

Guidelines on Auditor Selection and Audit Fees

Scan code to enter our recent reports:



[Survey report
on auditor selection](#)



[Audit fees report](#)

Policy, Registration and Oversight Department, AFRC

Agenda

1. Introduction
2. Selecting auditors
3. Setting audit fees
4. Key messages to stakeholders

1. Introduction



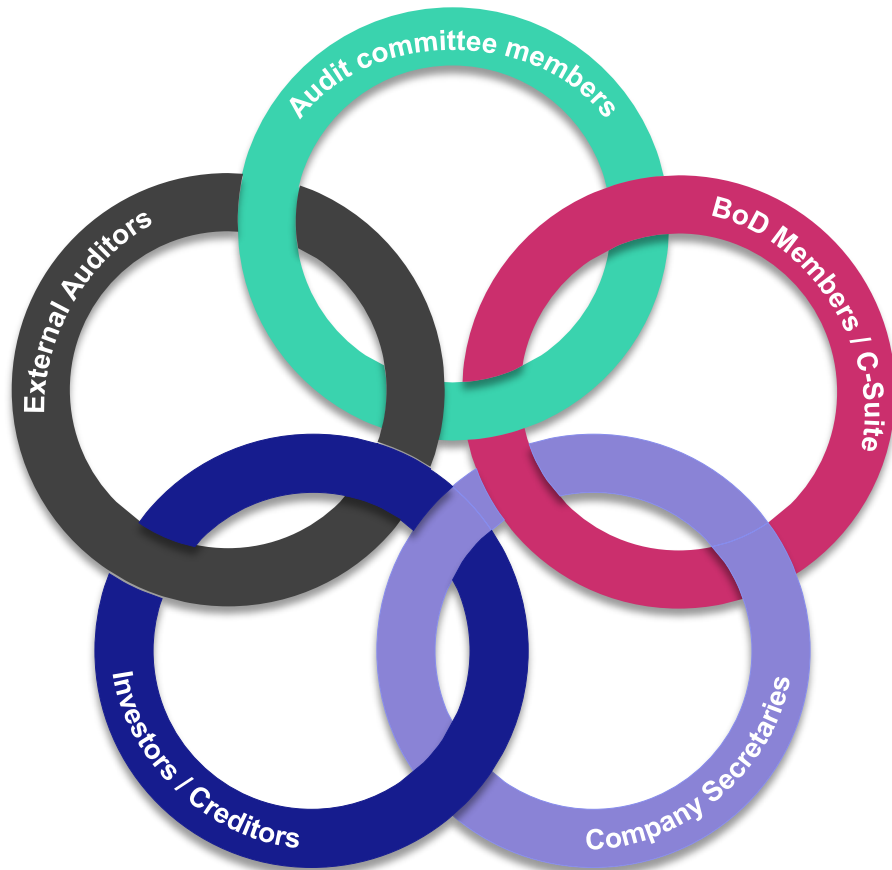
The importance of audit quality



Better outcomes for all stakeholders



Why is the selection of a suitable auditor and the setting appropriate audit fees relevant to my role?



- **Audit Committee Members**
 - responsible for overseeing companies' financial statements
 - responsible for making recommendations to the Board of Directors on the selection of auditors and evaluation of audit fees
- **Board of Directors / C-Suite Executives**
 - take overall responsibility for the financial statements
 - make decisions on auditor selection and determine audit fees
 - rely on financial information to make informed decisions about strategic business activities that are paramount for ensuring the long-term success
- **Company Secretaries**
 - play a pivotal role in corporate governance by ensuring compliance with legal and regulatory requirements, including financial reporting and auditing
 - support the Board of Directors and Audit Committees in making a thorough selection of auditors and evaluating audit fees
- **Investors / Creditors**
 - rely on audited financial statements to make informed investment / loan decisions
- **External auditors**
 - affect their ability and strategy to win and retain engagements in the competitive audit market
 - need sufficient audit fees to carry out quality audits

AFRC: Hong Kong's independent regulator for the accounting profession

AFRC's mission statement

Our mission is to shape a competitive environment that will nurture and promote the success of the profession.

- This pivotal role not only enhances the quality of financial reporting but in turn reinforces our pursuit of promoting the healthy development of the profession, and Hong Kong's position as a competitive international financial centre

Policy, Registration and Oversight

Policy and governance

- Conduct research and set policies in relation to the quality of financial reporting and auditing
- Publish guidance on governance and other issues where appropriate

Registration

- Review new and renewal applications for the issuance of practising certificates to CPAs, and the registration of practice units and PIE auditors.

Oversight

- Oversee specified functions performed by the HKICPA, including:
 - Registration of certified public accountants (CPAs)
 - Setting continuing professional development requirements
 - Setting standards
 - Providing training

AFRC guidelines and resources

Guidelines for Effective Audit Committees – Selection, Appointment and Reappointment of Auditors (“AC Guidelines”)

- Provides practical guidance to audit committees on:
 - selecting capable and experienced auditors; and
 - evaluating audit fees



Scan code to open the [AC Guidelines](#)

2023 Survey Report on the Implementation of AC Guidelines (“Survey”)

- Contains the results of AFRC’s survey to auditors and audit committees on the implementation progress of the AC Guidelines
 - Provides practical recommendations to audit committees, auditors, management / the Board and investors



Scan code to open the [Survey](#)

Audit Fees Paid by Listed Companies in Hong Kong 2020-2021 (“Audit Fee Report”)

- Analyses the audit fees paid by listed companies and what effects, if any, COVID-19 and the ensuing economic downturn have had on the market



Scan code to open the [Audit Fee Report](#)

