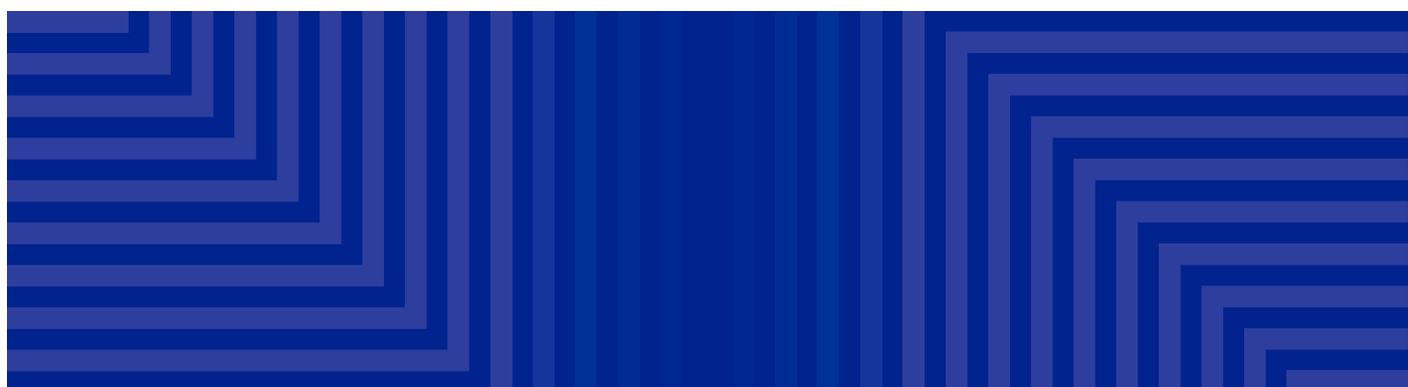


AFRC Quarterly Report

19 July 2023



Highlights

Transparency and accountability

- We published our [2022 Annual Inspection Report](#) to highlight key findings from our 2022 inspections and over our first three-year inspection cycle, and to set out our expectations for 2023 and beyond.
- We published our [2022-23 Annual Report](#) to keep the public informed about our regulatory focus and our continuing progress and achievements.

Regulatory collaboration and thought leadership

- We enhanced relationships with other regulators to enable deeper collaboration through duty visits and attending international regulatory meetings including the IOSCO Annual Meeting 2023.
- We provide thought leadership to the accounting profession by participating and speaking at various industry events and engaging with professional bodies.

All the details can be found as you turn the pages of this quarterly report.

Transparency and accountability

2022 Annual Inspection Report

On 11 July 2023, we published our [2022 Annual Inspection Report](#) (Report). The Report provides an overview of our Inspection work in 2022 and our first three-year inspection cycle (2020-22 Cycle). It highlights our key findings from the 2022 inspections and trends in our findings over the 2020-22 Cycle. This includes the major common deficiencies in the engagement performance and systems of quality control of practice units, and our observations on the effectiveness of their root cause analysis (RCA) and remediation planning and execution. Based on our findings, we give directional guidance to practice units for further improvement and set out our expectations of all stakeholders to uphold the quality of audits and financial reporting.

Engagement inspections

In our 2022 inspections of PIE auditors, we continued to increase the number of PIE engagements inspected, began to implement inspections of non-PIE engagements of Category A PIE auditors for regulated entities, and conducted follow-up inspections of non-PIE practice units transferred to us by the HKICPA under the transitional arrangements. Our 2022 inspections covered all Category B and C PIE auditors not previously inspected by us.

We also increased our work on RCA and remediation work by PIE auditors and brought forward inspections of Category B and C PIE auditors (which are not inspected annually) where we had identified very significant deficiencies in previous inspections. In view of our growing concerns over risks to audit quality arising from a surge in the number of late changes of auditors, we also implemented proactive measures and took direct action to ensure all PIE auditors understood our concerns and the need to address them.

