

## Press Release

11 March 2021

### **FRC issues Overview of the Market for Listed Entity Audits in Hong Kong**

Financial Reporting Council (FRC) today issues its first policy and governance report on the Overview of the Market for Listed Entity Audits in Hong Kong (the “Market Report”), which provides high level insights into how competition operates in the market for listed entity audits in Hong Kong (the “Market”). It includes an analysis of the size and competitive structure of the Market, the relative significance of non-audit to audit services provided to listed entities by their auditors and how these factors have developed from 2010 to 2019. The Market Report ([click here](#)) can be accessed on the FRC’s official website – <http://www.afrc.org.hk/>.

Dr Kelvin Wong, Chairman of the FRC remarked, “As an effective auditor regulator, upholding the quality of financial reporting and protecting public interest is at the core of everything we do. Apart from our statutory functions, the FRC conducts research and studies that are conducive to enhancing audit quality, audit independence and the healthy development of the market for listed entity audits in Hong Kong.”

Introducing the Market Report, Mr Marek Grabowski, CEO of the FRC said, “The primary concern of the FRC is to understand whether the Market is functioning effectively in the interests of the investing public and the wider public interest. The Market Report provides a basis for us to exercise our regulatory functions and to give directional observations to listed entity auditors and related guidance to key stakeholders concerned with listed entity governance, including their audit committees.”

The findings of the Market Report assist us in understanding how competition operates in the Market and therefore in identifying related factors, such as market concentration, auditor switching rates, audit firm resilience vulnerabilities, audit pricing and auditor provision of non-audit services, which may indicate risks to audit quality under the oligopolistic structure of the Market.

Ms Florence Wong, Deputy CEO and Head of Oversight, Policy and Governance said, “Audit quality is one of the key elements of quality financial reporting. The report highlights factors that may indicate risks to audit quality that audit firms, listed entities and audit committees should care about. The Department of Oversight, Policy and Governance will conduct further research and develop guidance to drive audit quality.”

Five key findings of the Market Report include:

## 1 Increase in Market size

The Market increased by 82.8% by total audit fees, 67.9% by number of listed entity audits, and 85.2% by total market capitalization of listed entities audited from 2010 to 2019.

	Total audit fees	Number of listed entity audits	Total market capitalization of listed entities audited
<b>2010</b>	HK\$6,666 million	1,386	HK\$20,191 billion
<b>2019</b>	HK\$12,187 million	2,328	HK\$37,384 billion
<b>Compound annual growth rate</b>	6.9%	5.9%	7.1%

The Market is characterized by significant buyer concentration by size. Whether measured by market capitalization or audit fees, in 2019 the largest 5% (116) and 20% (466) of listed entities accounted respectively for 77.4% and 49.4%, and 93.7% and 71.5%, of the Market.

There were 72 audit firms that performed listed entity audits in the Market in 2019, compared with 66 in 2010 (compound annual growth rate of 1.0%).

In 2019, 41 local (Hong Kong) PIE auditors performed the audits of 95.2% of the 2,328 listed entities. The audits of the remaining listed entities are performed by the 11 Mainland auditors and 20 overseas auditors that were recognized as PIE auditors, as local PIE auditors are not able to perform these audits. The number of local PIE auditors reduced by 9, with 19 entrants and 28 leavers, over the period. The number of overseas auditors increased by 15, with 28 entrants and 13 leavers, over the period.

	Number of audit firms			Total
	Category A <sup>1</sup>	Category B <sup>1</sup>	Category C <sup>1</sup>	
Start of the period	4	13	49	66
Firms entered	-	-	47	47
Firms exited	-	-	(41)	(41)
Reclassifications	2	5	(7)	-
End of the period	6	18	48	72

<sup>1</sup> Audit firms are categorized according to the number of listed entities that they perform audits in the year.

Audit firm category	Number of listed entities that audit firms perform audits
Category A	100 or more
Category B	10 to 99
Category C	At least one and less than 10

## 2 A high level of market concentration

Category A audit firms had a combined market share of 80.2% (77.2%) by audit fees, 71.1% (64.2%) by number of listed entity audits, 90.1% (82.4%) by market capitalization of listed entities audited, respectively in 2019 (2010).

4 Category A PIE auditors served all but 2 of the 105 listed entities with a market capitalization in excess of HK\$50 billion audited by local auditors. In particular, the largest one accounted for 18.3% (by number), 50.9% (by market capitalization) and 32.0% (by audit fees) of the Market. The Market is characterized by a high level of concentration.

## 3 Switching rate

The switching rate for the Market (the percentage by number of listed entities that changed auditor) in each year over the period was between 6.6% and 9.6%.

Number of listed entities that changed their auditors

	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Number of listed entities</b>	107	129	127	114	121	166	146	192	224
<b>Percentage of total number of listed entities</b>	7.3%	8.5%	7.8%	6.6%	6.6%	8.6%	7.1%	8.6%	9.6%

## 4 Audit fee trends

Total annual audit fees increased by 82.8% compared with an increase of 67.9% in the number of listed entity audits.

Average and median annual audit fees increased respectively at compound annual rates of 0.9% and 1.8%.

Total, average and median annual audit fees (in HK\$ million)

<b>Audit fees</b>	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	6,666	7,660	8,263	8,666	9,356	9,868	10,212	10,718	11,840	12,187
<b>Average</b>	4.8	5.2	5.4	5.3	5.4	5.4	5.3	5.2	5.3	5.2
<b>Median</b>	1.7	1.9	1.9	2.0	2.1	2.1	2.1	2.0	2.1	2.0

Between 52.6% and 75.4% of the listed entities paid lower or the same audit fees after a change in auditor. When there was a decrease in audit fees after a change in auditor, the average decrease was 24.9% and when there was an increase, the average increase was 37.4%.

## **5 Non-audit services**

The ratio of non-audit fees to audit fees paid by listed entities during period was between 24.6% to 29.0%, which was similar to the United States market and lower than the United Kingdom market.

Compared with local audit firms, Mainland and overseas audit firms had a relatively higher ratio of non-audit fees to audit fees, mainly due to the inclusion of a small number of large United Kingdom incorporated overseas listed entities.

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### **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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