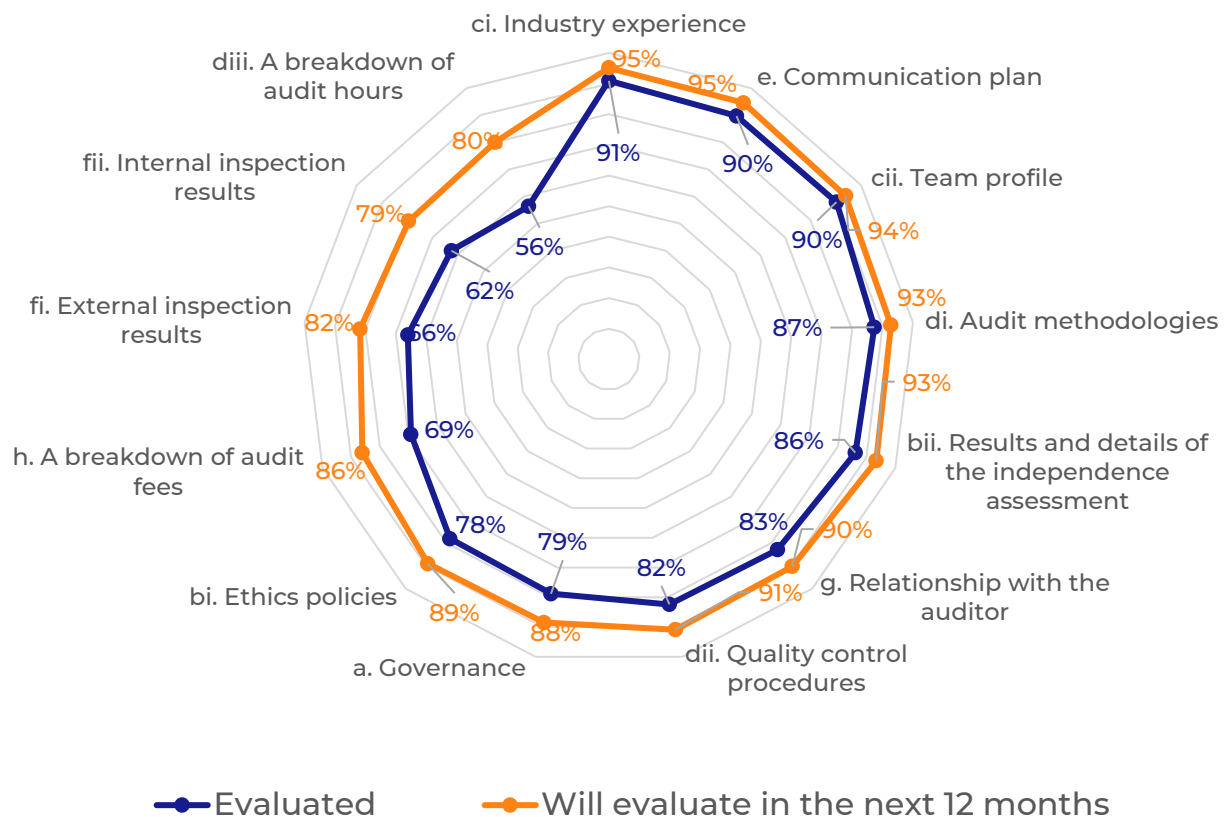
2. Selecting auditors



What factors should be considered when selecting auditors

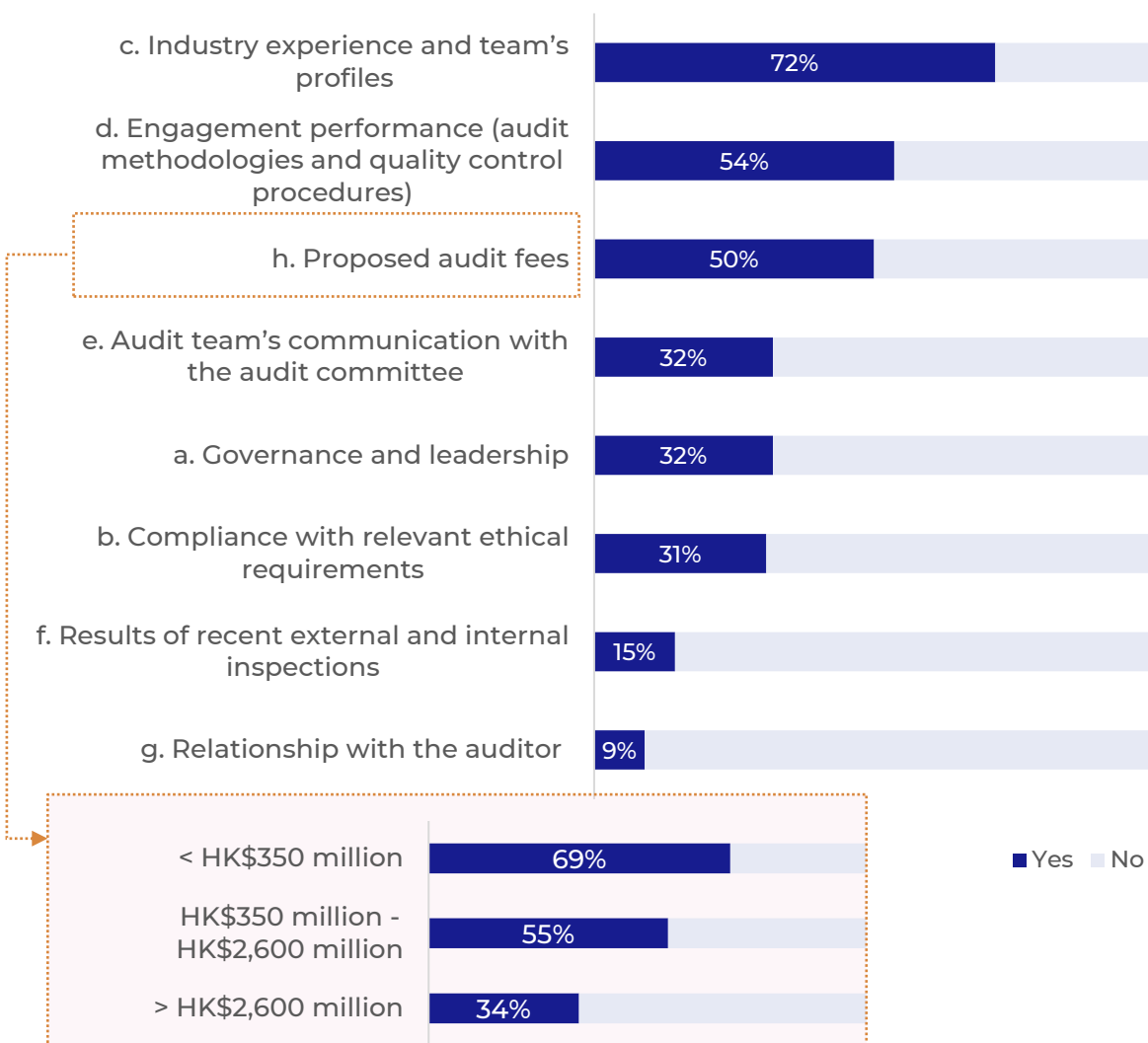


Finding 1: What factors have been / will be evaluated by audit committees in the past and next 12 months



- We asked listed company respondents to select from a list of 13 items those they evaluate when selecting auditors.
- There is an **increase in audit committees' intention** for all the items to be evaluated in the next 12 months.
- By comparing the survey results relating to the information required by audit committees against that supplied by auditors, we noted the **response of auditors is consistent with that of audit committees**.