Based on our 4-point scale of audit quality ratings (from 1 to 4, where 1 is good and 4 requires significant improvement), the average audit quality ratings of the PIE engagements we inspected for 2022 was 2.8 (2020: 3.1).

Overall, across the 2020-22 Cycle, improvement was mainly attributable to consistent progress in improving audit quality by 4 Category A PIE auditors. However, even for these firms, there is a need for further improvement.

The average audit quality ratings of PIE engagements of Category B and C PIE auditors inspected for the first time in 2022 was 3.4. This is broadly consistent with the results of the 2021 and 2020 inspections of PIE engagements by these categories of PIE auditor. With 90% of their engagements rated 3 or 4, the position is unsatisfactory.

In our 2022 PIE engagement inspections, we continued to identify common inspection performance deficiencies in nine key areas of audit work on PIE engagements. Of these nine areas, three have a persistently high incidence of deficiencies, three have increasing incidence and three are improving with a reduced incidence. The three areas of persistent incidence are audit work on journal entry testing and on the application of accounting standards for the recognition and measurement of revenue and expected credit losses on financial instruments. These deficiencies have been highlighted in our previous inspection reports, publications and webinars for PIE auditors and they urgently need to pay attention to their root causes and take action to address them.

We also identified deficiencies in six non-PIE audit and compliance assurance engagement inspections of Category A firms for 2022. The common deficiencies in these firms' non-PIE audit engagements were consistent with those in their PIE engagement inspections. The deficiencies in their compliance assurance engagement inspections were mainly related to compliance by the regulated entities with requirements for annual renewal of standing authorities from their clients for receiving and holding client money, and the testing of the reliability of information provided by the regulated entities.

Inspections of systems of quality control

Our Report summarises good practices we observed relating to the systems of quality control of Category A firms, which other auditors could consider adopting to strengthen their policies and procedures in enhancing audit quality. In 2022, we found significant deficiencies in relation to controls over the acceptance and continuance of client relationships and specific engagements (A&C) and over engagement performance for two Category A firms which achieved no substantive improvement in their audit quality ratings over the 2020-22 Cycle. 4

The common deficiencies in the systems of quality control of Category B and C firms are largely consistent between the different batches of these categories of firms inspected in each year of the 2020-22 Cycle. A&C is an area requiring immediate attention and improvement, given that the number of Category B and C firms with deficiencies found in this area increased substantially from 33% in 2020 to 71% in 2022.

In 2022, we also identified instances where the auditors violated the independence rules under the Code of Ethics for Professional Accountants, for the first time during the 2020-22 Cycle. This raised concerns over the auditors' objectivity in performing the audits.

Remediation plans and RCA

A comprehensive and effective RCA is essential for a firm to identify the underlying causes of audit deficiencies and establish appropriate remedial actions and measures to prevent them from recurrence.

We summarise in the Report both the common deficiencies and good practices of firms we observed in their performance RCA. We also emphasise the importance of performing real-time reviews on the remediation plans and assigning a designated person to confirm that the remedial actions are effectively implemented in improving audit quality.

Our expectations and actions

We urge auditors to take immediate action to robustly address our findings in the 2020-22 Cycle and prevent them from occurring or re-occurring in their engagements and systems of quality control.

We will continue to take proactive measures, including refining our inspection focus areas where needed, closely monitoring and taking direct action to address risks to audit quality arising from late changes in auditors, and increasing the frequency of inspection of practice units with significant quality issues, to uphold the audit quality of the profession in our second inspection cycle from 2023 to 2025.

The Report sets out our inspection approach for the 2023-25 Cycle, our guidance to auditors on the key aspects of the audit. It also emphasises the respective roles of auditors, directors and audit committees of listed entities and sets out our expectations of all stakeholders in upholding the quality of audit and financial reporting.



