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Upholding trust in capital markets: Maintain healthy practices in auditor appointments and audit fee setting

Quality financial reporting and reliable audit opinions are the foundation of a well-functioning and stable capital market. They empower investors and stakeholders to make informed decisions with confidence.

To uphold audit quality, auditors and listed companies should be vigilant in avoiding the following unhealthy practices, which undermine the integrity and effectiveness of the audit process:



Late auditor changes that put pressure on audit delivery and increase the risk of opinion shopping.



Aggressive fee reductions to win audit engagements that weaken audit execution and erode the profession's resilience.



Delayed settlement of audit fees that places auditors under financial strain and jeopardises their objectivity and independence.

1. Introduction

- 1.1. Since 2022, the AFRC has observed two behaviours that pose risks to audit execution and delivery:
 - a. **Late auditor changes** by listed companies, which compress audit timelines and increase the risk of opinion shopping; and
 - b. **Aggressive audit fee reductions** by auditors, which may weaken audit execution and erode the profession's long-term resilience.



- 1.2. In response, the AFRC has issued a series of communications outlining practice guidance for managing auditor transitions. In our 2022 Open letter on late changes in auditor appointments, we urged auditors to proactively address contentious audit issues with audit committees. We emphasised that the auditor should complete the audit, rather than resign to avoid issuing an unfavourable audit opinion on the financial statements.
- 1.3. In the 2023 Guidance Notes on Change of Auditors, we raised concerns about insufficient planning and resource allocation by incoming auditors. We also provided practical guidance to both auditors and audit committees on fulfilling their respective responsibilities during auditor transitions.
- 1.4. To rally industry action, we held briefing sessions in collaboration with eight professional bodies and two fellow regulators, engaging over a thousand participants across 2023 and 2024. These combined efforts have contributed to a notable decline in late auditor resignations defined as those occurring one month before the end of the financial year or later from 70% of all auditor resignations in the financial year 2021 to 30% in the financial year 2024. While the improvements are encouraging, further efforts and collaboration remain essential to uphold and strengthen audit quality.
- 1.5. In recent observations, we noted instances of delayed settlement of audit fees that may affect auditor objectivity in specific cases. While the number of incidents remains low, we consider it important to address such behaviours early. By highlighting these developments, the AFRC aims to assist stakeholders in upholding audit quality and mitigating associated risks.

2. Safeguard audit integrity: Avoiding late auditor changes

2.1. Opinion shopping occurs when companies replace auditors to secure a more favourable audit opinion. This can happen when a company anticipates receiving a modified audit opinion. Such behaviour, if revealed, may tarnish the company's reputation in the eyes of investors and other stakeholders. It also poses risks to market integrity and the reliability of financial reporting.



2.2. Frequent or late changes of auditors may, in certain circumstances, be associated with opinion shopping, particularly when such changes coincide with unresolved audit issues. While such patterns are not definitive on their own, they should serve as red flags to shareholders and investors.



Frequent changes: 42 listed companies replaced auditors **three or more times** between 2020 and 2024.



Over the five-year period

- Eight companies replaced auditors four times.
- One company replaced auditors five times.

Within one-year period

- 14 companies replaced auditors twice, while two companies replaced auditors three times.
- Three of them replaced auditors twice within two months.

Late changes: 62% (84) of changes among these 42 companies took place one month before the financial year-end or later.



Guidance for Audit Committees:

Late auditor resignations may signal weak governance

- 2.3. Under the Companies Ordinance, a company may appoint a replacement auditor to fill a casual vacancy such as one arising from resignation without requiring shareholders' approval.
- 2.4. While this provision offers procedural flexibility, it may be misused to facilitate premature auditor resignation to avoid receiving a modified audit opinion, obscure critical audit findings, or even bypass audit fee negotiations.
- 2.5. Audit committees should ensure that auditor transitions are justified, well-considered, and in the interest of audit quality. As highlighted earlier, 14 listed companies replaced their auditors twice between 1 January 2020 and 31 December 2024, and two did so three times. Notably,



three of them replaced auditors twice within just two months, suggesting that these decisions may not have been sufficiently deliberated.