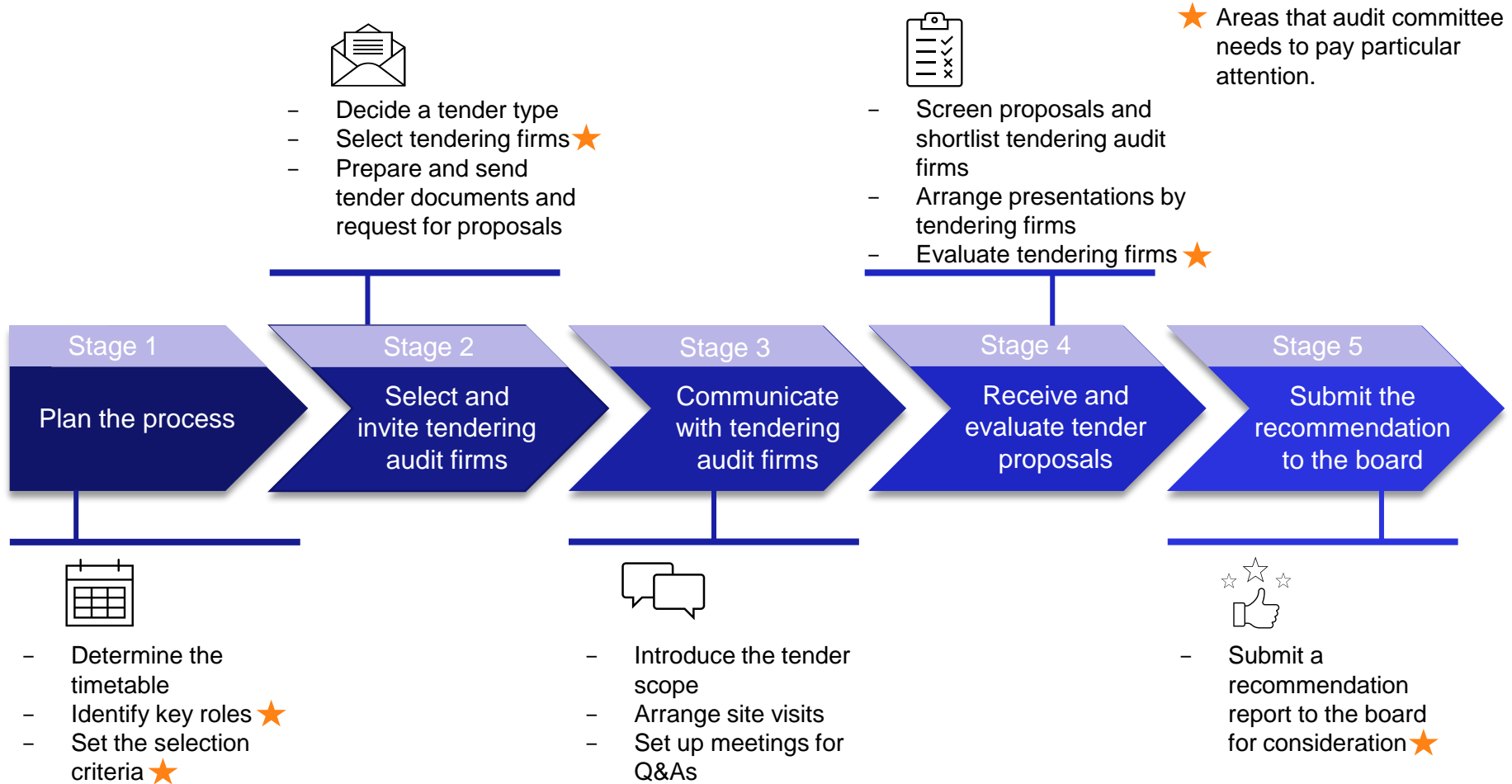
Finding 2: Which factors do listed companies consider most when selecting auditors



- The results show a mixed picture. “**Industry experience and team’s profiles**” and “**Engagement performance**” were selected as the two most important factors in selecting an auditor. We concur they are important factors to consider.
- However, despite AFRC’s continuous effort in promoting audit quality when evaluating an auditor’s capabilities, listed companies still rank proposed audit fees as one of the top three factors.
- There appears to be **some inconsistencies** in the factors audit committees evaluate.

