**2016 Financial Statements**); and
- (b) express an appropriate modified opinion on the 2016 Financial Statements given the misstatement set out in item (a) above.

Under the transitional provisions of the amended FRC Ordinance, since the relevant audit was completed before 1 October 2019, the investigation report has been referred to the Hong Kong Institute of Certified Public Accountants to determine if any disciplinary actions are warranted. Names of the relevant parties are being withheld at this time to avoid prejudicing any related disciplinary proceedings.

The investigation was initiated in September 2018, following referrals by regulators in September 2017 and May 2018.

The misstatement in relation to impairment loss on a receivable

A subsidiary of the Listed Entity (**Subsidiary A**) had a receivable due from a former subsidiary of the Listed Entity (**the Receivable**). Since the Receivable was not considered to be recoverable, the Listed Entity recognised an impairment loss on the entire balance of the Receivable in 2014 by way of a consolidation adjustment. Due to an error, the Listed Entity recognised the impairment loss on the Receivable in Subsidiary A's individual financial statements for the year ended 31 December 2016 which were also consolidated into the 2016 Financial Statements.

The duplication of the impairment loss recognised on the Receivable resulted in an overstatement of the loss of the Listed Entity and a corresponding misstatement of the exchange reserve attributable to the translation of Subsidiary A's financial statements into the Listed Entity's presentation currency.

Subsequently, the Listed Entity reissued the 2016 Financial Statements with adjustments to correct the abovementioned misstatement.

The audit quality failure of the Auditor

The investigation revealed that the Auditor failed to:

- (a) identify the risk of material misstatement at the assertion level in relation to the exchange reserve and appropriately design and perform substantive procedures to test the accuracy of the exchange differences attributable to Subsidiary A; and
- (b) evaluate the appropriateness and accuracy of the consolidation adjustment in relation to the translation of Subsidiary A's financial statements.

As a result of the above failures, the Auditor drew an inappropriate conclusion that sufficient appropriate audit evidence had been obtained and that the 2016 Financial Statements as a whole were free from material misstatement. The Auditor also failed to express an appropriate modified opinion on the 2016 Financial Statements.

Accordingly, the engagement partner failed or neglected to observe, maintain or otherwise apply the fundamental principle of due care in the Code of Ethics for Professional Accountants.

Relevant technical standards

HKSA 330 The Auditor's Responses to Assessed Risks deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor.

HKSA 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) prescribes the requirement to obtain sufficient appropriate audit evidence on which to base the audit opinion on the group financial statements.

HKSA 700 Forming an Opinion and Reporting on Financial Statements prescribes the need for an auditor to evaluate in forming their audit opinion whether sufficient appropriate audit evidence has been obtained and whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

Code of Ethics for Professional Accountants is a guidance on ethics for professional accountants.

Our purpose in reporting publicly

The FRC announces the adoption of reports on audit investigations and enquiries into financial reporting of listed entities:

- (a) to promote continuous improvement in the quality of auditing and financial reporting by all our regulatees;
- (b) to encourage audit committee members to consider the implications of our findings for the financial reporting and audits of their own listed entities; and
- (c) to maintain public confidence in the system for independent auditor regulation.

END

About the Financial Reporting Council

The FRC is the full-fledged independent listed entity auditor regulator for Hong Kong committed to upholding the quality of financial reporting of listed entities of Hong Kong so as to enhance investor protection and strengthen investor confidence in corporate reporting.

For more information about the statutory functions of the FRC, please visit www.frc.org.hk.

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