Guidance for Auditors:

Time pressure increases risk of undetected misstatements

- 2.6. Late auditor appointments can significantly increase the difficulty of conducting a high-quality audit. When engagements begin too close to the financial year-end, there may be insufficient time for proper planning and execution, leading to rushed decisions and heightened audit risk.
- 2.7. In first-year audits, newly appointed auditors must invest time to understand the company's business model, internal controls, information technology systems, and overall operating environment. This foundational knowledge is essential for effective risk assessment and audit planning. In addition, auditors are required to perform additional procedures on opening balances, which adds to the complexity and time demands of the engagement.
- 2.8. When auditors are appointed one month before the financial year-end or later, they are expected to complete all audit procedures within a compressed timeline. This time pressure can limit the depth of audit work and increase the risk of undetected accounting misstatements.
- 3. Safeguard audit profession's resilience: Resisting aggressive fee reductions
- 3.1. Audit fees represent a minuscule percentage (0.33% on average) of a listed company's revenue. Any cost savings from fee reductions are therefore negligible to improve the bottom line.
- 3.2. While competitive pricing is a natural course of business, **lowballing** defined as charging audit fees that are below cost recovery with the expectation of subsequently reverting to normal levels **poses a serious** threat to audit quality and presents an ethical issue.

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¹ AFRC (2023) Audit fees paid by listed companies in Hong Kong in 2020/2021



3.3. When audit fees are set too low, some auditors may adjust their audit strategies. This could include performing fewer procedures, relying on the company's systems and/or management representations without sufficient testing, reducing sample sizes, relying on less experienced staff, or foregoing the use of specialists. If not properly managed, these choices may compromise the scope and depth of the audit, increasing the risk of audit failure and elevating the risk exposure for Audit Committees.



Annual reports from 2020 to 2024 show that 1,016 listed companies collectively made 1,233 auditor changes.²



73% of these changes resulted in lower audit fees (905 cases). Among them:

- 58% saw their fees cut by 20% or more (525 cases).
- 10% saw their fees cut by 50% or more (89 cases).



Guidance for Audit Committees:

Invest in audit quality to safeguard shareholders' trust

- 3.4. Since the AFRC first raised concern about aggressive fee reductions, the proportion of auditor changes involving fee cuts of 20% or more has gradually declined—from 62% in 2020 to 53% in 2024. This downward trend suggests that audit committees and firms are becoming more cautious about pricing decisions that could compromise audit quality.
- 3.5. However, fee reductions remain prevalent, particularly among smaller listed companies. Among companies with market capitalisation below HK\$210 million, 64% of auditor changes between 2020 and 2024 with fee reductions involved cuts of 20% or more.³

² This trend is analysed based on annual reports of listed companies whose reporting year ends between June of the previous year and May of that year.

³ For this analysis, companies were divided into approximately equal tiers corresponding to large-cap, medium-cap, and small-cap, based on their market capitalisation as of 31 December 2023.



3.6. Among companies with market capitalisation of HK\$1.4billion or more, 22% of auditor changes in the same period resulted in fee increases, reflecting a more strategic mindset and quality-focused approach by their audit committees. Engaging competent auditors strengthens the audit committee's ability to meet its legal responsibilities with confidence.

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A global perspective: Rising audit fees



Audit fees have been rising in some jursidictions,⁴ largely driven by wage inflation and increased audit efforts to address changes of accounting and auditing standards. This trend suggests that listed companies in those markets are willing to invest in audit quality.

In contrast, audit fees in Hong Kong increased by only **0.4%** annually between 2018 and 2022.⁵ To enhance audit quality locally, auditors should consider drawing lessons from these international experiences through greater collaboration within the profession.

We encourage audit firms to proactively engage with listed companies and their audit committees to articulate the value and quality of their services.



Guidance for Audit Committees:

Recognise the hidden costs of under-pricing

3.7. Audit committees should be cautious of auditors who compete primarily on price, as this may reflect gaps in audit quality, experience, or service. Engaging such auditors often increases the committee's oversight burden, requiring more frequent reviews of audit progress, closer scrutiny of audit judgments, and more active monitoring of independence and professional scepticism. This added effort can strain the audit committee's focus, diminishing the effectiveness of audit oversight.



Guidance for Auditors:

Set audit fees with tomorrow in mind

⁴ Based on FRC (2020-2024) *Audit Market and Competition Developments*, audit fees for FTSE 350 companies rose by 9.4% annually on average between 2018 and 2022.