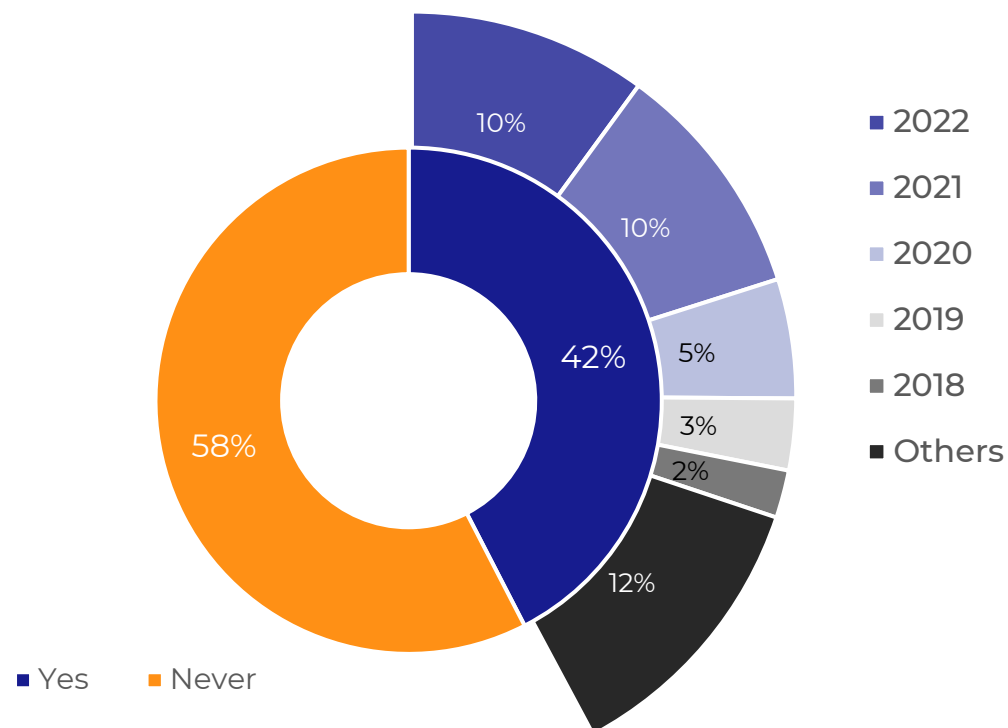
How to run an effective audit tender when selecting auditors

A 5-stage approach for audit tender process

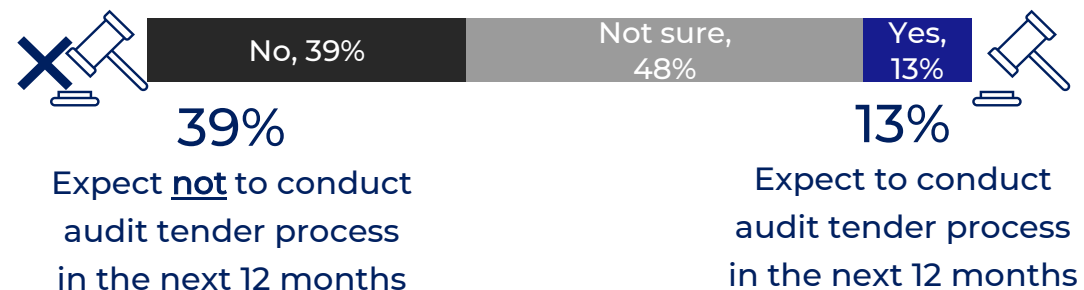


Findings 3 and 4: How common is it for audit committees to conduct an audit tender when selecting auditors

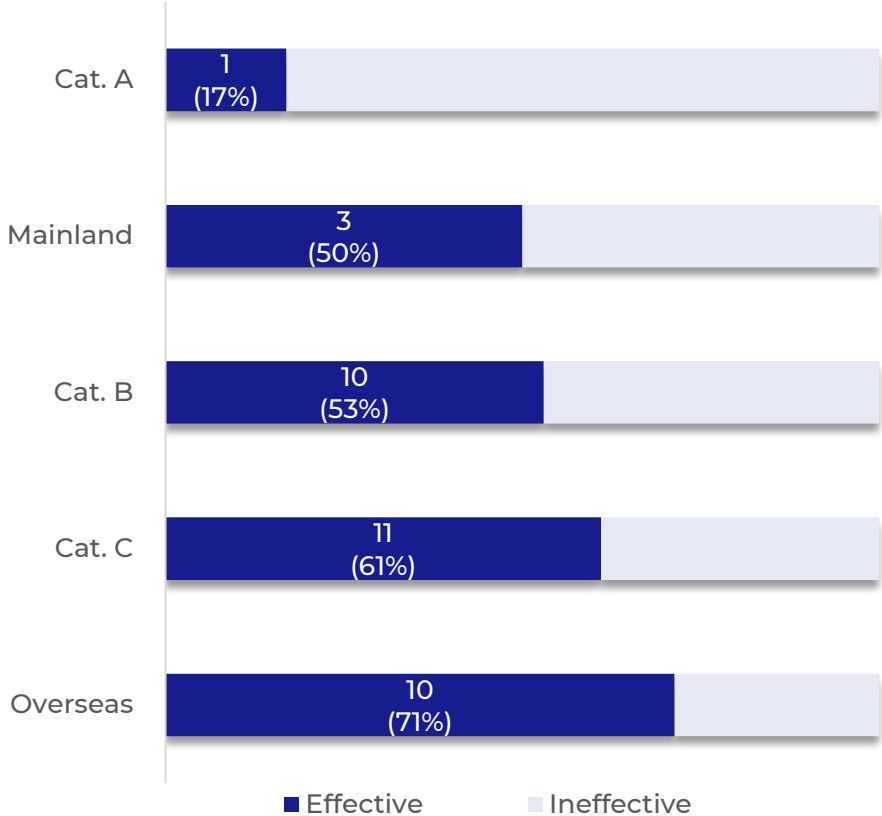
Have audit committees conducted an audit tender when selecting auditors?



