

AFRC

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

2023 Annual Investigation and Compliance Report

4 September 2023

Investigation and Compliance Department



Dr Kelvin Wong, SBS, JP

Chairman



Mr Marek Grabowski

Chief Executive Officer



- Accuracy, integrity and consistency of listed entity financial statements are essential to maintaining investor confidence and the effective functioning of the capital markets.
- Accountants and auditors, as gatekeepers of financial reporting quality, play an important role in upholding high-quality financial statements and audits.
- AFRC has a strategic focus on enhancing the quality of financial reporting and auditing.

Ms Florence Wong

Head of Investigation and Compliance

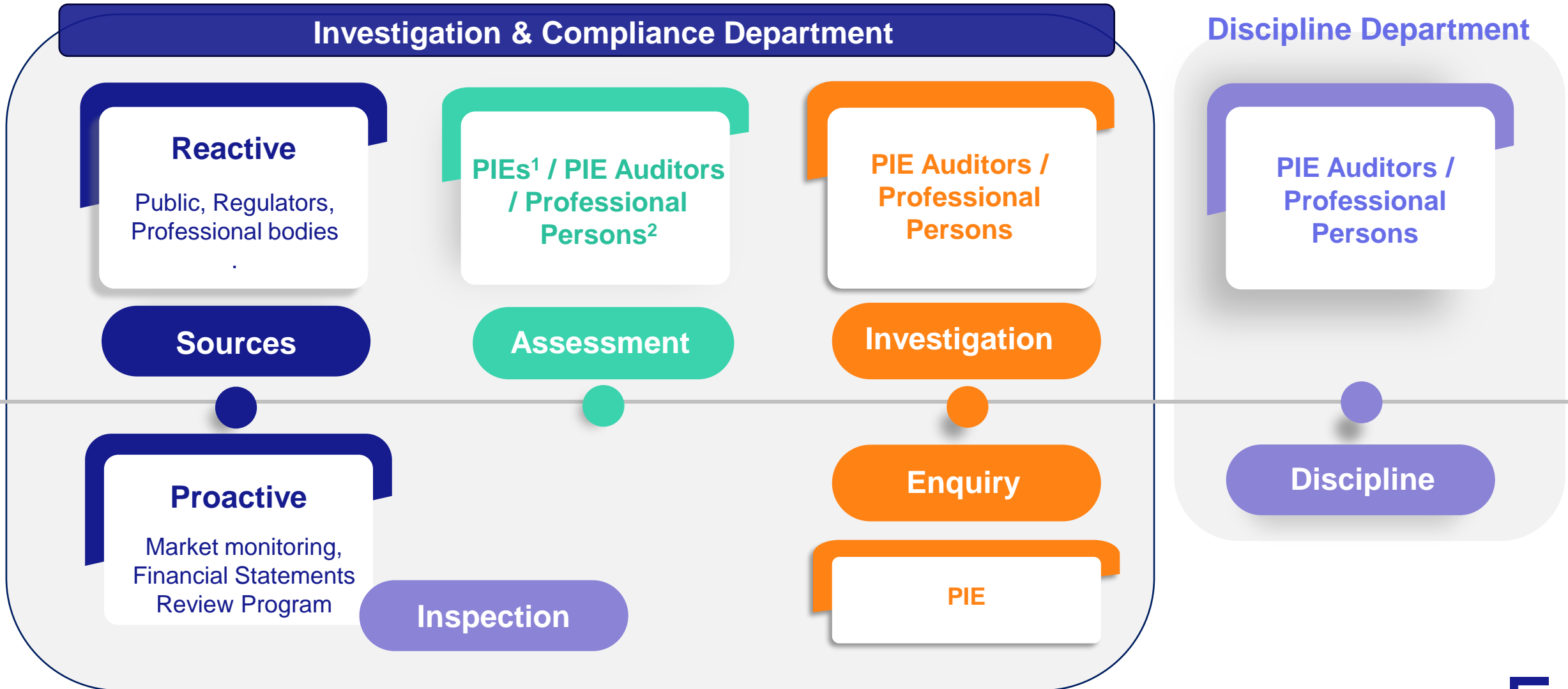


Agenda

1. Our Remit
2. Highlights of Our Operations 2022/23
3. Findings and Observations
4. Our Expectations and Actions



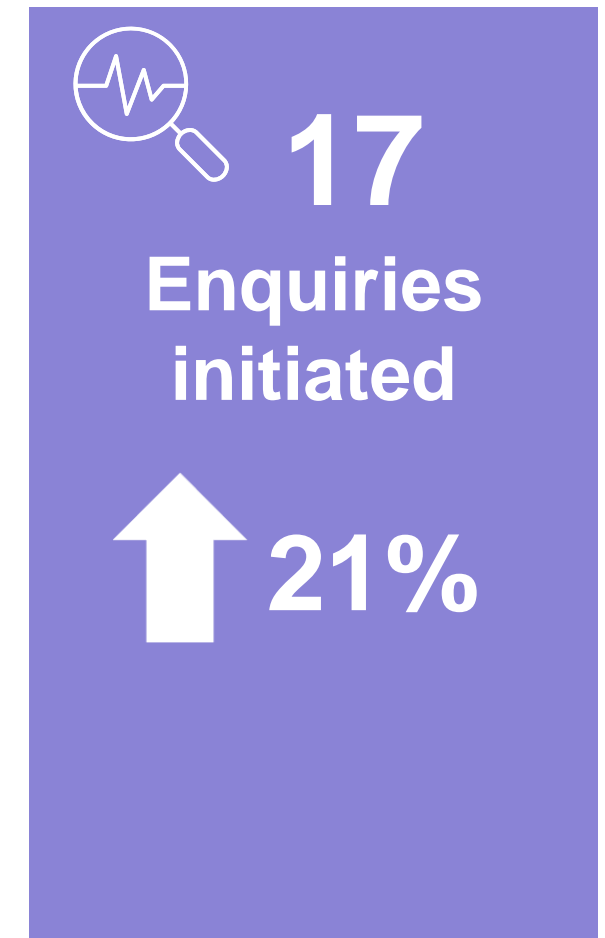
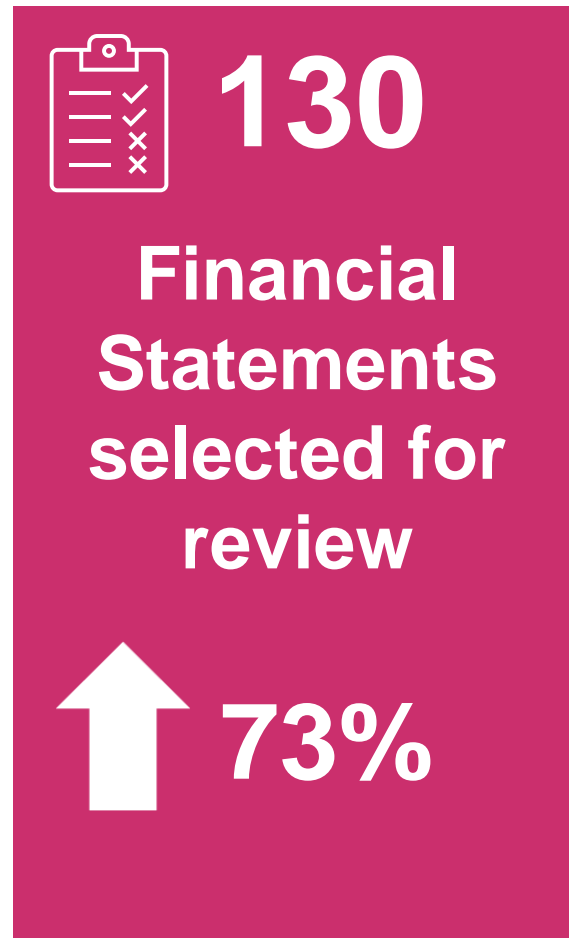
1. Our Remit



