

**Process Review Panel
for the Accounting and Financial Reporting Council**

2022 Annual Report

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Message from the Chairperson

On 1 October 2022, we witnessed the beginning of a new era for the Accounting and Financial Reporting Council (“AFRC”) and the accounting profession as the former Financial Reporting Council (“FRC”) took on an expanded role in the regulation of the accounting sector. Upon the commencement of the new regulatory regime of Hong Kong’s accounting profession, the AFRC has become a full-fledged independent regulatory and oversight body of the accounting sector. On top of its regulatory powers over Public Interest Entities (“PIE”) auditors, the AFRC has been vested with expanded statutory functions of, *inter alia*, registration, inspection, investigation and discipline of accounting professionals and practices.

Accordingly, the Process Review Panel (“PRP”) for the FRC has been renamed as the PRP for the AFRC, and charged with the responsibilities to review cases handled by the AFRC under its expanded functions and to consider whether actions taken by the AFRC are consistent with its internal procedures and guidelines in future review cycles.

In the 2022 review cycle, the PRP continued its review on the AFRC’s work in relation to the regulation of PIE auditors. In particular, the PRP reviewed the AFRC’s handling of (a) 10 complaint, investigation and/or enquiry cases, (b) inspections on six PIE firms and seven PIE engagements, (c) four overseas PIE auditors recognition applications, and (d) the oversight of the Hong Kong Institute of Certified Public Accountants’ specified functions from January to December 2021. I am pleased to present in this Annual Report the PRP’s observations and recommendations made in the review process.

On completion of the 2022 review cycle, I wish to thank all members for their devotion to the PRP’s work. My thanks also go to the AFRC executive team for the unwavering efforts and cooperation in assisting the PRP in the review exercise whilst in parallel pressing ahead with the preparatory work for the launch of the new regulatory regime. As the AFRC continues to gear up for the progressive implementation of the new regime, I look forward to working closely with PRP members and

the AFRC to review and refine its case handling procedures with a view to helping the AFRC enhance its regulatory efficiency and effectiveness.

Ms Edith SHIH
Chairperson

Chapter 1 : Background

Overview

1.1 In 2008, the Process Review Panel (“PRP”) for the Financial Reporting Council (“FRC”) was established by the Chief Executive as an independent non-statutory panel to review cases handled by the FRC, and consider whether actions taken by the FRC were consistent with its internal procedures and guidelines. The establishment of the PRP reflects the Government’s commitment to enhancing the accountability of the FRC.

1.2 On 1 October 2022, the new regulatory regime of the accounting profession was launched. The FRC has been renamed as the Accounting and Financial Reporting Council (“AFRC”) in accordance with its expanded regulatory role. Pursuant to the Financial Reporting Council (Amendment) Ordinance 2021, the AFRC, on top of its pre-existing regulatory functions over Public Interest Entities (“PIE”)¹ auditors, has been vested with expanded powers to issue practising certificates to certified public accountants; register practice units and PIE auditors; and deal with matters regarding inspection, investigation and discipline of the accounting profession. It is also tasked to promote the development of the accounting profession and oversee the performance of the various statutory professional functions of the Hong Kong Institute of Certified Public Accountants (“HKICPA”).

1.3 With the agreement of the Chief Executive, the terms of reference of the PRP has been correspondingly expanded to review the cases as well as internal procedures and operational guidelines in relation to the aforementioned new functions of the AFRC. To reflect its expanded ambit, the PRP has also been renamed as the PRP for the AFRC.

Functions of the PRP

1.4 The latest terms of reference of the PRP are as follows –

¹ A PIE means a listed collective investment scheme or a corporation with its equities listed on Hong Kong’s stock market.

- (a) to review and advise the AFRC on the adequacy of its internal procedures and operational guidelines governing the actions taken and operational decisions made by the AFRC and its staff in the performance of the regulatory functions in relation to the following areas –
 - (i) issuance of practising certificates;
 - (ii) registration of local PIE auditors and practice units;
 - (iii) recognition of overseas PIE auditors;
 - (iv) inspection of PIE auditors and practice units;
 - (v) complaints handling, enquiry and investigation;
 - (vi) disciplinary actions; and
 - (vii) oversight of the performance of the HKICPA of specified functions which include–
 - (1) in relation to PIE auditors: setting requirements for continuing professional development (“CPD”), and setting standards on professional ethics, auditing and assurance; and
 - (2) in relation to practice units and certified public accountants (“CPAs”): registration and training, arranging for recognition of accounting qualifications, and setting CPD requirements and standards on professional ethics, accounting, auditing and assurance;
- (b) to receive and consider periodic reports from the AFRC on completed or discontinued cases in the areas mentioned in (a) above;
- (c) to receive and consider periodic reports on enquiries, investigations and disciplinary cases lasting more than one year;
- (d) to receive and consider periodic reports from the AFRC on

complaints against the AFRC or its staff;

