

# Chamber of Hong Kong Listed Companies

## Financial Reporting Council Workshop on Annual Investigation and Compliance Report and Interim Inspection Report

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# Mission statement of FRC

To uphold the quality of financial reporting of listed entities in Hong Kong, so as to enhance protection for investors and deepen investor confidence in corporate reporting.

# Functions of the FRC

- Inspection
- Investigation and enquiry
- Discipline
- Recognition of overseas auditors
- Oversight of HKICPA's performance on:
  - Registration of local auditors
  - Standards setting
  - Continued professional development

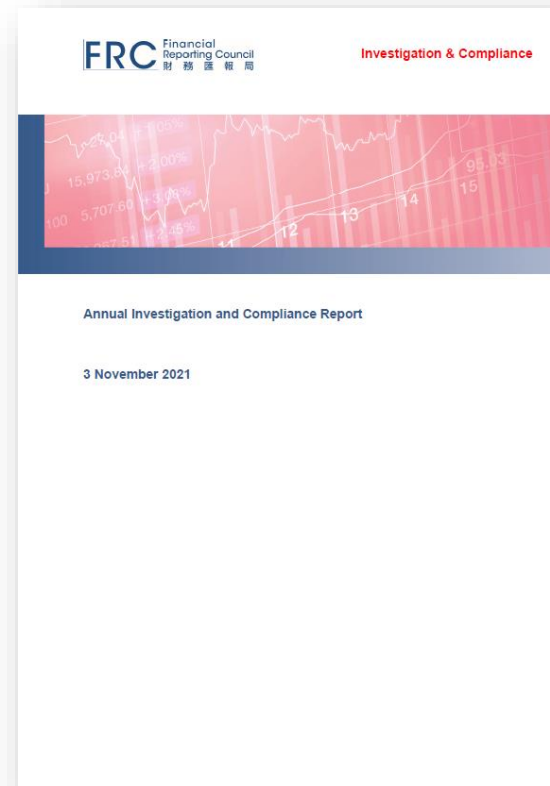
# Recent Publications

- Annual Investigation and Compliance Report (November 2021)
- Interim Inspection Report (November 2021)
- eNews (November 2021)
- Annual Inspection Report (June 2021)
- FRC Annual Report (June 2021)
- Overview of the Market for Listed Entity Audits in Hong Kong (11 March 2021)
- Report on the FRC's Assessment of the HKICPA's Performance of the Specified Functions (11 December 2020)



Interim Inspection Report

3 November 2021



Annual Investigation and Compliance Report

3 November 2021



# Financial Reporting Council - 2021 Annual Investigation and Compliance Report



# Agenda

- 1. Overview of investigation and enquiry functions**
- 2. Key findings of financial reporting non-compliance in listed entities' financial statements and misconduct of their auditors**
- 3. Expectations and roles of boards and management of listed entities, their audit committees and auditors**

# 1. Overview of investigation and enquiry functions



# Our investigation and enquiry functions

Since the establishment of FRC in 2006, we

- Enquire into potential non-compliance in financial statements of listed entities
  - Require listed entities concerned to remove non-compliance identified
- Investigate potential misconduct of auditors of listed entities
  - For audits completed before 1 October 2019, refer to HKICPA for disciplinary action
  - For audits completed on or after 1 October 2019, refer to the Department of Discipline of the FRC for disciplinary action

# Overview of our work

We acquire intelligence about potential misconduct or financial reporting non-compliance through:

- **Reactive market surveillance activities**
  - Complaints from the public, whistleblower reports and referrals from other regulators
- **Proactive risk-based market monitoring activities**
  - Referrals from inspections of auditors of listed entities
  - Reviews of financial statements of listed entities under the Financial Statements Review Programme (FSRP)



# Overview of our work

Operations statistics for the reporting period (from 1 October 2019 to 31 March 2021):

	FSRP	Reactive sources	Investigation	Enquiry
As at 1 October 2019	39	23	42	1
Received / initiated	62	67	23	2
Completed	(71)	(61)	(7)	-
As at 31 March 2021	30	29	58	3
As at 30 November 2021	18	79	70	13

During the reporting period, first batch of audit working papers located in the Mainland for seven investigations were received with the assistance of the Supervision and Evaluation Bureau (SEB) of the PRC Ministry of Finance under the Memorandum of Understanding (MoU) with the SEB.

## 2. Key findings of financial reporting non-compliance in listed entities' financial statements and misconduct of their auditors

# Common financial reporting non-compliances

During the reporting period, common potential or actual non-compliance with financial reporting requirements relate to areas where preparers of financial statements need to make significant judgement or estimates.