¹ PIE: Public interest entities

² Professional Persons: CPA and practice units

2. Highlights of Our Operations 2022/23

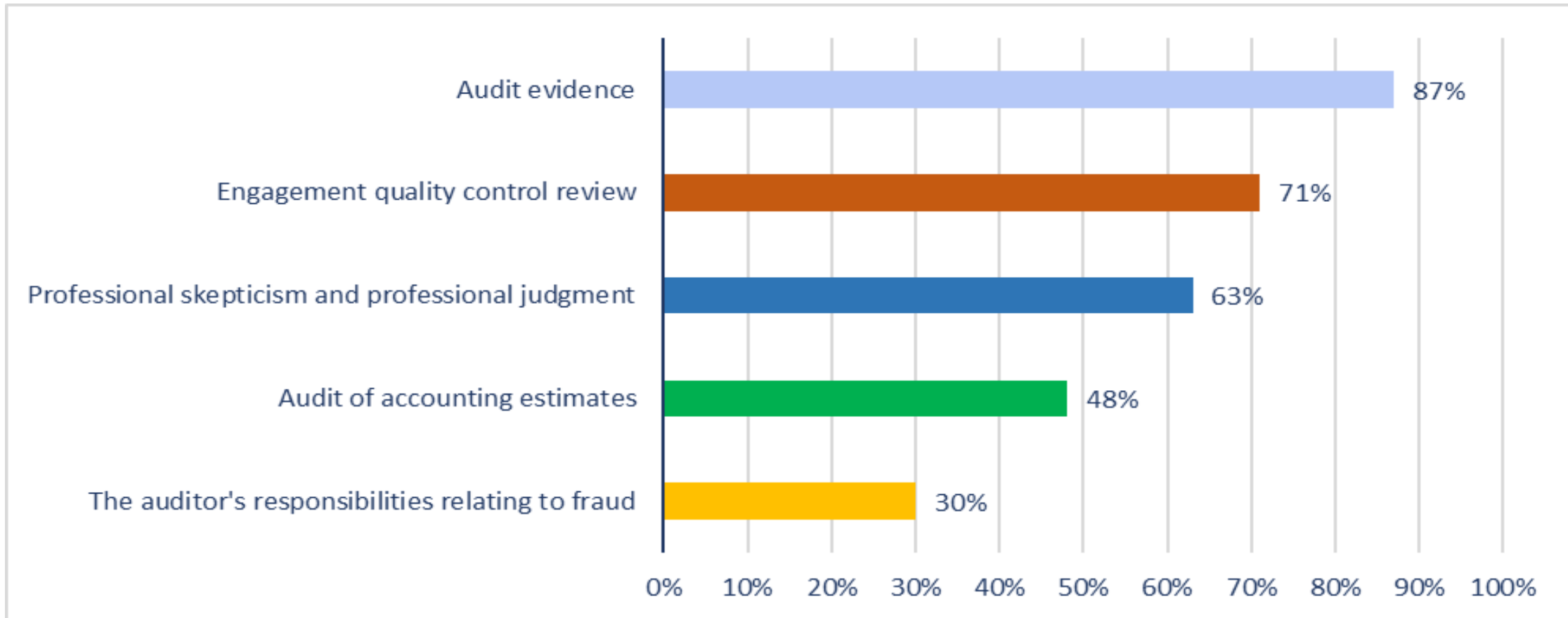


3. Findings and Observations

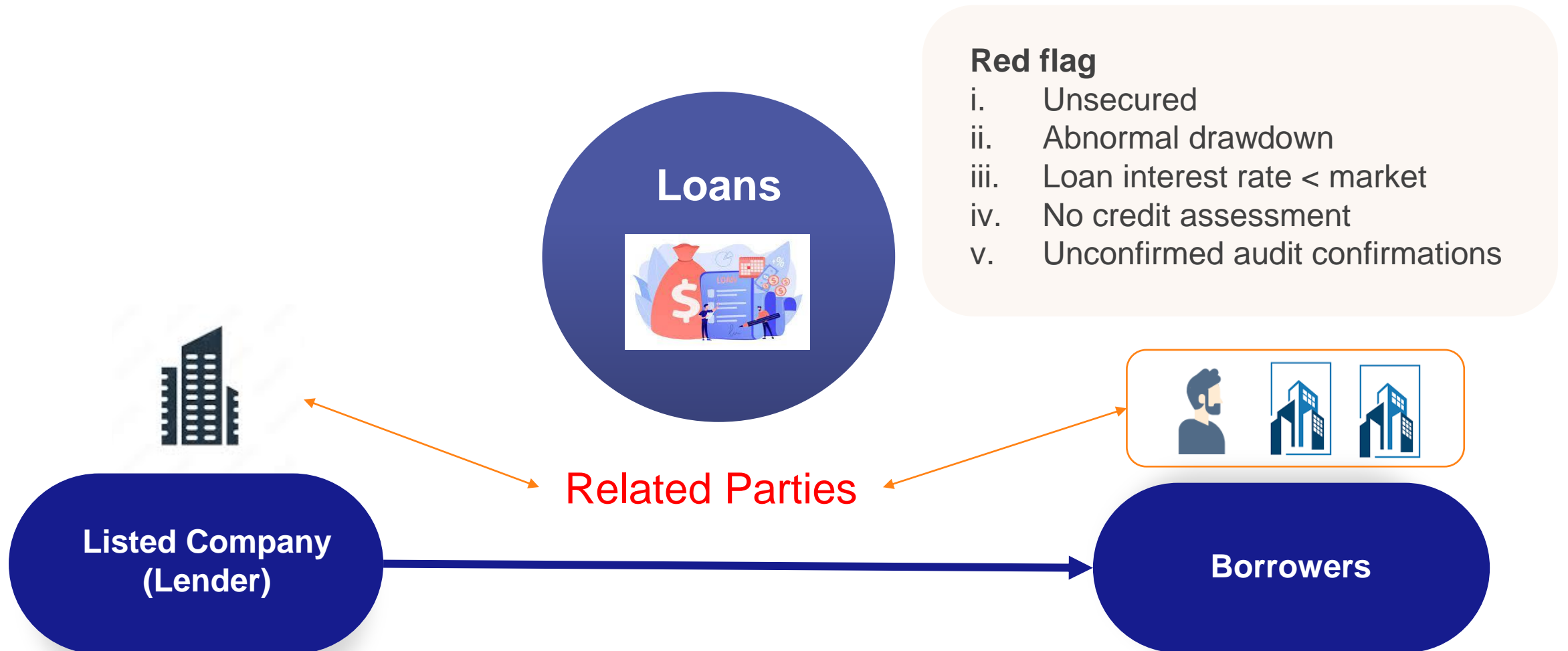
- (3.1) Top 5 potential misconduct by PIE Auditors
- (3.2) Potential fraudulent financial transactions and reporting
- (3.3) Reminders to Financial Statements Preparers
- (3.4) Financial Reporting Non-Compliance
- (3.5) Top 5 potential financial reporting non-compliance
- (3.6) Top 4 potential misconduct by Professional Persons

(3.1) Top 5 Potential Misconduct by PIE Auditors

(by % of investigations in 2022/23)



(3.2) Potential fraudulent financial transactions and reporting



(3.2) Potential fraudulent financial transactions and reporting

Auditor might have failed to:

- a. Verify original loan agreements
- b. Critically evaluate:
 - i. Commercial rationale
 - ii. Reasonableness of credit terms
- c. Evaluate internal controls on credit and risk assessment
- d. Challenge the draw-down arrangement and approval (e.g., Why a loan borrowed by a company was drawn down by an individual?)
- e. Question about the relationship with the borrowers
- f. Obtain direct audit confirmations on principal terms and the amount outstanding
- g. Challenge the basis of the recoverability of the loans

(3.2) Potential fraudulent financial transactions and reporting

Potential misconduct areas

- a. Fraud risk assessment
- b. Maintaining professional skepticism and judgement
- c. Audit of accounting estimates
- d. Audit evidence
- e. Engagement quality control review

(3.3) Reminders to Financial Statements Preparers

**Those charged
with governance
(Directors and
Audit Committee
of listed entities)**

should

- a. Establish a proper control environment
- b. Maintain policies and procedures
- c. Ensure:
 - i. Credit assessments and due diligence on counterparties
 - ii. Internal control on loans and advance, and prepayment and borrowings
 - iii. Follow up on outstanding amounts
 - iv. Impairment assessment
 - v. Documentation
 - vi. Disclosure

(3.4) Financial Reporting Non-Compliance

Convertible Bonds (CB) issued

Nature

- a. Recognition and measurement of financial instruments
- b. Fair value measurement

What went wrong?