- (e) to call for files from the AFRC to review the handling of cases in the areas mentioned in (a) above to ensure that the actions taken and decisions made are adhered to and are consistent with internal procedures and guidelines and to advise the AFRC where appropriate;
- (f) to advise the AFRC on such other matters relating to the AFRC's performance of statutory functions as the AFRC may refer to the PRP or on which the PRP may wish to advise; and
- (g) to submit annual reports to the Financial Secretary which, subject to applicable statutory secrecy provisions and other confidentiality requirements, will be published.

1.5 The internal procedures which the PRP would make reference to in reviewing the AFRC's cases include guidelines on its statutory functions, working protocols with other regulatory bodies, preservation of secrecy and identity of informers, and relevant legislative provisions.

1.6 The PRP is tasked to review and advise the AFRC on its handling of cases, not its internal operation or administrative matters. Therefore, the work of the committees set up under the AFRC Board is not subject to direct review by the PRP.

Modus operandi of the PRP

1.7 The case review cycles of the PRP run on a calendar year basis. The AFRC provides the PRP with lists of cases completed or discontinued or ongoing for more than one year in the previous calendar year, from which the PRP would select cases for review in the format of case review sessions. In the discharge of their duties, the PRP members are reminded to preserve secrecy in relation to information furnished to them, and not to disclose such information to other persons. To maintain independence and impartiality of the PRP, all PRP members would declare their interests upon commencement of their term of appointment and before conducting each case review.

Composition of the PRP

1.8 In 2022, the PRP comprised eight members, including the Chairperson, from a wide spectrum of professions including the accounting, legal, business and academic sectors. The Chairperson of the AFRC and the representative of the Secretary for Justice are ex-officio members of the PRP.

1.9 The membership of the PRP in 2022 is as follows –

Chairperson

Ms Edith SHIH

Members

Mr Patrick LAW Fu-yuen

Mr Andrew MAK Yip-shing

Mr Frederick TSANG Sui-cheong

Prof Anna WONG Wai-kwan

Mr YU Chung-leung

Ex-officio Members

Dr Kelvin WONG Tin-yau, SBS, JP
(in his capacity as the Chairman of the AFRC)

Ms Denise LAM Kien-sau
(in her capacity as the representative of the Secretary for Justice)

Secretariat

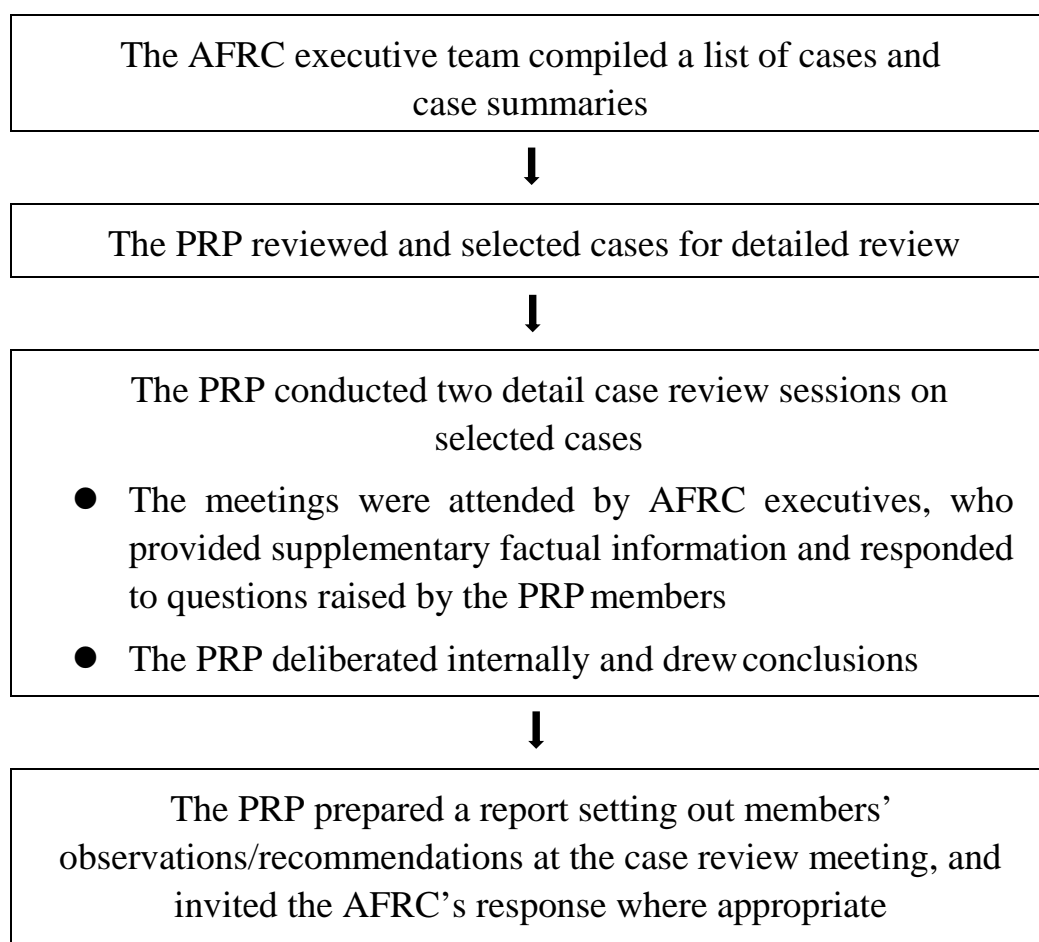
Financial Services and the Treasury Bureau