Dr Kelvin Wong, Chairman (right) and Ms Janey Lai, Head of Inspection (left) of the AFRC present to media the 2022 Annual Inspection Report.

2022-23 Annual Report published

On 23 June 2023, we published the [AFRC 2022-23 Annual Report](#). Our report provides transparency and enables public accountability about our strategies, progress and achievements in delivering effective regulatory outcomes. The Report presents the AFRC's major accomplishments during the year. These include monitoring market developments and identifying and combating market misconduct. We do this through the exercise of our powers under the AFRC Ordinance, and by taking proactive measures (including guidance and engagement) and direct action to influence the mindset and behaviour of our regulatees and educate the market about good practices in corporate governance to uphold the quality of financial reporting and audit.

Highlights included:

- Inspected 26 listed entity audit firms, 55 listed entity audit engagements and 6 non-listed entity audit engagements
- Received 185 pursuable complaints and referrals
- Initiated 72 investigations and completed 8
- Initiated 17 enquiries and completed 2
- Approved 7,077 new and renewal applications for registration of practice unit, 79 new and renewal applications for local PIE auditor, 60 new and renewal applications for overseas entities
- Reviewed 4 Hong Kong Institute of Certified Public Accountants (HKICPA)'s periodic reports and observed 27 HKICPA committee meetings

The Report has been tabled at the Legislative Council on 5 July 2023.

Regulatory collaboration and thought leadership

A strategic focus of the AFRC is to strengthen collaborations with other regulators to enhance the effectiveness of collective regulatory outcomes. We also engage with professional bodies for accountants and other market participants to disseminate our thought leadership and positively influence market behaviour.

Visit to PRC's Ministry of Finance and CSRC in Beijing

In April 2023, an AFRC delegation comprising representatives from the Inspection Department, Policy, Registration and Oversight Department, and Investigation and Compliance Department paid a three-day visit to Mainland authorities in Beijing.

During the visit, the AFRC delegation met with representatives from Mainland regulatory authorities and a professional body, including the Supervision and Evaluation Bureau and the Accounting Regulatory Department of the Ministry of Finance (MoF) of the People's Republic of China, the China Securities Regulatory Commission (CSRC) and the Chinese Institute of Certified Public Accountants.

The AFRC and Mainland regulatory authorities exchanged information on their respective recent regulatory focus and key regulatory challenges during the meetings. We discussed with the Mainland regulatory authorities our concerns about the issue of late auditor resignations in Hong Kong and sought their views on handling similar issues in Mainland China. Both parties agreed to explore ways to collaborate to address this issue.

In addition, due to the significance of Mainland Enterprises listed on the Hong Kong stock market and increasing cooperation between the audit firms in Hong Kong and those in Mainland China, both the AFRC and Mainland authorities recognised the need for more extensive collaboration on inspection to further enhance cross-border regulatory efficiency and effectiveness.

Leveraging on the current regulatory collaboration with the MoF, the AFRC further discussed and worked with the MoF to explore ways to enhance cooperation on information sharing and expedite the process of retrieving audit working papers located in Mainland China for investigation purposes.

The visit not only strengthened mutual understanding of the regulatory approach in Mainland China and Hong Kong, but also paved the way for the AFRC to establish a more comprehensive cooperation mechanism with the Mainland authorities.



The AFRC delegation paid a three-day visit to Mainland authorities in Beijing.

Meeting with ACCA

On 9 May 2023, we received Ms Helen Brand, the Chief Executive of the Association of Chartered Certified Accountants (ACCA), and her Greater China and Hong Kong leadership team. We discussed global megatrends shaping the accounting profession, such as the mainstreaming of sustainability reporting and the growing importance of technology in all aspects of the profession. We also exchanged views on challenges faced by the accounting profession, such as increasing public expectations on the profession and perceptions about its attractiveness by graduates.



AFRC meets with ACCA to discuss the megatrends shaping the accounting profession and the challenges that the profession is facing.