- a. Fair value of CB = CB's principal amount
- b. Recognised revaluation gain on the liability component of the CB

Reasons for non-compliance

- a. Financial statements preparer did not have
 - i. Adequate understanding of accounting standards on financial instruments
 - ii. An appropriate valuation of CB components at issuance of the CB

Reminders

- a. Understand the substance and terms of the CB agreement to properly classify the components of the CB
- b. Proper valuation of the CB components and its embedded options at initial recognition

(3.4) Financial Reporting Non-Compliance

Financial statements disclosure deficiencies

What went wrong?

Inadequate or inappropriate financial statements disclosures

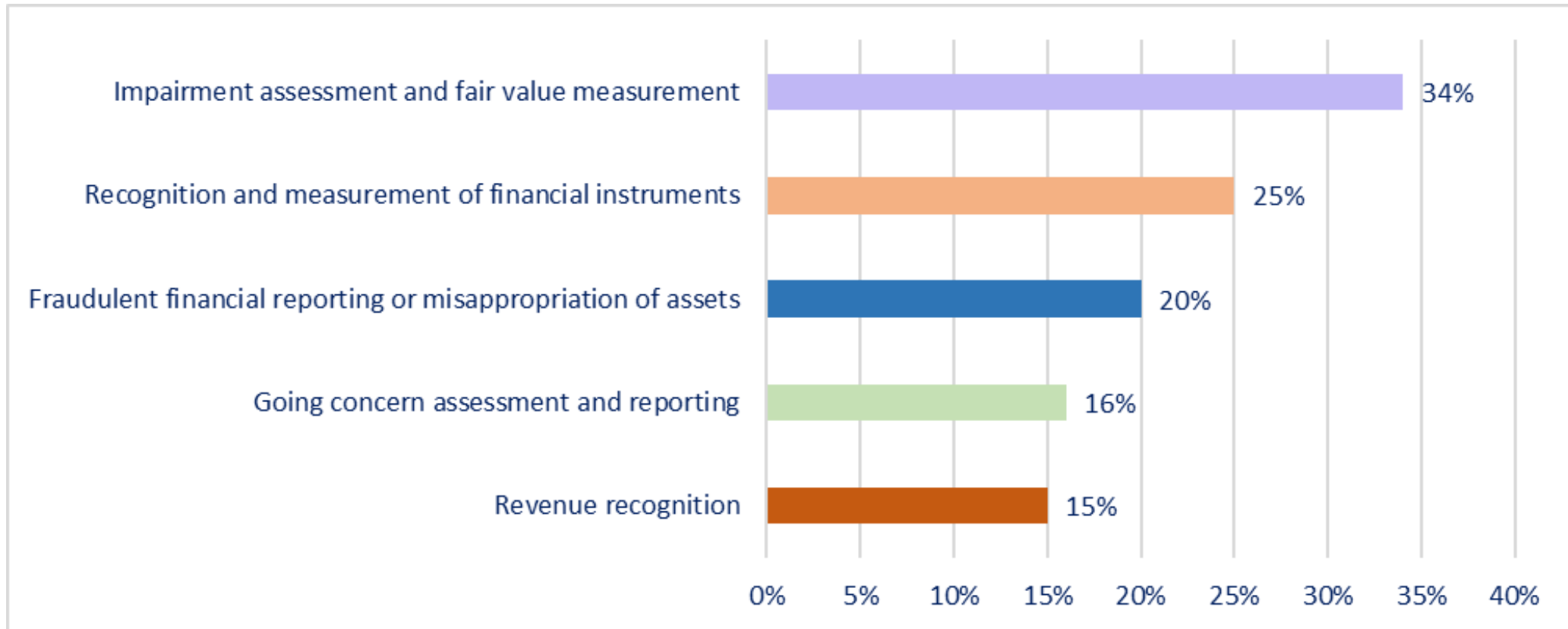
- i. Gross carrying amount of financial assets (HKFRS 7)
- ii. Exposure of credit risk on loan commitment and financial guarantee contracts by credit risk rating grades (HKFRS 7)
- iii. Events and circumstances leading to significant changes of contract liability (HKFRS 15)