⁵ AFRC (2024) Report on the Analysis of the Public Interest Entity Audit Market in Hong Kong



- 3.8. Auditors are encouraged to thoughtfully consider whether fee levels support the standards expected of their work. Persistent low audit fees make it challenging for auditors to invest in the talent and technology needed to consistently deliver high-quality audits.
 - a. In today's increasingly complex and volatile business environment, maintaining audit rigour and depth requires adequate resources.
 Without them, auditors will struggle to meet rising investors' expectations and regulatory demands.
 - b. Undervaluing audit work makes it harder to attract and retain skilled professionals. If the profession is seen as underpaid and underappreciated, it becomes harder to position auditing as a worthwhile and rewarding career path.
- 3.9. Once audit fees are cut, they are rarely restored. Between 2020 and 2024, only 5% of audits that started with reduced first-year fees returned to or exceeded the previous auditors' level. When initial fees are set too low, auditors will find it difficult to justify future increases.
- 3.10. Over time, this dynamic can erode the perceived value of audit services. To cope with constrained budgets, some audit teams may under-report audit hours, which can further undermine staff morale and audit quality.
- 4. Safeguard the independence of auditors: Timely settlement of audit fees
- 4.1. **Delayed payments can threaten auditors' independence and objectivity**. When auditors become financially dependent on their clients, their independence and objectivity may be compromised, raising risks of biased opinions and potential non-payment.
- 4.2. In 2021, the HKICPA Code of Ethics for Professional Accountants (the Code) was further revised to reinforce safeguards. The Code clarifies that a self-interest threat may also arise if audit fees remain unpaid during the audit process. Therefore, overdue audit fees are generally expected to be fully settled before the audit opinion is issued.





The strengthened HKICPA Code of Ethics

Auditors are required to identify and evaluate any potential threats to auditor independence from:

- Overdue fees,
- Reliance on a single client for revenue, and



• Fees from non-audit services,

before accepting an audit engagement, or when circumstances change during the audit process.

- 4.3. As at 31 March 2025, public disclosures indicate that at least 10 listed companies have not fully settled audit fees for their FY2023 and/or FY2024 audits. Submissions to the AFRC indicated that some audit fee payments were delayed by up to nine months after the audit opinion was issued, with one notable case deferring payment for 30 months. Although not widespread, these instances highlight emerging risks to auditor independence and financial discipline.
- 4.4. To strengthen oversight, audit committees should set clear payment timelines, monitor settlements regularly, and challenge unreasonable credit terms, if any. By doing so, they reinforce their role in protecting audit integrity and accountability as stewards of ethical governance.

5. Next steps

5.1. We urge auditors and audit committees to remain vigilant and avoid these unhealthy practices in auditor appointments and fee setting. We have developed guiding principles for auditors and audit committees, which are detailed in the next two pages.



All stakeholders should work to protect the quality of audit and financial reporting in Hong Kong. Through collective efforts, we can foster a trustworthy audit environment, and maintain the high standards that define Hong Kong as a premier international financial centre.



Annex A - Call to action for auditors:



When setting audit fees, auditors should:

a. Set audit fees that reflect the scope and complexity of the required audit work, by considering the size, industry, and operations of the listed entity.



- b. Ensure audit fees also cover other costs, including maintaining a robust system of quality management, building competent audit team, and investing in technology to improve audit efficiency and effectiveness.
- c. Do not resort to relying on future fees or fees for non-audit services to make up shortfalls in current audit fees. Such approach creates a self-interest risk and undermines auditor independence.
- d. Agree a reasonable payment schedule with audit clients to mitigate self-interest threats from unpaid fees.





When bidding for an engagement, auditors should:

a. Evaluate their ability to deliver a high-quality audit within tight timelines, including the availability of resources and the need to perform additional procedures for the first-year audit.



b. Assess the feasibility to overcome challenges faced by the outgoing auditor, such as demands to lower audit fees or unresolved audit issues.



c. Firmly reject any attempts of opinion shopping by companies and decline audit engagements if they anticipate undue influence on their professional judgement.





Before resigning, auditors should:

- a. Make all reasonable efforts to discharge the duty they owe to shareholders to report on the financial statements.
- c. Disclose all circumstances of their resignation and outstanding audit issues in a letter to the audit committee.
- b. Raise any outstanding audit issues
 with the audit committee and
 seek its assistance.
- d. Report any concerns to relevant authorities through appropriate whistleblowing channels.



Annex B - Call to action for audit committees



Audit committees should:

a. Safeguard shareholders' interests
 by ensuring that auditors
 appointed at the annual general
 meeting are empowered to carry
 out a robust audit.



 Ensure audit fees reflect the resources needed to address the complexity of the business and industry. The fees should be agreed before appointing the auditor.



c. Exercise caution when evaluating bids from audit firms offering substantially lower fees, to ensure they are able to deliver high quality audit with a skilled audit team.



- d. Minimise the risk of a delay in publishing results by preventing auditors from resigning late in the reporting cycle.
- e. Ensure audit fees are timely settled to minimise the threat of self-interest.



f. If late resignation is unavoidable, closely monitor the firstyear audit work which must be completed within a tight timeline.



g. Following a change of auditors, ensure that the reasons for the change are accurately disclosed in regulatory filings.

