

## Press Release

24 March 2023

### **AFRC issues the Audit Fee Report and 2023 Survey Report on the implementation of Guidelines for Effective Audit Committees – Selection, Appointment and Reappointment of Auditors**

The Accounting and Financial Reporting Council (**AFRC**), the independent audit regulator in Hong Kong, publishes two new reports today on audit fees and the appointment of auditors in Hong Kong. In the reports, AFRC calls for auditors, audit committees, listed companies and institutional investors to develop a stronger focus on the setting of audit fees and the appointment of auditors, both of which are crucial in upholding the quality of financial reporting and audit in listed companies. This in turn will drive the resilience and continued success of Hong Kong's capital markets.

Mr Marek Grabowski, CEO of AFRC said, "These reports provide key insights on the factors contributing to audit quality. These factors include the level of audit fees, the market structure of audit services and the selection, appointment and reappointment of auditors."

AFRC's studies show that many listed companies prioritise audit fees over other factors when selecting auditors and this is apparent in the audit fee trend in Hong Kong.

"Not only is the level of audit fees a reflection of the complexity and risk inherent in the underlying businesses, but also of the quality and reputation of the auditor themselves. Through these reports, we wish to draw attention to the strong linkage between these factors, and their importance to market integrity and investor outcomes."

#### **Key findings: 2023 Survey Report on the Implementation of the Guidelines for Effective Audit Committees – Selection, Appointment and Reappointment of Auditors (the Survey Report)**

[The Survey Report](#) contains the results of AFRC's online survey on the practical realities facing auditors and audit committees in relation to auditor appointments and audit fee setting. The Survey was conducted in November and December 2022 and in total AFRC received responses from 165 listed companies and 63 Public Interest Entity auditors (**PIE auditors**).

Key findings of the Survey include:

- i) In terms of the implementation of the Guidelines, the picture is mixed. While 97% of listed company respondents agreed that they play a key role in enhancing and

maintaining audit quality, only one Category A PIE auditor<sup>1</sup> (17%) believed that the audit committees they work with have implemented the Guidelines effectively. This suggests there is significant room for improvement.

- ii) Despite AFRC's efforts in promoting audit quality during auditor selection, listed companies still rank proposed audit fees as one of the top three factors.
- iii) Audit teams experienced frequent pressure to reduce fees and to issue a clean audit opinion. Almost half of the Category A and C auditors experienced some fee pressure on a periodic basis as opposed to only 16% of Category B auditors. Auditors across all categories experienced pressure to issue a clean audit opinion, with half of Category A firms reported experiencing such pressures.
- iv) Quality of listed company disclosures leaves a lot to be desired: in three out of the four disclosure areas<sup>2</sup>, more than half of the auditor respondents believed that disclosures by listed companies were not satisfactory.

### **Key findings: Audit Fees Paid by Listed Companies in Hong Kong 2020-2021 (The Audit Fee Report)**

The way in which audit committees discharge their fiduciary duties and approach issues such as audit quality has a direct impact on the level of audit fees. [The Audit Fee Report](#) provides an analysis of the audit fees paid by listed companies and analysed what effects, if any, COVID-19 and the ensuing economic downturn have had on the market.

Key findings include:

- i) Total audit fees in Hong Kong in 2021 were HK\$13.1 billion, representing a compound annual growth rate (**CAGR**) of 6.0% from 2010.
- ii) On a per engagement basis, average and median<sup>3</sup> audit fees were HK\$5.4 million and HK\$2.1 million respectively in 2021. When adjusted for inflation, average and median fees show a decline of 20% and 10% respectively since 2010.

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<sup>1</sup> Category A PIE auditors are auditors with 100 or more PIE audit engagements; Category B PIE auditors are auditors with 10 to 99 PIE audit engagements; and Category C auditors have one to nine PIE audit engagements.

<sup>2</sup> The four disclosure areas: (i) Auditor selection process (ii) Auditor selection criteria and basis for decision (iii) Explanation of how the audit committee has assessed the effectiveness of the auditor (iv) Reasons for a change in auditor.

<sup>3</sup> In this press release, "average" or "mean" refers to the average fees per engagement, calculated by dividing the sum of audit fees by the number of engagements. "Median" is the middle value in the data set of audit engagement fees arranged in order. Both are indications of the typical fees paid, although the median value is less affected by outliers than the average.

- iii) Even though the level of audit fees typically reflects the level of complexity in the underlying business, in Hong Kong, growth of average audit fees significantly lags behind the growth experienced by listed companies. Between 2010 and 2021, the average total assets of listed companies in Hong Kong increased by 91%, and average revenues by 67%, but average audit fees only by 9%.
- iv) For local Category A PIE auditors, their market share has been in decline since peaking in 2019. This is irrespective of whether such market share is measured by way of audit fees or number of engagements.
- v) There is a strong association between a change in auditors and a subsequent reduction in audit fees. In 2020 and 2021, the number of listed companies which changed auditors continued to increase. Out of the 249 and 285 listed companies that changed auditors in 2020 and 2021, 80.7% and 69.5% experienced a fee reduction.

“The appointment of auditors and the determination of audit fees are deeply interconnected, giving rise to additional complexity when formulating policy responses. For example, audit committees may prioritise getting a fee reduction from their auditors, and may even change auditors to achieve that, without fully appreciating the potential negative consequences on audit quality and ensuing reputational damage when things go wrong,” said Mary Leung, Head, Policy, Registration and Oversight.

“There is a symbiotic relationship between the appointment of auditors and audit fees, and it is important for audit committees, auditors, listed companies and institutional shareholders to be more mindful and to approach the issue with extra care and diligence.”

### **Key messages to stakeholders**

- i) Audit Committees:
  - Develop a robust set of processes and procedures in auditor selection and audit tender by making reference to the Guidelines;
  - Ensure that audit fees are set at a level that allows auditors to devote sufficient time and specialised resources to conduct a quality audit.
- ii) Auditors:
  - Ensure audit fees are commensurate with the complexity and scale of the engagement; and maintain a high degree of professional scepticism.
  - Conduct a frank and open dialogue with audit committees and management to seek resolution when audit issues arise, and endeavour to complete the audit.

- iii) Management and the Board:
  - Not pressure their auditors to reduce audit fees to a level that may compromise audit quality.
- iv) Shareholders and investors:
  - Attend shareholder meetings, actively pose questions and exercise their voting rights on auditor selection, remuneration and the implementation of the Guidelines

Dr Kelvin Wong, Chairman of the AFRC concluded, “In times of heightened market volatility and economic uncertainty, the integrity of financial reporting and audit becomes especially critical. By raising awareness on a complicated issue, by providing guidance to the profession, and by calling for relevant stakeholders to act appropriately, AFRC aims to raise the quality of financial reporting, with the ultimate goal of maintaining public trust and confidence in Hong Kong’s capital markets.”

#### Notes to Editors

- [Overview of the Market for Listed Entity Audits in Hong Kong](#), AFRC, March 2021;
- [Guidelines for Effective Audit Committees – Selection, Appointment and Reappointment of Auditors](#), December 2021



Dr Kelvin Wong, Chairman (middle), Mr Marek Grabowski, CEO (right) and Ms Mary Leung, Head of Policy, Registration and Oversight (left) present to media The Survey Report and The Audit Fee Report.

### **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.

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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