These are often required in:

- i. Fair value measurement
- ii. Impairment assessment

Which are commonly used in accounting for:

- a. Business combinations
- b. Financial instruments or changes in their terms
- c. Exchanges involving non-financial assets
- d. Contracts for the provision of goods or services to customers

# Key findings on financial reporting non-compliances

## Calculation of earnings per share

- Failure to appropriately apply special considerations in determining the effect on the average number of shares of a bonus issue and an open offer of shares during the period

## Fair value measurement of consideration shares

- Failure to measure the consideration shares at the market price of the shares at the date of an acquisition when a listed entity issued its own shares as part of the purchase consideration for a business combination

## Recognition of identifiable assets acquired

- Failure to recognise, separately from goodwill, identifiable assets acquired in a business combination such as intangible assets

# Key findings on financial reporting non-compliances

## Useful life of intangible assets

- Failure to consider the terms of a sales contract acquired in a business combination, which provided a right to sell a specific product with no specific condition or significant cost for renewal

## Consolidation of investee

- Failure to perform control analysis of an investee, i.e. to understand all arrangements which govern the way decisions about the relevant activities are made, to determine whether the listed entity has control or significant influence over the investee

## Measurement of convertible bonds

- Failure to recognise the difference between the aggregate carrying amounts of the financial liabilities extinguished and the aggregate fair values of the convertible bonds determined by a valuation expert for settlement of financial liabilities by issuance of convertible bonds

# Key findings on financial reporting non-compliances

## Impairment of investment in an equity instrument

- Failure to record an impairment loss of an available-for-sale equity investment when the decline in the fair value of the investment was both significant and prolonged, which provided objective evidence of impairment under HKAS 39

## Impairment of investments in associates

- Failure to properly assess the recoverable amount of investments in associates when there was objective evidence of impairment from unfavourable events and circumstance

## Impairment of investments in subsidiaries

- Failure to identify objective evidence of impairment and recognise impairment loss on interests in subsidiaries when presenting or reporting the parent company's financial position in the consolidated financial statements



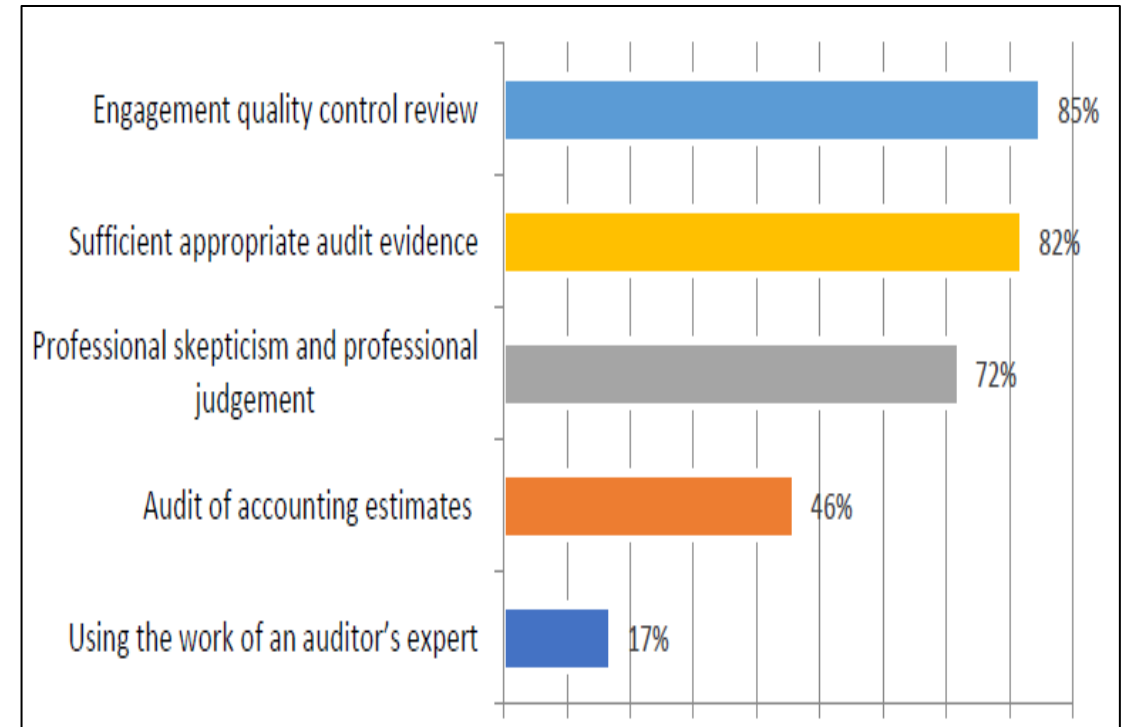
# Key findings on non-compliances with disclosure requirements

