

# ACUMINOUS

2023 FIRST ISSUE

## AN OVERHAUL OF THE REGULATION OF ACCOUNTING INDUSTRY – ACCOUNTING AND FINANCIAL REPORTING COUNCIL (AFRC)

In this issue, we will take a look at the recent overhaul of regulation of accounting industry in Hong Kong and its implications.

### Background

The Accounting and Financial Reporting Council (the “**AFRC**”) was first established in 2006 under the name Financial Reporting Council (“**FRC**”) and its key function was initiating enquiries into possible non-compliance with accounting requirements and conducting investigations into auditing misconduct. After the enactment of the Financial Reporting Council (Amendment) Bill, the FRC was renamed as AFRC and was given an extended scope as an independent regulatory body for the accounting profession.

### Functions

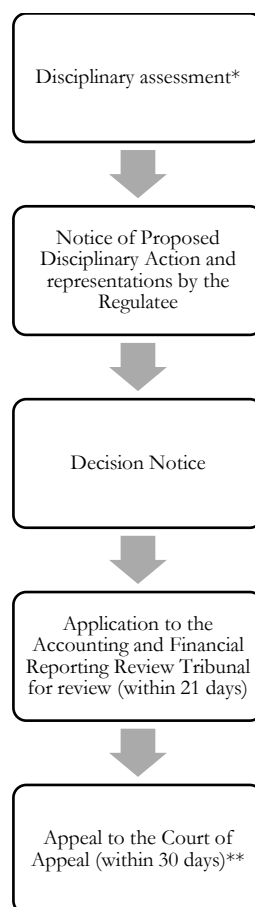
With effect from 1 October 2022, the AFRC is charged with expanded statutory functions including:

Policy and oversight	Oversees the performance of statutory functions of the Hong Kong Institute of Certified Public Accountants (the “ <b>HKICPA</b> ”).
Registration	Responsible for registration functions including but not limited to (i) the issuance of practising certificates and (ii) registration of firm names and firms, corporate practices and local auditors as public interest entities (“ <b>PIE</b> ”) auditors.
Inspection	Directs an inspector to carry out an inspection in relation to the PIE engagements completed by a PIE auditor on or after 1 October 2019.
Investigations and enquiries	Directs an investigation to be carried out in respect of possible misconduct committed by certified public accountants (“ <b>CPA</b> ”) registered with the HKICPA, auditors registered with or recognized by the AFRC, registered responsible persons of a registered PIE auditor, and non-PIE auditors; and Initiate enquiries into possible non-compliance with regulatory requirements for financial reports of listed entities.
Discipline	Has disciplinary powers over PIE auditors, registered responsible persons and professional persons (i.e. CPAs and practice units) (collectively, “ <b>Regulatee(s)</b> ”).

### Investigation and Enquiry

The AFRC detects potential misconduct and non-compliances through reactive and proactive market monitoring. For reactive sources, the AFRC respond to complaints from members of the public, whistleblower reports, and referrals by other regulators. The AFRC also proactively monitors announcements by listed entities and other public sources of information and comments on financial reports and audits of listed entities. As in the case of China Evergrande Group and Evergrande Property Services Group Limited (a subsidiary of China Evergrande Group), the FRC, based on public announcements published by both companies, initiated: (1) an enquiry into the financial statements of the two companies; and (2) an investigation of the audit carried out by the auditors.

### The AFRC’s disciplinary process



*\* With effect from 1 October 2022, the disciplinary process for all investigation cases under both old regime and new regime will be handled by the Department of Discipline of the AFRC.*

*\*\* If a party to a review is dissatisfied with the determination of the review made by the Tribunal, the party may apply to the Court of Appeal for leave to appeal against that determination on a question of law and/or fact.*

## Sanctions from the AFRC

PIE auditors and registered responsible persons	Professional persons (i.e. a CPA or a practice unit)
<ul style="list-style-type: none"><li>• Remedial action</li><li>• Reprimand (private / public)</li><li>• Pecuniary penalty</li><li>• Registration or recognition (imposition of a condition / suspension / revocation / prohibition from application)</li><li>• Removal of name from the list of registered responsible persons</li></ul>	<ul style="list-style-type: none"><li>• Reprimand (private / public)</li><li>• Pecuniary penalty</li><li>• Registration (suspension or revocation)</li><li>• Practising certificate (cancellation or non-issuance)</li></ul>

Upon conclusion of the disciplinary process, the AFRC will disclose to the public the material facts of the case, the AFRC's decision with reasons and the disciplinary sanction imposed/ action taken, unless the disclosure: (a) relates to a private reprimand; (b) may adversely affect any criminal proceedings before a court or magistrate; or (c) is not in the interest of the investing public or in the public interest.

For the 12-month period between 1 April 2021 and 31 March 2022, the HKICPA took regulatory actions in response to seven investigations completed and referred by the AFRC. Two cases completed through resolution by agreement, and the relevant parties were public reprimanded, ordered to pay an administrative penalty and reimburse the costs of the FRC and the HKICPA. In the remaining five cases, relevant parties were publicly reprimanded, ordered to pay an administrative penalty ranging from HK\$100,000 to HK\$500,000 and reimburse the costs of the AFRC and the HKICPA.

### AFRC's growing concern over auditor changes

In view of the increasing number of PIE auditors resigning just before or even after the end of the reporting period of a listed entity, the AFRC has expressed concerns as to (i) whether the incoming auditors possessed the necessary competence and adequate capabilities (including manpower, time and other resources) to perform quality audits within limited time frame; and (ii) whether there was appropriate communication between the incoming and outgoing auditors on the audit implications of the circumstances leading to the outgoing auditors' resignations.

The AFRC, in its latest open letter, further highlighted the observations and concerns below:

- Auditors were requested to resign by listed entities as a result of issues identified in audits
- "Corporate governance considerations" is misused as a reason for auditor resignation
- Premature announcements regarding the appointment of an incoming auditor
- Using "disagreement over audit fees" as a catch-all explanation for auditor resignations

### AFRC's expectations of directors and audit committees

**Directors' responsibilities** include:

- prepare financial statements that give a true and fair view of the state of affairs of an entity; and
- exercise sufficient oversight over management to ensure that management provide auditors with all information and explanations that may be relevant.

**Audit committees' responsibilities** include:

- ensure that the entities have robust internal controls and competent resources to prepare high-quality financial information;
- thoroughly understand the business rationale of significant unusual or highly complex transactions and how their companies have been impacted by the recent drastic economic and market changes;
- maintain close and effective dialogue with their auditors, and monitor and assist them, where necessary, to resolve significant matters arising from the audits with management;
- ensure that the auditors have access to the information they need; and
- challenge auditors on whether and how the common deficiencies have been addressed.

### Going forward

Issuers should take note of the reports and guidelines published by the AFRC from time to time and the latest development on implementation of the AFRC's policies which may affect all listed entities, in particular, the potential consequences for financial reporting misconduct and the recent concerns over change of auditors as summarised in this issue.

For enquiries related to this newsletter, please get in touch with the following person or your usual contacts in Asian Capital.

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