Chapter 2 : Work of the PRP in 2022

2.1 This Annual Report covers the work of the PRP in 2022, which reviewed reports from the AFRC on cases it handled in relation to the regulation of PIE auditors from January to December 2021.

Case review work flow

2.2 The work flow adopted by the PRP in reviewing the cases is set out below –



Selection of cases for consideration/review

2.3 The AFRC executive team provided the PRP with the summaries of cases that were completed, discontinued or ongoing for more than one year in 2021. The distribution of the cases and the number of cases selected for review by the PRP are as follows –

<u>Category of cases</u>	<u>Number of cases completed / discontinued / ongoing for more than one year as at 2021</u>	<u>Number of cases selected for review</u>
(A) Inspection	67	13
<i>Completed inspection on quality control system of PIE firms</i>	17	6
<i>Completed inspection on PIE engagements</i>	50	7
(B) Handling of complaints, enquiries and investigations	113	10
<i>Ongoing cases lasting more than one year as at 31 December 2021</i>	52	3
<i>Ongoing cases</i>	19	2
<i>Completed cases arising from complaints</i>	9	3
<i>Completed cases arising from financial statements review programme</i>	8	2
<i>Complaints not taken further due to unsubstantiated allegations</i>	24	-
<i>Complaints against AFRC or its staff</i>	1	-
(C) Recognition of overseas PIE auditors	96	4
<i>New applications from overseas corporations</i>	5	2
<i>New applications from collective investment schemes</i>	34	-
<i>New applications from listing applicants</i>	7	-

<i>Renewal applications from overseas corporations</i>	46	1
<i>Renewal applications from collective investment schemes</i>	2	-
<i>Renewal applications from listing applications</i>	2	1

In addition to the above selected cases, the PRP also reviewed the AFRC's work in relation to the oversight of the HKICPA's performance of specified functions in 2021.

2.4 Highlight of the PRP's observations and recommendations are set out in Chapter 4. Follow-up actions taken by the AFRC on PRP's recommendations in the 2021 Annual Report are set out in Chapter 3.

Chapter 3 : Follow-up Actions Taken by AFRC on PRP's Recommendations in the Past Year

3.1 In its 2021 Annual Report, the PRP made a number of recommendations to the AFRC (formerly known as the FRC) in relation to its functions of inspection, investigation and enquiry. The AFRC's follow-up actions are summarised as follows.

A. *Consistency and robustness of regulatory judgements across inspections*

3.2 According to the AFRC's inspection programme, PIE auditors are grouped under three categories according to the number of PIE audit clients of the auditors, i.e. Category A firms are those with more than 100 PIE audit clients, Category B firms are with 10 to 100 PIE audit clients while Category C firms less than 10. The composition of inspection teams is different for inspecting firms of different categories, i.e., teams inspecting Category A firms led by executive staff at Director level and those inspecting Categories B and C firms led by staff at Associate Director or Manager level. The PRP considered it necessary to put in place targeted measures to ensure that the assessment of audit quality have been carried out, and the audit quality ratings have been assigned consistently across different inspection teams with robust justifications.