Do they intend to conduct an audit tender in the next 12 months?



Finding 5: The effectiveness of audit committees implementing the AC Guidelines viewed by PIE auditors



- We asked PIE auditors to rate the overall effectiveness of the implementation of the AC Guidelines by the audit committees.
- Only **one Cat. A auditor (17%)** believes that the audit committees they work with have implemented the Guidelines effectively.
- This is far lower than Overseas auditors, where **10 (or 71%)** thought implementation was effective.

Cat. A – Local PIE auditors which audit 100 or more Hong Kong listed companies
 Cat. B – Local PIE auditors which audit 10 to 99 Hong Kong listed companies
 Cat. C – Local PIE auditors which audit 1 to 9 Hong Kong listed companies
 Mainland – Mainland PIE auditors recognized by AFRC
 Overseas – Overseas PIE auditors recognized by AFRC



3. Setting audit fees



How to set and assess audit fees

Why are audit fees important?

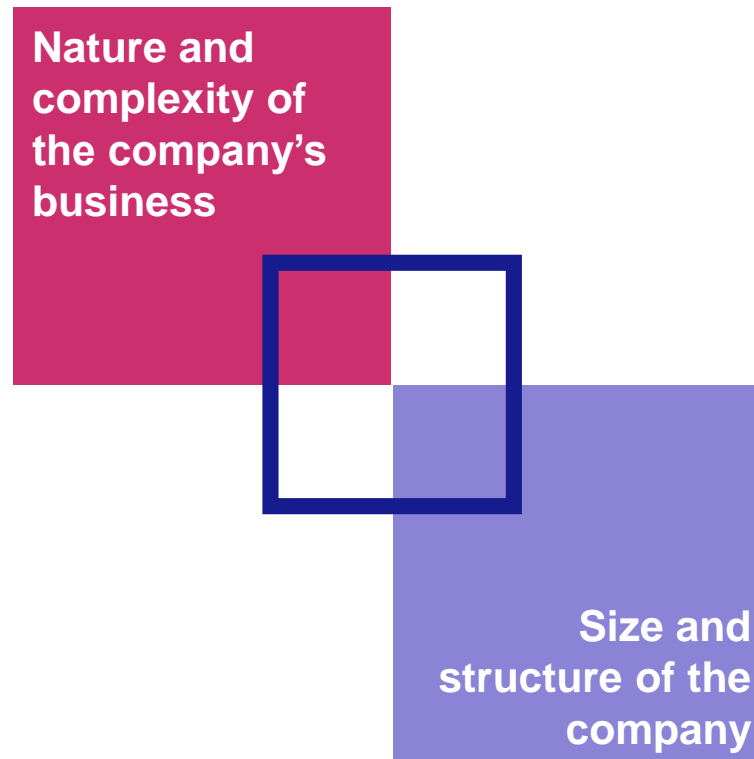
“There is usually a relationship between the quality of an audit and the quality and quantity of the resources used in its performance; this will usually be reflected in the audit fee” according to “*Audit Quality Framework, IAASB [2014]*”.

What is an adequate audit fee?

It should be at a level that:

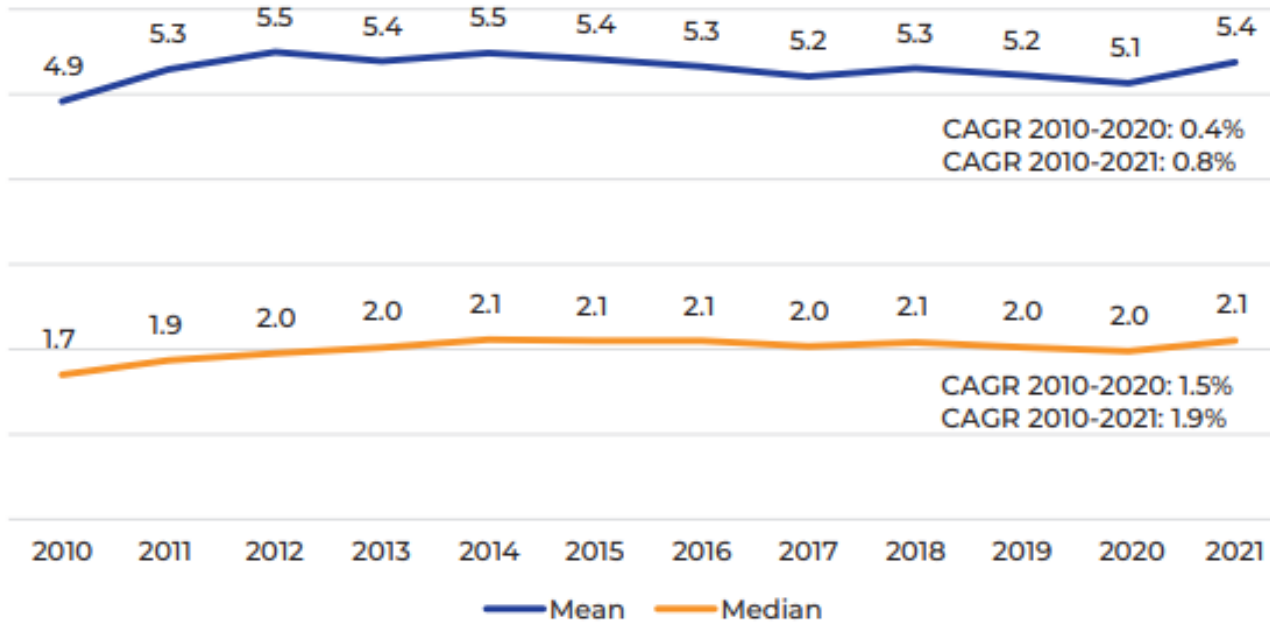
- enables sufficient audit resources to be allocated to perform audit procedures; and
- is comparable to the previous year if there is no significant change in the audit scope.

