

Press Release

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AFRC calls for concerted efforts to improve the quality of financial reporting and audit in Hong Kong

The Accounting and Financial Reporting Council (**AFRC**) today publishes its report [*Roundtable Discussion on Audit Quality and Climate-integrated Audits in Hong Kong*](#). The report summarises insights gathered from roundtable discussions with investors, members of audit committees, and auditors of listed companies. The discussions focused on audit quality of Hong Kong listed companies and the threat posed to them by stagnation of audit fees and opportunistic changes of auditors. The discussions also covered current limitations of climate-integrated financial reporting and audit in Hong Kong and the need for independent assurance of sustainability reporting. The report presents a three-prong call to action for these stakeholders to foster better quality of financial reporting and audit.

Audit quality: its importance, definition and determinants

The report notes that although all participants agree on the importance of high-quality audit, the understanding of what audit quality is varies. Some companies not only equate it to the quality of service an auditor provides, but often prioritise it over audit quality when appointing auditors. The report points out the need for thorough understanding of the benefits of high-quality audits and what audit quality entails among audit committees and auditors. It calls for greater transparency around auditor selection and the audit process, which will allow investors to make informed decisions.

The report also points out that the right “tone at the top” at the audit firm is a prerequisite for a quality-focused mindset and high audit quality. However, this notion does not resonate deeply among auditor participants and requires ongoing emphasis.

The perils of stagnant audit fees: how price wars and a compliance-driven mindset threaten audit quality

The report attributes the observed decade-long stagnation of audit fees for listed companies in Hong Kong, which have not kept pace with inflation, to an intense price war among audit firms. This has been exacerbated by listed companies’ perception of audit as a mere compliance requirement and auditors’ inability to successfully convey the value of quality audit. The long-term fee stagnation threatens audit quality, as it may force audit firms to stretch their staffing resources, reduce investments in staff retention, technology, and training. It may also force audit firms to rely on revenue from non-audit services, which may undermine the auditor’s independence.

The threat to audit quality stemming from instances of opportunistic changes of auditors

The report also discusses the phenomenon of companies changing auditors to save on audit fees and changes of auditors taking place late in the reporting period. It stresses that any opportunistic auditor changes should be scrutinised as they may signify prioritising cost cutting to the potential detriment of audit quality, “opinion shopping”, or an attempt to avoid addressing unresolved audit issues. Such behaviour is enabled by audit committees that are not sufficiently independent of the company’s management to properly safeguard the quality of financial reporting and audit.

The current limitations of climate-integrated financial reporting and auditing in Hong Kong, and the need for independent assurance of sustainability reporting

Hong Kong investors pay increasing attention to climate-related and sustainability risks of companies they invest in. However, they consider the current state of climate-integrated financial reporting and auditing in Hong Kong is inadequate for assessment of such risks. In addition to calling for better disclosures of climate-related risks, the roundtable participants agreed that the reliability of sustainability reporting would be enhanced by independent sustainability assurance.

Ms Janey Lai, CEO of the AFRC said, “The roundtable discussions provided valuable insights for the AFRC to better understand the perceptions of stakeholders regarding factors that impact audit quality, and to develop meaningful guidance. A concerted effort of auditors, members of audit committees and investors is needed to boost the awareness of the importance of high-quality audit, as well as to improve overall audit quality. Setting the right tone at the top at the audit firm is a prerequisite to nurturing a quality-focused culture.”

The AFRC urges stakeholders to take the following actions addressing critical areas of concern:

PIE auditors should:

- Demonstrate a commitment to audit quality through adherence to professional standards, robust planning, commitment to addressing outstanding audit issues, open communication with audit committees and being transparent to them about inspection findings, and making informative disclosures when resigning from an engagement.
- Ensure sufficient audit fees are charged at a level that allows the allocation of adequate resources for audit engagements, enabling long-term viability of the business through talent management and investment.

Audit committees should:

- Safeguard the financial reporting and audit quality: Prioritise audit quality when selecting auditors, facilitate the negotiation of adequate audit fees, preserve the auditor's independence, monitor audit execution, proactively resolve any disagreements between the auditor and management and prepare for climate-integrated financial reporting and sustainability reporting.

Investors should:

- Drive high quality and reliable financial reporting: Be vigilant for red flags signifying possible issues with audit quality, express concerns about changes of auditors, audit fees and the auditor selection process and demand that investee companies accurately reflect climate-related factors in their financial reporting.

Ms Tracy Wong, Acting Head of Policy, Registration and Oversight, concluded, "Given that audit quality is a complex topic, initiating discussions to address the importance of audit quality is of utmost importance. Stakeholders are keen to unmask and address threats to the sustainable development of the financial reporting and audit ecosystem. Maintaining close and timely communication with various stakeholders will always be key to the efforts of the AFRC to better understand the market. This will not only shape the AFRC's future policies and regulatory initiatives but also contribute to the continuous improvement of audit quality, benefiting all stakeholders."

End

About the Accounting and Financial Reporting Council

The Accounting and Financial Reporting Council (AFRC) is an independent body established under the Accounting and Financial Reporting Council Ordinance. As an independent regulator, AFRC spearheads and leads the accounting profession to constantly raise the level of quality of professional accountants, and thus protects the public interest.

For more information about the statutory functions of the AFRC, please visit www.afrc.org.hk.

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