

## Press Release

28 August 2024

### **The importance of regulatory synergy in upholding financial reporting and audit quality**

The Accounting and Financial Reporting Council (**AFRC**) has today published the [2024 Annual Investigation and Compliance Report \(Annual INC Report\)](#) which provides an operational overview of our investigation and enquiry functions and highlights our significant findings and observations from concluded and ongoing investigations and enquiries.

In the reporting period ended 31 March 2024, the AFRC received a record total of 190 pursuable complaints, of which 67% were assessed and completed. In addition, 130 sets of financial statements were selected for review under the Financial Statements Review Program. The assessments of complaints and reviews of financial statements resulted in the initiation of 77 investigations and 14 enquiries.

#### **Regulatory synergy leading to effective outcomes**

As the independent regulator and promoter of sustainable development of the accounting profession, the AFRC is committed to maintaining high standards in financial reporting and auditing through a comprehensive regulatory approach. During the year, over 80% of regulators' referrals have led to the initiation of investigations and/or enquiries. Through regulatory collaboration and intelligence sharing, we can expedite our investigation process for cases where the protection of public interest is of paramount importance. This will eventually bring benefits to the accounting profession and safeguard the integrity of Hong Kong's capital markets.

#### **Key findings and observations of the Annual INC Report**

##### **Three areas of misconduct by auditors identified from concluded investigations**

From the concluded investigations, the AFRC identified the following areas of misconduct:

- i) Failure to act diligently and exercise due professional care;
- ii) Failure to exercise professional judgment and maintain professional skepticism;  
and
- iii) Failure to comply with the requirements imposed by the AFRC.

The findings underscore a lack of basic professionalism and compliance awareness by the audit profession. The root cause appears to be a lack of a culture that emphasises a commitment to quality and compliance.

Leadership of audit firms are expected to:

- i) Ingrain the requirements of exercising due care and professionalism into daily operations as a fundamental aspect of the firms' culture and quality management system;
- ii) Embed a commitment to compliance within the firm's culture, and ensure all staff within the firm cultivate a compliance mindset; and
- iii) Promote a culture of heightened professional skepticism.

### Observations from newly initiated cases

During the reporting period, the AFRC initiated 46 investigations concerning PIE auditors and 14 enquiries in relation to PIEs.

For PIEs, areas subject to significant management judgment continue to present substantial challenges for preparers of financial statements. Despite observing a slight improvement in impairment assessment and fair value measurement following repeated reminders, there has been a notable increase in instances of potential non-compliance with accounting requirements related to revenue recognition. Conversely, the frequency of cases involving fraudulent financial transactions and reporting due to management override of internal controls remains relatively stable. This indicates a persistent need for rigorous oversight and review by audit committees and auditors to address these critical areas effectively.

For PIE auditors, the key areas of potential misconduct involve the sufficiency and appropriateness of audit evidence, the failure to exercise professional skepticism and judgment, and the effectiveness of engagement quality control reviews. Although there have been improvements in all three areas, the AFRC believes that further strengthening the engagement quality control review could significantly enhance the rigor in obtaining sufficient and appropriate audit evidence, as well as in exercising the necessary professional skepticism and judgment, thereby further reducing the cases of misconduct.

Of the newly initiated investigations related to PIE auditors, 20% of which are associated with late auditor resignations. A major issue identified relates to the incoming auditors' client acceptance and audit planning. The AFRC urges incoming auditors to place emphasis on analysing the audit implications of the circumstances leading to the outgoing auditors' resignation and assessing their capabilities before undertaking the engagement. Where necessary, they should consider declining the relationship if there are concerns over internal resources and clients' integrity.

In respect of misconduct of professional persons, the predominant areas of potential misconduct are non-compliance with the Code of Ethics for Professional Accountants and the assurance standards. We remind the PIE auditors and their responsible persons undertaking PIE engagements to comply with the registration requirements set forth in the AFRCO.

Ms Florence Wong, Head of Investigation and Compliance said, “Our report highlights the critical areas where misconduct and non-compliance continue to challenge the integrity of financial reporting and auditing. Compliance with laws, regulations and professional standards is the cornerstone of public trust and reputation in the financial markets. The AFRC spares no efforts in taking decisive regulatory actions against misconduct and non-compliance to protect the public interest and maintain the credibility of the accounting profession.”

### **Fostering a culture of quality in financial reporting and auditing**

The AFRC administers an effective investigation and enquiry regime that deters misconduct and non-compliance, fosters high standards of professional conduct in the accounting profession, and leads the accounting profession to enhance the quality of financial reporting and auditing.

Ms Janey Lai, CEO of the AFRC, said, “Our investigation revealed that misconduct and non-compliance generally stem from a disregard for good governance. Identifying the root cause is the first step to addressing misconduct, which includes examining the corporate governance of firms and companies and ensuring a proper tone has been set by the leadership that emphasises the importance of fostering a culture of quality auditing. Promoting governance at the fundamental level is key for maintaining public trust in financial reporting as well as for the healthy development of the accounting profession.”

Dr Kelvin Wong, Chairman of AFRC, said, “With our persistent effort since 2019, we are encouraged to observe initial signs of improvement in the quality of financial reporting and auditing. It is imperative for the leaders of the accounting profession to cultivate a firm-wide culture of effective governance, compliance, and continuous learning that is conducive to improvement in audit quality. Robust governance and market development are complementary. They solidify public trust on the accounting profession, and thereby create positive ripple effects that will reinforce Hong Kong’s standing as a leading international financial centre.”

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 and promotes the healthy development of the accounting profession.

For more information about the statutory functions of the AFRC, please visit [www.afrc.org.hk](http://www.afrc.org.hk).

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