3.3 In response, the AFRC has put in place the following measures –

- (a) reviewing and updating the operations manual for the inspection function to (i) require inspectors to document, using a standardised form, the rationale for the key judgements made in determining the audit quality rating of individual PIE engagement inspected; (ii) specify rating criteria to be taken into consideration when determining audit quality rating; and (iii) require the documentation to be reviewed by the Inspection Team Leaders, Case Reviewers (if any), and the head of department before finalisation of the ratings; and
- (b) tasking the Inspection Subcommittee comprising members with experience in PIE engagements to carry out annual review on both

the merits and procedures of the AFRC's inspections by selecting cases for scrutiny, thereby ensuring that the AFRC adhered to its internal procedures, and the ratings assigned to the PIE engagements inspected are appropriate.

B. Procedural guidelines for handling investigation cases

3.4 The PRP noted in one of the cases selected for review in 2021 that the AFRC initiated an investigation arising from a complaint, and later on expanded the investigation scope of the case to cover a second complaint concerning the audits for two other financial years of the same PIE auditor, with a view to conducting a holistic review of the audit quality of the PIE auditor in question. With consideration of the potential implications of an expansion of investigation scope during the investigation process to the progress of the case and the parties concerned, the PRP recommended the AFRC to devise a set of standard procedures based on the experience for more systematic handling of similar cases in future.

3.5 In response, the AFRC has updated the Operations Manual for the investigation function to require (i) reporting to the Audit Investigation Board (“AIB”)² / head of the Department as soon as practicable of any new issue identified in respect of which there might be a possible misconduct, practice irregularity or relevant irregularity on the part of PIE auditors or professional irregularity on the part of non-PIE practice units and CPAs in relation to an ongoing investigation; (ii) submission of a proposal with justification(s) to the AFRC Board / head of the Department for consideration and approval of the modification of the scope of an ongoing investigation; and (iii) informing the regulatees of any modification of the investigation scope.

C. Manpower planning for efficient handling of investigation and enquiry cases

3.6 The PRP observed that the long processing time in some of the investigation and enquiry cases selected for review was partly due to staffing issues including the shortage of human resources, reallocation of

² The Audit Investigation Board comprises the Chief Executive Officer of the AFRC as the Chairman and AFRC executives as members, and is responsible for handling investigation cases concerning PIE engagements completed before 1 October 2019.

cases due to departure of officers or internal review of workload, or some other unforeseen circumstances. It recommended the AFRC to consider potential ways to address the issue, including but not limited to stepping up monitoring and guidance by senior management, as well as proactive coordination on inter-departmental case referrals and case intake from other financial regulators.

3.7 In terms of manpower, the total headcount of the Investigation and Compliance Department has been increased from 13 to 29 professional staff pursuant to the AFRC's approved budget for 2022/23. With the expansion of the establishment, the AFRC has higher capacity to handle the increasing caseload. The Department is developing policies to enhance efficiency in handling complaints and granting extension requests and a plan for the clearance of backlogs, which are expected to be developed by the third quarter of 2023.

3.8 As for coordination among departments for referral of cases, the AFRC has updated the Operations Manual in relation to inter-departmental cooperation covering referrals and sharing of information. Regular meetings among departments are held to facilitate cross-departmental collaboration on case referrals or other matters, e.g. early alert to the Investigation and Compliance Department of potential investigation cases arising from ongoing inspections being carried out by the Department of Inspection. Externally, the AFRC has signed Memoranda of Understanding for regulatory cooperation with the HKICPA, the Securities and Futures Commission, the Stock Exchange of Hong Kong Limited, the Independent Commission Against Corruption, and the Commercial Crime Bureau of the Hong Kong Police Force. These MoUs facilitate more efficient and effective collaboration in respect of identifying cases of mutual interest / benefits and sharing of intelligence.

3.9 The PRP welcome the above follow-up actions and lookforward to the AFRC's continuous efforts to ensure procedural efficiency and effectiveness.

Chapter 4 : Observations and Recommendations on Cases Reviewed

4.1 In the current review cycle, the PRP reviewed the AFRC's handling of (a) 10 complaint, investigation and/or enquiry cases, (b) inspections on six PIE firms and seven PIE engagements, (c) four overseas PIE auditors recognition applications, and (d) the oversight of the HKICPA's specified functions. The PRP recognised the AFRC's efforts in discharging its various regulatory functions in relation to PIE auditors, and was satisfied that the AFRC had handled the cases selected for review in accordance with the internal procedures set out in the AFRC's Operations Manuals.