Key factors for consideration



Finding I: Average (“mean”) and median audit fees

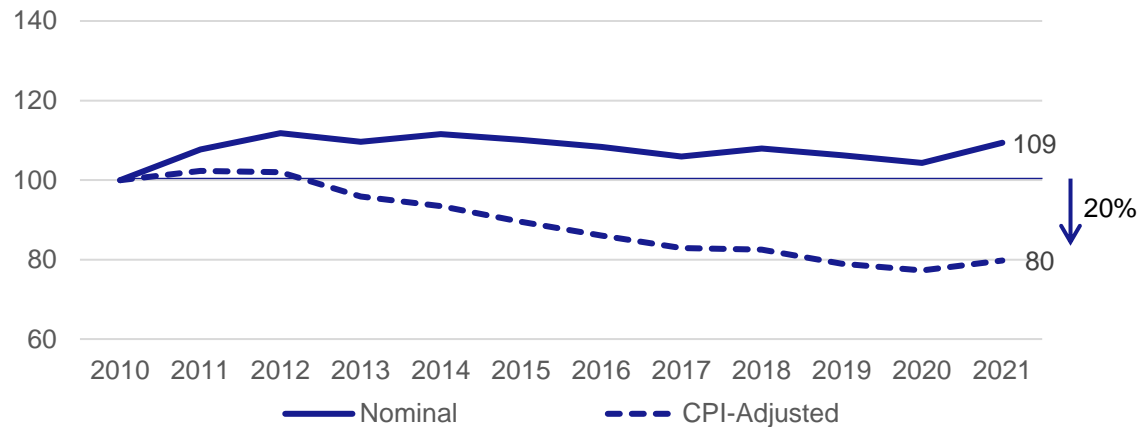
Mean and median audit fees (HK\$m)



- Both average and median audit fees were stagnant in 2020 as compared with 2019, but recovered some ground in 2021.
- The large gap between average and median audit fees shows that the market is skewed towards a small number of engagements with higher fees.

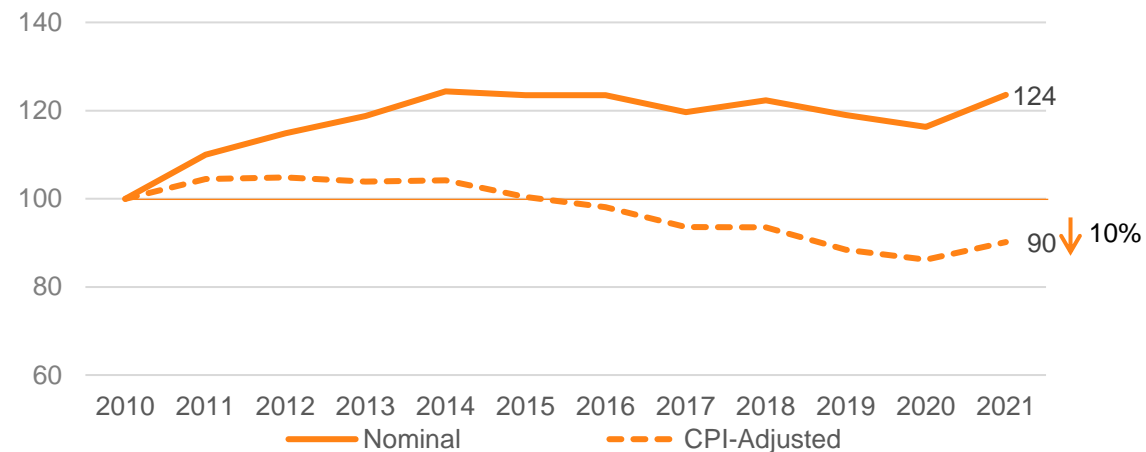
Finding II: Nominal and CPI-adjusted audit fee

Average audit fees



- Audit fees have not kept pace with inflation, regardless of whether we are looking at average fees or median fees.
- The absence in real growth in audit fees may signal margin erosion.
 - If situation persists, it may adversely affect the ability for firms to upskill their workforce or invest in new technology. **Audit quality will be adversely affected** as a result.