Reasons for non-compliance

Financial statements preparer did not understand disclosure requirements in accounting standards

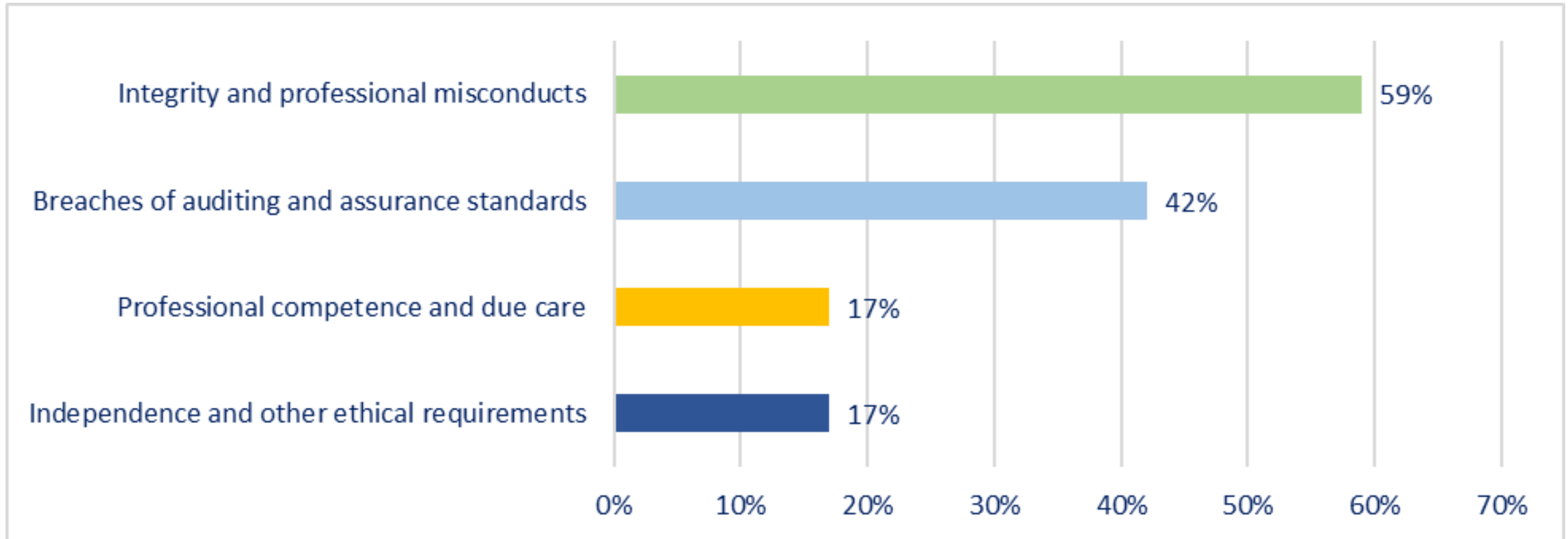
(3.5) Top 5 Potential Financial Reporting Non-Compliance

(by % of investigation and enquiry cases initiated in 2022/23)



(3.6) Top 4 Potential Misconduct by Professional Persons

(by % of investigations initiated in 2022/23)



4. Our Expectations and Actions

Expectations of Financial Statement Preparers and Auditors

- Stay up-to-date with the financial reporting and auditing standards
- Be alert to misstatements due to errors and fraud
- Allocate sufficient time and resources to planning

Our Actions

- Alert regulatees and market participants by sharing the findings of our work
- Prioritizing investigations with high public interest
- Actively follow up to rectify financial reporting non-compliance identified in Enquiries

Dr Kelvin Wong, SBS, JP

Chairman



Q & A



Thank you

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