

## Press Release

16 December 2021

### **FRC issues Guidelines for Effective Audit Committee and Report on Assessment of the HKICPA's Performance of the Specified Functions**

The Financial Reporting Council (FRC) today issues [Guidelines for Effective Audit Committees – Selection, Appointment and Reappointment of Auditors](#) (the Guidelines) and the FRC's second Report on its [Assessment of the HKICPA's Performance of the Specified Functions](#) (the Oversight Report).

Mr Marek Grabowski, CEO of the FRC said, "The role of Audit Committees in overseeing the financial reporting process is a cornerstone of the governance process of listed entities to ensure the quality of the financial statements and the audit of these financial statements. The Audit Committees have a duty to recommend for Board approval the appointment and reappointment of the auditor. Therefore, we urge Audit Committees to adopt and implement the Guidelines, which set out key considerations that should be taken into account in making their recommendations to the Board."

"The Oversight Report includes findings from both our evaluation of the policies and procedures established by the HKICPA for the performance of the specified functions and our assessment of their performance, together with our recommendations for improvements. Given the timing of our assessment, it will take more time for the HKICPA to fully address some of our prior year recommendations. We will therefore continue to monitor progress in addressing these and our new recommendations. We welcome the constructive engagement by the HKICPA that we experienced in our assessment and acknowledge the HKICPA's cooperation in facilitating our work."

Dr Kelvin Wong, Chairman of FRC remarked, "In fulfilling our mission to uphold the quality of financial reporting of listed entities so as to enhance protection for investors, the FRC goes further than just effectively discharging our statutory functions. Through our non-statutory Policy and Governance functions, we aim to identify key issues, share insights and make recommendations about the pivotal role of good governance in supporting high quality financial reporting and audits of listed entities."

"The Guidelines should enable audit committees to adopt best practices in selecting quality auditors that will enhance the quality of corporate reporting and the entire financial reporting ecosystem," continued Dr Wong.

#### Highlights of the Guidelines

The Guidelines highlight two key factors that audit committees should consider in selecting and appointing auditors – audit quality and audit fees.

Audit quality should be the key determinant when reappointing an incumbent auditor or selecting an auditor. When evaluating audit quality, audit committees should consider audit firm's governance and leadership, compliance with relevant ethical requirements, industry knowledge and technical competence, engagement performance, communication and interaction with the audit committees, and internal and external inspections and regulatory outcomes. When reappointing an incumbent auditor, the audit committees should also consider the effectiveness of their previous audits.

The Guidelines emphasise the importance that audit fees are not at a level that would compromise audit quality. Audit committees should be satisfied that audit firms will allocate sufficient resources with appropriate expertise and experience to enable the audit to be performed in accordance with professional standards and applicable legal and regulatory requirements. They should also challenge audit firms charging lower audit fees compared to the incumbent auditor or competing firms and be satisfied that the audit firm does not intend to rely on obtaining additional or higher margin non-audit services to subsidise their costs of the audit.

A proper tender process should encourage competition and stimulate innovation. It also ensures a transparent and fair selection process. Therefore, the FRC recommends that audit committees consider conducting audit tenders periodically. The Guidelines outline the key stages of an audit tender process and provide guidelines on how to run an effective audit tender.

In addition, the Guidelines outline some key issues and procedures that audit committees should consider or perform when auditors resign or when audit committees are considering whether to remove the auditor.

Ms Florence Wong, Deputy CEO and Head of Oversight, Policy and Governance said, "Audit committees are expected to put these guidelines into practice. The FRC will collaborate with other regulators to promote the active adoption of these guidelines by audit committees and engage audit committees and other stakeholders on these Guidelines."

### Highlights of the Oversight Report

This year, the FRC assessed the HKICPA's performance of the specified functions from 1 April 2020 to 31 March 2021, and assessed the follow-up actions taken by the HKICPA in response to our recommendations from the first assessment.

Four of our nine recommendations from last year were satisfactorily followed up by HKICPA. While policies and procedures had also been developed by HKICPA to address four other recommendations from our first assessment, we found that there was room for improvement in terms of their effectiveness. We, therefore, made

additional recommendations in the Oversight Report to re-address those recommendations from last year. Regarding the remaining finding and recommendation on prescription of specific continuing professional development requirements for registered PIE auditors, for which no follow-up actions had been taken, we have repeated and strengthened this recommendation in the Oversight Report. In addition, we have made three new recommendations based on the findings from our second assessment. We will continue communicating with the HKICPA to ensure satisfactory resolution of the issues identified.

Ms Florence Wong said, “The HKICPA is addressing our recommendations and we will continue to engage with them to ensure satisfactory resolution of the issues identified.”

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Dr Kelvin Wong, Chairman (middle), Mr Marek Grabowski, CEO (right), and Ms Florence Wong, Deputy CEO and Head of Oversight, Policy and Governance of the FRC present to media the Guidelines for Effective Audit Committee and Report on Assessment of the HKICPA's Performance of the Specified Functions.

## **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](http://www.frc.org.hk).

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