Median audit fees

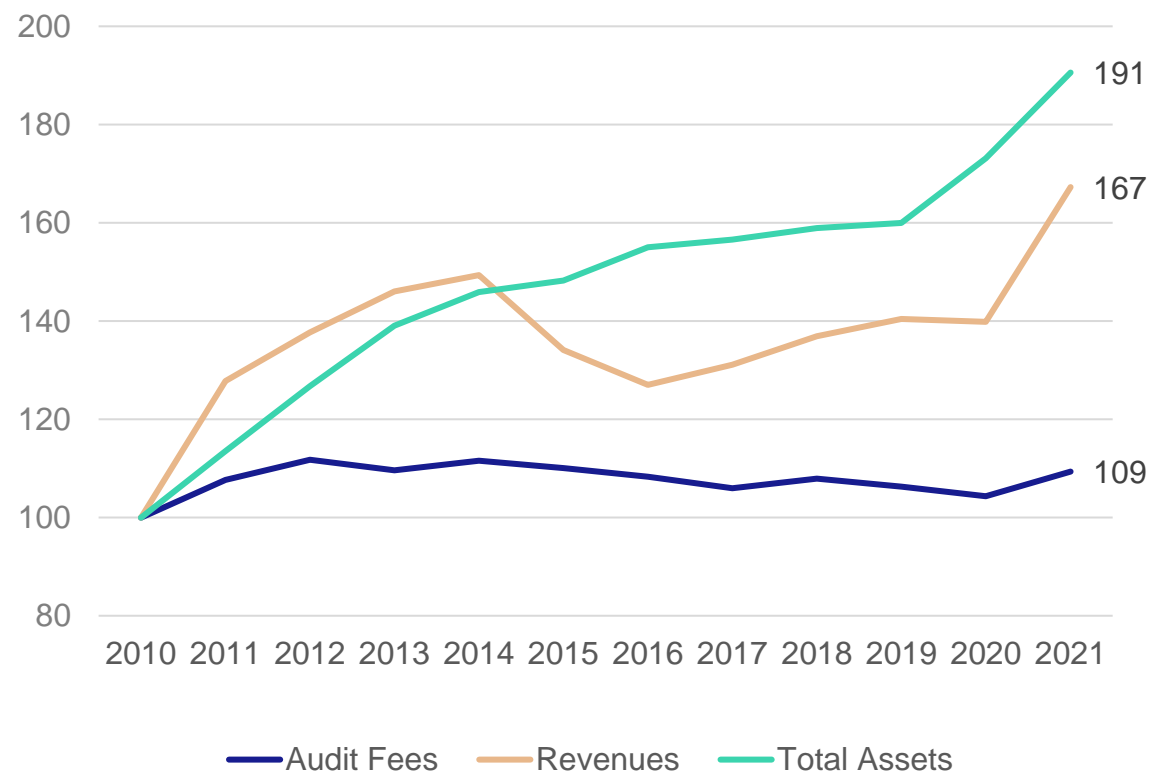


Note: Both nominal and CP-adjusted audit fees are shown here as indices, with their 2010 values rebased to 100.



Finding III: Average audit fees, revenues and total assets

Index of audit fees, revenues and total assets



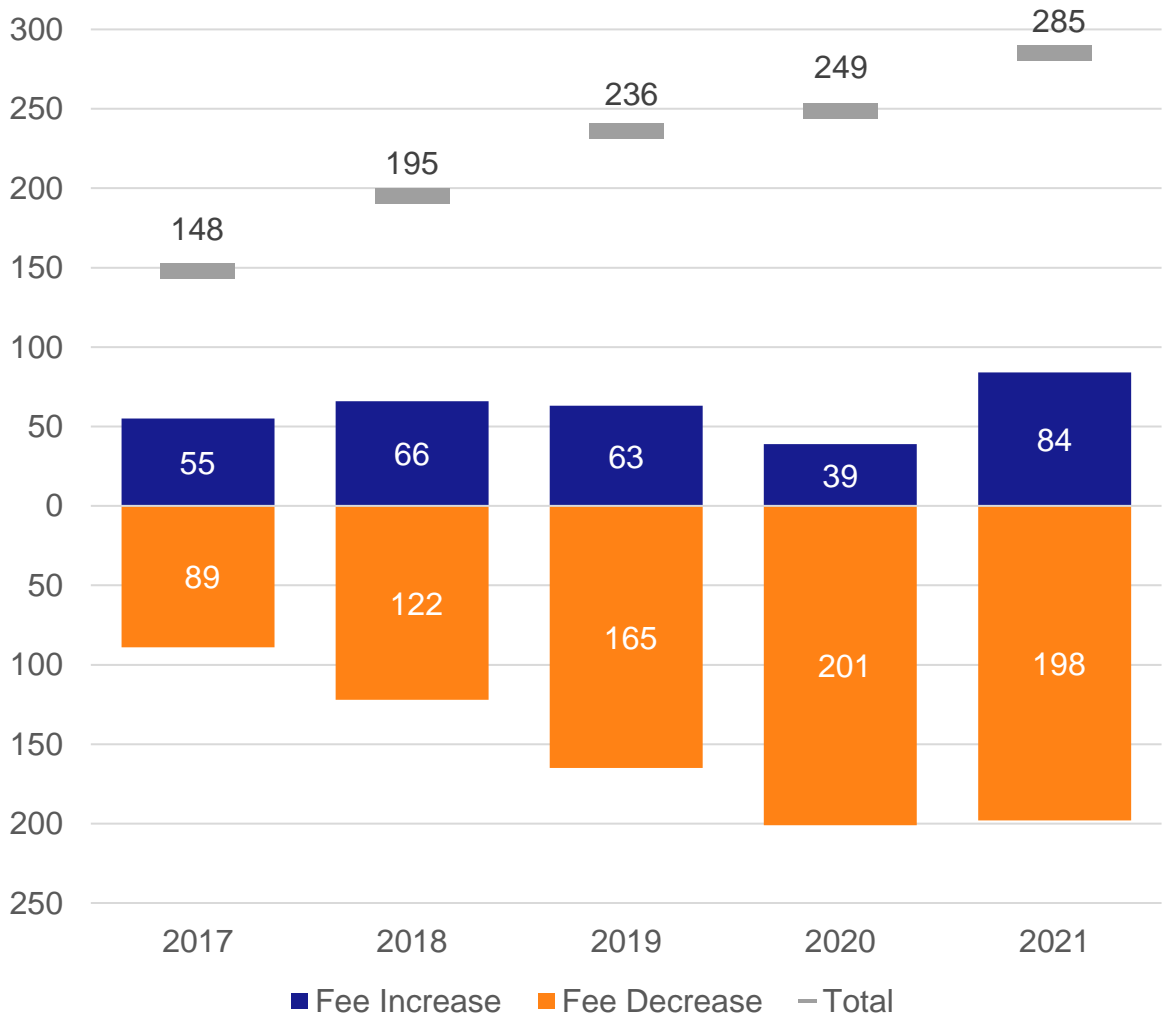
- Growth of audit fees significantly lags behind the growth experienced by listed companies and the level of complexity in the underlying business.

 - Revenue and total assets were used as indicators of company size and proxies for audit complexity.
 - Between 2010 and 2021, the average total assets of listed companies in Hong Kong increased by 91% and average revenue by 67%, but average audit fees only by 9%.

Note: Audit fees, revenue and total assets are computed as average values to ensure they are comparable across years. Each series is depicted as indices, with their 2010 values rebased to 100.