Courtesy visit of Mr Keith Giang, Deputy Secretary for Financial Services and the Treasury

On 17 May 2023, Mr Keith Giang, recently appointed Deputy Secretary for Financial Services and the Treasury (Financial Services) paid a courtesy visit to the AFRC. Mr Giang met with the Chairman and the Management of the AFRC who briefed him on the latest developments, work progress and challenges of the AFRC since the implementation of the Further Reform of the accounting profession.



Mr Keith Giang, Deputy Secretary for Financial Services (fifth from the right) pays a courtesy visit to the AFRC.

Attending the IOSCO Annual Meeting 2023

As an affiliate member of the International Organization of Securities Commissions (IOSCO), the AFRC's delegation attended IOSCO's Annual Meeting held in Bangkok from 13 to 15 June 2023 which was hosted by SEC Thailand.

As the audit regulator of an international financial centre, the AFRC recognises the importance of not only local but also global cooperation among our regulatory partners and international stakeholders, for the benefit of investors globally. We have an important regulatory interest in the work of IOSCO, especially in areas relating to financial and corporate reporting and audit quality. For this reason, we have joined IOSCO as an affiliate member.

Our delegation consisted of our Head of Inspection Ms Janey Lai, Head of Discipline Ms Hester Leung, Head of Policy, Registration and Oversight Ms Mary Leung, Head of Legal Department Mr Alfred Chan and Director of Investigation and Compliance Mr Andrew Ng. As it was AFRC's first attendance at a physical Annual Meeting since it joined IOSCO, Mr Alfred Chan gave a speech introducing the AFRC to the meeting of the Affiliate Members Consultative Committee (AMCC) which has a membership of 74 organisations from around the world.

In addition to the AMCC meeting, our delegates attended four regulatory workshops on crypto-assets regulation, sustainability reporting standards, the use of technology in market supervision and the building of central counterparties in emerging markets. These workshops provided updates and the latest information on the regulatory topics.

Our delegation also took the opportunity to meet with our regulatory counterpart in SEC Thailand, Ms Areewan Aimdilokwong, Assistant Secretary-General (Accounting and Auditing) and discussed and exchanged views on matters of mutual interest in the regulation of audits of listed companies. Our team also met and connected with delegates from regulators and stakeholders from other countries both during the official meetings and at the social events organised by the host.



From left: Director of Investigation and Compliance Mr Andrew Ng, Head of Policy, Registration and Oversight Ms Mary Leung, Head of Legal Department Mr Alfred Chan, Head of Inspection Ms Janey Lai and Head of Discipline Ms Hester Leung attend the IOSCO Annual Meeting.

Courtesy visit of CSRC

On 16 June 2023, a delegation of the China Securities Regulatory Commission (CSRC) paid a duty visit to the AFRC and met with our Chairman Dr Kelvin Wong and the Management team. During the meeting, we introduced our mission and statutory functions to the delegates and exchanged views on the latest development of the capital markets and audit markets in Mainland China and Hong Kong. We also discussed the recent focus of regulatory actions and challenges encountered and explored ways to enhance cross-border regulatory collaboration.



A delegation of the CSRC paid a duty visit to the AFRC in June.

Courtesy visit of ISCA

On 19 June 2023, we received Mr Teo Ser Luck, the President of the Institute of Singapore Chartered Accountants (ISCA), and his team. During the meeting, we shared an understanding of the regulatory environment and accounting landscape in both Hong Kong and Singapore, and the importance of the capital markets in driving growth and innovation in the accounting profession. We also exchanged ideas on how to attract and retain top talent in the industry and explored the potential use of artificial intelligence to promote the accounting profession.



AFRC exchanges ideas with ISCA of Singapore on the regulatory environment and accounting landscape in Hong Kong and Singapore

Supporting CPA Sports Carnival 2023

As one of the supporting organisations, the AFRC showcased our passion, energy and 'One Team One Culture' spirit at the inaugural CPA Sports Carnival 2023 co-hosted by the Hong Kong Institute of Certified Public Accountants and the Society of Chinese Accountants and Auditors on 7 May 2023.

