

## Press Release

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### AFRC highlights impact of current economic conditions on financial reporting and audit practices

The Accounting and Financial Reporting Council (**AFRC**) has today published a report "[Audit implications of current economic conditions for Hong Kong-listed companies](#)" (**the Report**). The Report examines how current economic conditions are impacting financial reporting and audit practices for Hong Kong-listed companies. It also provides relevant insights for company management, audit committees, and auditors.

- (a) **Impact on financial reporting:** Economic conditions influence companies' business strategy, management behaviour, and financial position. Economic conditions can drive companies to engage in earnings management to misrepresent their financial situations. Earnings management practices that mislead investors and other users of financial statements are unacceptable.
- (b) **Role of company management and audit committees:** When preparing financial statements, company management should consider factors such as GDP growth, inflation, and interest rates to ensure that the statements accurately reflect the company's financial position. Audit committees should oversee the process to ensure high-quality financial reporting.
- (c) **Role of auditors:** Auditors should assess how economic conditions impact financial statements and audit practices. They need to scrutinise accounting estimates such as expected credit loss, asset impairment and going concern assessment, as these areas could carry higher audit risks due to their subjectivity.

Ms Janey Lai, CEO of the AFRC, said, "Auditors must assess economic conditions throughout the audit. To ensure a comprehensive audit risk assessment, we reiterate the importance of early involvement by engagement partners and engagement quality reviewers, as the audit risks brought by economic conditions can be far-reaching and necessitate proper planning to address."

The preparation of financial statements involves making subjective judgements in accounting estimates, particularly those that are likely to be affected by changes in economic conditions. These estimates include:

- (a) **Expected credit loss:** Although the banking sector's overall asset quality remains healthy, companies should continue to diligently assess the recoverability of their accounts receivable. When new information emerges, such as a reduction in the interest rate, companies should update their economic scenario forecasts for a more representative loan provision.

- (b) **Asset impairment:** Changes in the market and the economy may impact the company's operations, which could lead to asset impairment. Therefore, a comprehensive assessment should be conducted to evaluate any impairment needs.
- (c) **Going concern assessment:** The economy of Hong Kong has continued to recover after the pandemic; however companies must continue to evaluate their own ability to continue operating in the foreseeable future.

The three accounting estimates above, along with other accounting estimates, involve subjective judgements that could carry higher audit risks. To deliver high audit quality, auditors must ensure that they:

- (a) Understand the audited entity and its environment;
- (b) Plan an effective audit based on the evolving economic conditions;
- (c) Maintain professional scepticism when obtaining sufficient audit evidence for accounting estimates; and
- (d) Evaluate the competence, capabilities and objectivity of experts, and the adequacy of their work when engaging them in testing accounting estimates.

Ms Lai stressed, "Company directors are responsible for preparing the financial statements with reasonable care and diligence, while auditors must maintain vigilance and professional scepticism to deliver a high-quality audit. Audit committees play a critical role in overseeing both the integrity of financial statements and audit quality. Together, these efforts safeguard the quality of financial reporting, market integrity, and Hong Kong's position as a leading international financial centre."

End

## About the Accounting and Financial Reporting Council

The Accounting and Financial Reporting Council 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 and promotes the healthy development of the accounting profession.

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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