4.2 During the review, the PRP noted some areas for enhancements, and its observations and recommendations are summarised in ensuing paragraphs.

A. Regular review of inspection approach vis-à-vis ultimate regulatory objectives

Observations and recommendations

4.3 The PRP noted that the AFRC had only been vested with inspection power over PIE auditors since October 2019. Time should be allowed for the AFRC to progressively enhance its inspection approach, including the procedures and rating system. Meanwhile, firms should also be allowed reasonable time to familiarise themselves with the AFRC's modus operandi and regulatory requirements.

4.4 In the AFRC's continuous review and enhancement of its inspection approach, the PRP suggested that the AFRC should, in addition to aiming for regulatory efficiency, strategically assess on a regular basis the procedures and rating system in light of its ultimate regulatory objectives to ensure that the inspection approach is fit for purpose.

4.5 In relation to the engagement rating system, while the PRP was mindful of its scope of review which covered the procedures but not the AFRC's professional judgements and regulatory decisions, it invited the

AFRC to ensure clear and rational differentiation between the ratings so as to provide clarity for the firms on what and how they are expected to improve.

Response from the AFRC

4.6 Following the expansion of inspection powers vested with the AFRC since October 2022, the AFRC now covers all practice units in its inspection programme. To ensure effective regulation of all practice units, the AFRC adopts the principle of proportionality and a risk-based approach, categorising practice units based on the number of audit clients they have, and the level of public interest elements in their engagements. The AFRC applies different frequencies and scopes of inspection to each category of practice units. To uphold audit quality and address emerging risks, the AFRC regularly assesses and, if necessary, increases the frequency of inspections and adjusts the inspection scope for specific practice units based on their past inspection results and identified risks. In addition, the AFRC has taken a proactive approach to monitoring the evolving challenges in the auditing profession and remains vigilant in adjusting the regulatory approach through a system of registration and recognition, and through inspection, investigation and disciplinary action to effectively address any potential risks or issues that may arise.

4.7 In relation to the engagement rating system, the AFRC indicates that the overall audit quality rating for an audit engagement is based on the number of inspection findings and their nature and significance to the audit. Each individual finding is classified as either “rating driver on its own” or “rating driver in conjunction with others”, depending on its assessed impact on the audit quality of the engagement. During the course and at the conclusion of the inspection, the inspectors held meetings with the engagement team and the quality control responsible persons of the audit firm to discuss all inspection findings and indicated those that were classified as “rating driver on its own”. This communication ensures that the engagement team and the quality control responsible persons of the audit firm are fully aware of the findings that drive the engagement rating, facilitating them to develop remedial actions that address the root causes of the findings and prevent their recurrence in future audits. In addition, the Inspection Sub-committee, which is constituted by the AFRC Board,

has also been tasked to carry out independent annual review of the completed inspections by selecting cases randomly from each Category of the practice units and thereby ensuring consistency of the audit quality ratings across all engagements that were inspected.

4.8 The AFRC also publishes periodic inspection reports and organises briefing sessions to inform our regulatees and the public about our principal inspection findings. These reports and briefing sessions provide valuable insights into the most common deficiencies that auditors should consider and address to prevent occurrence in their audits. Additionally, the reports and briefing sessions highlight the characteristics of high-quality audits and good practices that have been observed, as well as outline the AFRC's expectations, including the expectation that auditors should focus on auditing the key areas of deficiencies identified. This enables auditors to take proactive actions to improve their audit quality.

B. Streamlining of multi-layered internal review processes for preparation of investigation findings and reports

Observations and recommendations

4.9 The PRP observed in the chronologies of investigation cases selected for review that it was common for the preliminary investigation findings and subsequent reports to go through several rounds of internal review and revisions before finalisation for issuance to relevant parties. In the review of a case which lasted for more than a year, the PRP noted that the Investigation and Compliance Department of the AFRC had taken over eight months for internal preparation of the draft preliminary findings, involving numerous rounds of internal submissions, commenting and resubmissions. The AFRC explained that multiple rounds of commenting and revisions of findings and reports would be necessary if and when new issues were identified after holistic review of the cases by the Department Head.

