Financial Reporting Council
財務匯報局

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Press Release

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FRC concludes that a listed entity failed to recognise an impairment loss on equity investments and its auditor failed to identify the misstatements

The FRC adopted an enquiry report and an investigation report, which found that:

(a) a listed entity (**Listed Entity**) failed to recognise an impairment loss on the available-for-sale equity investments (**the Investments**) in the consolidated financial statements for the year ended 31 December 2016 (**2016 Financial Statements**); and

(b) the auditor (**the Auditor**) of the Listed Entity failed to identify the material misstatements in relation to the impairment of the Investments in the 2016 Financial Statements.

In light of the findings of the enquiry, on 15 December 2021, the FRC required the Listed Entity to remedy the inclusion of the materially misstated impairment loss of the Investments information in market disclosures about the Listed Entity by retrospectively adjusting the impairment loss recognised in the relevant years as disclosed in the financial summary of the latest annual report to be issued.

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 January 2019, stemming from the financial statements review programme in April 2018. The enquiry was subsequently initiated in April 2021.

The material misstatement in relation to the impairment of the Investment made by the Listed Entity

Hong Kong Accounting Standard (**HKAS**) 39 *Financial Instruments: Recognition and Measurement* (**HKAS 39**) was the applicable financial reporting standard at the material time.

HKAS 39 requires an entity to recognise an impairment loss on available-for-sale equity instruments if there is objective evidence of impairment. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is an objective evidence of impairment. Either a significant or a prolonged decline is sufficient to require the recognition of an impairment loss. The determination of what constitutes a significant or prolonged decline is a matter of fact that requires the application of judgement.

The Investments were measured at fair value based on the quoted market price of the investees' shares. The fair values of each of the Investments as at the end of the reporting period had declined below their original cost by between 45% and 70%.

The declines in the fair values of each of the Investments were significant which was objective evidence of impairment under HKAS 39. The Listed Entity failed to record an impairment loss on the Investments in the 2016 Financial Statements as required when the decline in fair values is either significant or prolonged.

The Listed Entity also failed to provide disclosure about the judgement it made in determining the existence of objective evidence in the 2016 Financial Statements in accordance with HKAS 1 and HKFRS 7 (see below).

The audit quality failure of the Auditor

The Auditor failed to identify the above material misstatement and therefore issued an inappropriate unmodified audit opinion. The failure to identify the material misstatement occurred because the Auditor failed to properly interpret or apply the applicable financial reporting standard in evaluating the Listed Entity's accounting treatment of the impairment assessment of the Investments, and to exercise appropriate professional judgement in evaluating what constituted a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

The engagement quality control reviewer also failed to adequately perform an objective evaluation of the judgement made in relation to the accounting treatment of the impairment assessment of the Investments and the conclusion reached by the engagement team on this matter. As a result, the engagement quality control reviewer also did not identify the material misstatement.

Relevant technical standards

HKAS 39 establishes principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

HKAS 1 prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. It also prescribes the disclosure requirements for the judgment that the entity has made which have significant effect on the amounts recognised in the financial statements.

HKFRS 7 prescribes the presentation and disclosure requirement for financial instruments.

Hong Kong Standard on Auditing **(HKSA)** 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing* prescribes the application of a competent understanding of the applicable financial reporting framework in the exercise of professional judgement by an auditor.

HKSA 220 *Quality Control for an Audit of Financial Statements* prescribes the performance by an engagement quality control reviewer of an objective evaluation of significant judgements made by the engagement team, and the conclusion reached in formulating the auditor's report.

HKSA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control. It also requires the auditor to obtain an understanding of the applicable financial reporting framework.

HKSA 700 *Forming an Opinion and Reporting on Financial Statements* prescribes the need for an auditor to evaluate in forming their audit opinion whether the financial statements are prepared in all material respects in accordance with the requirements of the applicable financial reporting framework.

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 FRC

The FRC is the full-fledged independent listed entity auditor regulator for Hong Kong. We are 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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