- HKFRS 15 *Revenue from Contracts with Customers*
- HKFRS 13 *Fair Value Measurement*
- HKFRS 7 *Financial Instruments: Disclosures*
- HKFRS 3 *Business Combinations*

# Key findings on auditing irregularities

Common areas where potential or actual auditing irregularities identified:

- Failure to perform the engagement quality control review adequately in respect of significant judgements made and conclusions reached by the engagement team
- Failure to obtain sufficient appropriate audit evidence on which to base the audit opinion
- Failure to exercise appropriate professional scepticism and professional judgement
- Failure to properly evaluate the reasonableness of accounting estimates and the adequacy of the work of the auditor's expert



# Key findings on auditing irregularities

## Engagement quality control review

### Examples of deficiencies:

- Failure to discuss significant matters with the engagement team in relation to assessment of risks of material misstatements, response to assessed risks, results of substantive procedures performed and significant judgement made;
- Failure to evaluate the sufficiency and adequacy of engagement team's work and the conclusion reached; and
- Failure to identify that the engagement team had not sufficiently planned, reviewed or supervised audit work performed by a component auditor

# Key findings on auditing irregularities

## Sufficient appropriate audit evidence

### Examples of deficiencies:

- Failure to consider the limitations encountered in prior year and the availability of adequate reliable records;
- Failure to understand the rationale for the management's conclusion or obtain further evidence;
- Failure to perform procedures to obtain sufficient evidence to resolve the inconsistency between different audit evidence obtained; and
- Failure to test the accuracy and completeness of information produced by the listed entity to ensure its reliability or obtain support to ensure the validity of management's representation

# Key findings on auditing irregularities

## Professional skepticism

### Examples of deficiencies:

- Failure to attempt to obtain evidence from other sources or perform an independent evaluation before reliance on management's representations or explanations on identified variances or exceptions found in the audit tests;
- Failure to question the appropriateness of the methodology and approach applied, and challenge the reasonableness of the significant underlying assumptions used for estimations for areas involving significant management judgements and estimates; and
- Failure to remain alert to and further question contradictory or potentially inconsistent information obtained, including information that might indicate management bias

# Key findings on auditing irregularities

## Professional judgement

### Examples of deficiencies:

- Failure to consider the substance of the contractual arrangements and the rights of the relevant parties under the Articles of Association and the mutual agreements of an investee in determining whether a listed entity had control over its investee; and
- Failure to consider whether the decline in the fair value of a listed entity's available-for-sale investment was significant or prolonged and accordingly should be regarded as an objective evidence of impairment

# Key findings on auditing irregularities

## Audit of accounting estimates

### Examples of deficiencies:

- Failure to challenge management's assumptions;
- Failure to consider indications of impairment and challenge management's assumptions; and
- Failure to evaluate the application of the applicable financial reporting framework

# Key findings on auditing irregularities

## Using the work of an auditor's expert

### Examples of deficiencies:

- Failure to evaluate the relevancy and reasonableness of the scope of work of the expert and the assumptions and methods applied in the circumstances;
- Failure to perform additional work, such as consider the relevance or test the reliability of source data used by the expert before reliance on the work of the auditor's expert;
- Failure to consider and respond to the findings or comments of the expert and consider their implications for the audit; and
- Failures to consider inconsistencies between the results of the work of the auditor's expert and the auditor's overall knowledge of the matter and their impact on the audit



### **3. Expectations and roles of boards and management of listed entities, their audit committees and auditors**

# Our expectations

## Boards and management of listed entities

- ensure their financial reporting functions are professionally competent and properly resourced
- consult appropriate internal or external experts when necessary

## Audit committees

- oversee management's preparation of financial statements
- oversee the auditors' performance of the audits

## Auditors of listed entities

- evaluate and respond appropriately to risks of material misstatement in listed entities' financial statements
- ensure technical competence of their engagement teams
- make appropriate consultation (internal or external) when necessary

## Key take away

- Areas requiring significant judgement and estimation are a common driver of both financial reporting non-compliance and auditor deficiency or misconduct.
- Boards, audit committees, management and auditors all have a vital role in upholding the quality of financial reporting.



# Thank you