Dr Kelvin Wong, Chairman of the AFRC was invited as a Guest of Honour to witness the grand march-in of the Carnival participants. The staff of the AFRC rendered their full support to the event and participated in various races including tug-of-war, 1500-m running, plank and the 400-m relay, in which the Chairman ran the second leg. Staff also brought their families there to have fun at the game booths.



The AFRC showcases its 'One Team One Culture' spirit at the inaugural CPA Sports Carnival 2023

Speaking at webinars to promote guidelines on selecting auditors and setting audit fees

The consequences of having a subpar audit can be substantial, especially when audits fail to probe going concern assumptions rigorously or identify and pay attention to indicators of fraudulent behaviour that give rise to risks of material misstatement of the financial statements and may cause a company's collapse. Hence, the selection of suitable auditors and the setting of audit fees are critical issues of corporate governance and require the attention of management, audit committees, boards, and investors.

To raise awareness and deepen the understanding of these issues, we delivered an overview of AFRC's guidelines on selecting auditors and setting audit fees at four webinars held by different professional bodies and associations, namely CPA Australia, the Hong Kong Chartered Governance Institute (HKCGI), the Hong Kong Securities and Investment Institute (HKSI) and the Society of Chinese Accountants and Auditors (SCAA) in May and June 2023.

Our webinars attracted approximately 1,100 attendees and were packed with lively panel discussions with investors, independent directors, audit committees, management of listed companies, and auditors. We exchanged views on a range of topics, including the reasons behind static audit pricing, our collective vision for a quality audit, and our concerns about late auditor resignations.

Overall, our webinars successfully raised awareness and deepened the understanding of our attendees on the practical recommendations put forth by the AFRC's guidelines. We will continue to amplify our messages and drive positive behavioural changes, which will, in turn, reinforce our pursuit of promoting the healthy development of the profession.

Financial Reporting Review Panel appointments

Quality financial reporting is the bedrock of the effective functioning of the financial market and the source of public confidence in listed entities. Members of the Financial Reporting and Review Panel (the Panel) play a significant role in conducting enquiries into possible non-compliance with accounting requirements in the financial reports of listed entities and making recommendations to the Board of the AFRC on the removal of non-compliance identified.

On 7 July 2023, a new convenor, Mr Ernest Lee, was appointed and two members, Professor Hung Ming-yi and Professor Wang Xin were reappointed to the Financial Reporting Review Panel (FRRP). Meanwhile, Professor Gu Zhaoyang and Professor James Ohlson retired as members of the FRRP after 3 years of dedication to supporting the AFRC in conducting enquiries effectively. The AFRC welcomed the newly appointed convenor and reappointed members and expressed heartfelt gratitude to the retired members for their contributions to the Panel.

AFRC has moved to Two Taikoo Place

To cater for the manpower needs of our expanded roles as the independent regulator of the accounting profession, AFRC's headcount is being progressively increased. As such, additional office space is required to accommodate the anticipated increase in staff.

On 10 July 2023, the AFRC moved to Two Taikoo Place in Quarry Bay. The new office is characterized by its modern and open design to maximise the effective use of space. There are also ample common areas to enhance transparency, communication and efficiency. A better working environment will also facilitate the AFRC to attract and retain talent.

Our new address: 10/F, Two Taikoo Place, 979 King's Road, Quarry Bay,
Hong Kong



Contacts



If you have any enquiries or comments, please feel free to contact us.

Accounting and Financial Reporting Council

10/F, Two Taikoo place,
979, King's Road,
Quarry Bay, Hong Kong

T: (852) 2810 6321

F: (852) 2810 6320

E: general@afrc.org.hk

W: afrc.org.hk

Copyright © 2023 Accounting and Financial Reporting Council