4.10 While the PRP noted that certain cases, especially those of higher complexity involving a larger number of deficiencies may necessitate multiple rounds of internal reviews, it suggested that in general the AFRC should consider streamlining its internal clearance processes to enable

more efficient identification of investigation findings and preparation of relevant reports on the premise that the robustness of regulatory judgements and fairness to the regulatees will not be compromised.

Response from the AFRC

4.11 Following the enactment of the Financial Reporting Council (Amendment) Ordinance 2021 in October 2021 and in preparation of the commencement of the new regulatory regime of the accounting profession, the AFRC has updated the Operations Manual regarding the expanded functions including, *inter alia*, the function of investigation. The update included suitably streamlining the procedures for internal review of reports by multiple levels of executives with a view to increasing efficiency. Under the new regulatory regime, the AFRC has delegated certain powers in relation to investigations and enquiries to the head of the Investigation and Compliance Department to reduce the level of reviews. Discussions of findings and issues prior to the drafting of reports are also conducted to minimise multiple rounds of reviews and revisions.

C. Setting of Key Performance Indicators (“KPI”) or performance pledge

Observations and recommendations

4.12 The PRP appreciated the AFRC’s continued efforts in reviewing and updating its case-handling processes according to, *inter alia*, its regulatory experience and the PRP’s past suggestions. Following the launch of the new regulatory regime of the accounting profession in 2022 under which the AFRC has been vested with expanded powers and functions to regulate the entire profession, the PRP considered it worthwhile for the AFRC to put in place Key Performance Indicators (“KPI”) or performance pledge for internal monitoring of case-handling progress as well as external, including the PRP’s, assessment of the AFRC’s procedural efficiency and effectiveness.

4.13 The PRP suggested that the KPIs or performance pledge could be time-relevant for more straightforward procedures (e.g. processing of registration applications upon receipt of all documents required), or be set

using other suitable yardsticks for procedures involving greater uncertainty (e.g. request for information from relevant parties in investigation cases). The Board and executive team should work together and tap into the accumulated regulatory experience to ensure that the KPIs or performance pledge are reasonable and practicable.

Response from the AFRC

4.14 The development of KPIs or performance pledge for each function is in progress.

4.15 For the recognition, registration and licensing functions, the AFRC has set the following KPIs on the processing time for new and renewal applications which are published on the AFRC’s website, provided that no supplementary information is required for the application:

(a) New applications	<ul style="list-style-type: none"> ● <u>Issuance of practising certificates and registration of CPA firms, corporate practices and local PIE auditors:</u> Results to be available 10 weeks after the submission deadline on the AFRC website ● <u>Recognition of overseas PIE auditors:</u> Results to be available within 30 business days of the date of application
(b) Renewal applications	<ul style="list-style-type: none"> ● <u>Issuance of practising certificates and registration of CPA firms, corporate practices and local PIE auditors:</u> Results to be available within 30 business days of the date of renewal application ● <u>Recognition of overseas PIE auditors:</u> Results to be available within 20 business days of the date of renewal application

4.16 For the handling of complaints, the AFRC would also consider publishing appropriate performance pledges for responding to complainants in due course.

Chapter 5 : Way Forward

5.1 The PRP is pleased to note the AFRC's positive response to the PRP's recommendations. As the AFRC has started exercising expanded regulatory powers as a full-fledged independent regulator of the accounting profession since October 2022, the PRP, with its expanded terms of reference, will review the AFRC's work under its expanded remit to ensure the adequacy of its internal procedures and operational guidelines in the coming case review cycles.

5.2 The PRP welcomes and attaches great importance to the views from stakeholders and the public. Comments on the work of the PRP can be referred to the Secretariat of the PRP for the AFRC through the following channels³ –

By post : Secretariat of the Process Review Panel for
the Accounting and Financial Reporting Council
Financial Services and the Treasury Bureau
15th Floor, Queensway Government Offices,
66 Queensway, Hong Kong

By email : afrcprp@fstb.gov.hk

³ For enquiries or complaints not relating to the process review work of the AFRC, they should be made to the AFRC directly –
by post: 10/F, Two Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong
by telephone: (852) 2810 6321
by fax: (852) 2810 6320
by email : general@afrc.org.hk or complaints@afrc.org.hk

Chapter 6 : Acknowledgement

6.1 The PRP would like to express its gratitude towards the AFRC for its assistance in facilitating the review work, and its cooperation in responding to the PRP's enquiries and recommendations in the past year.

**Secretariat of the Process Review Panel
for the Accounting and Financial Reporting Council
September 2023**