Finding IV: Number of listed companies that changed auditors and subsequent fee movements



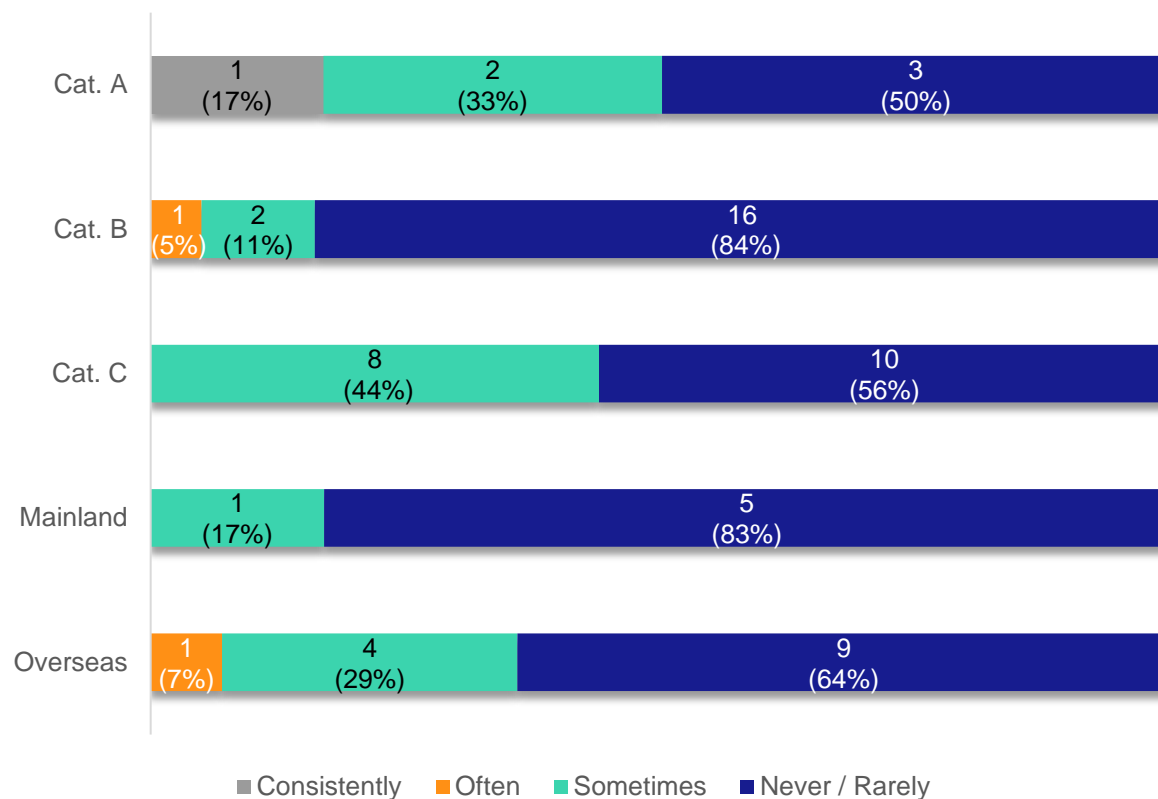
- The number of listed companies that changed auditors has been on the rise since 2011, and it has increased rapidly in the last five years.
- More than half of the listed companies who changed auditors experienced a fee reduction.
- Among the 534 listed companies that changed auditors in 2020 and 2021, audit fees were the most cited reason (346 times or 64.8%).

Note: The total population includes the listed companies that did not experience any fee changes following a switch in auditor.



Finding 6: Frequency with which audit teams experienced fee pressure that may compromise audit quality

Frequency of audit teams experiencing fee pressure



- Almost half of the Cat. A and C auditors experienced some fee pressure on a periodic basis. By contrast, only three Cat. B auditors (16%) indicated they often or sometimes experienced fee pressure.
- Possible reasons include:
 - The shift in market share from Cat. A to Cat. B auditors.
 - The quality of engagements typically undertaken by Cat. C auditors.

Cat. A – Local PIE auditors which audit 100 or more Hong Kong listed companies
 Cat. B – Local PIE auditors which audit 10 to 99 Hong Kong listed companies
 Cat. C – Local PIE auditors which audit 1 to 9 Hong Kong listed companies
 Mainland – Mainland PIE auditors recognized by AFRC
 Overseas – Overseas PIE auditors recognized by AFRC

4. Key messages to stakeholders

Key messages to stakeholders

Audit committees	Auditors
<ul style="list-style-type: none">• Develop a robust set of processes and procedures in auditor selection and audit tender by making reference to the Guidelines	<ul style="list-style-type: none">• Ensure audit fees are commensurate with the complexity and scale of the engagement; and maintain a high degree of professional scepticism regardless of fee level
<ul style="list-style-type: none">• Ensure that audit fees are agreed at a level that allows auditors to devote sufficient time and specialised resources to conduct a quality audit	<ul style="list-style-type: none">• Conduct a frank and open dialogue with audit committees and management to seek resolution of the issues when audit issue arise, and endeavour to complete the audit
Management and the Board	Shareholders and investors
<ul style="list-style-type: none">• Not pressure their auditors to reduce audit fees to a level that may compromise audit quality	<ul style="list-style-type: none">• Attend shareholder meetings, actively pose questions and exercise their voting rights on auditor selection, remuneration and the implementation of the Guidelines



Accounting and Financial
Reporting Council
會計及財務匯報局

Thank you

This presentation contains information compiled by the AFRC which is not intended to be exhaustive. The information has been prepared in general terms for reference only, without considering specific circumstances pertaining to any individual or individual case. It does not constitute advice from the AFRC and cannot be relied upon to cover specific situations. You should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. The AFRC does not accept any liability (whether in tort or contract or otherwise) for any loss or damage arising from any inaccuracy or omission or from any decision, action or non-action based on or in reliance upon information contained in this presentation.

© 2023 Accounting and Financial Reporting Council
All rights reserved.

