

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

**2018 Annual Report**

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## **Chapter 1 : Background**

### **Overview**

1.1 The Process Review Panel for the Financial Reporting Council (“the PRP”) is an independent and non-statutory panel established by the Chief Executive of the Hong Kong Special Administrative Region in 2008 to review cases handled by the Financial Reporting Council (“the FRC”), and to consider whether actions taken by the FRC are consistent with its internal procedures and guidelines. The establishment of the PRP reflects the Government’s continuing commitment to enhance the accountability of the FRC.

1.2 The FRC was established under the Financial Reporting Council Ordinance (Cap. 588) (“the FRCO”) in 2006 as an independent statutory body to investigate auditing and reporting irregularities by auditors of listed entities (i.e. listed corporations and listed collective investment schemes) and enquire into non-compliance with accounting requirements by listed entities in Hong Kong. The FRC plays a key role in upholding the quality of financial reporting, promoting the integrity of the accounting profession, enhancing corporate governance and protecting investors’ interest.

1.3 Under the FRCO, the FRC is empowered to conduct independent investigations into possible auditing and reporting irregularities in audits of listed entities and is assisted by the statutory Audit Investigation Board (“the AIB”) comprising executives of the FRC. The FRC is also tasked with conducting independent enquiries into possible non-compliance with accounting requirements by listed entities, and is assisted by the Financial Reporting Review Committees (“the FRRC”), whose members are drawn from the statutory Financial Reporting Review Panel comprising individuals appointed by the Financial Secretary (under the authority delegated by the Chief Executive) from a wide range of professions in addition to accountants.

### **Functions of the PRP**

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

- (a) to receive and consider periodic reports from the FRC on completed or discontinued cases;
- (b) to receive and consider periodic reports from the FRC on investigations and enquiries which have lasted for more than one year;
- (c) to receive and consider periodic reports from the FRC on complaints against the FRC or its staff;
- (d) to call for files from the FRC to review the handling of cases to ensure that the actions taken and decisions made adhere to and are consistent with internal procedures and guidelines of the FRC and to advise the FRC on the adequacy of its internal procedures and guidelines where appropriate;
- (e) to advise the FRC on such other matters relating to the FRC's performance of its statutory functions as the FRC may refer to the PRP or on which the PRP may wish to advise; and
- (f) to submit annual reports to the Secretary for Financial Services and the Treasury.

1.5 The internal procedures which the PRP would make reference to in reviewing the FRC's cases include guidelines on the handling of complaints, initiation and processing of investigations and enquiries, review of financial statements under its financial statements review programme, 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 Council on the FRC's handling of cases, not its internal operation or administrative matters. Therefore, the work of the committees set up under the Council is not subject to direct review by the PRP.

### **Modus operandi of the PRP**

1.7 At its inaugural meeting held in mid-November 2008, the PRP decided that except for the first review cycle that should start from July

2007 (when the FRC became fully operational) until the end of December 2008, all case review cycles thereafter should run on a calendar year basis.

1.8 Based on the FRC's caseload during the relevant review cycle, the PRP would select cases for review at the end of the cycle, and all the PRP members would join the Case Review Session(s). The approach for case selection could be reviewed or fine-tuned as the PRP proceeds with the case review work.

1.9 Members of the PRP are reminded to preserve secrecy in relation to information furnished to them in the course of the PRP's work, and not to disclose such information to other persons. To maintain the independence and impartiality of the PRP, all PRP members would declare their interests upon the commencement of their terms of appointment and before conducting each case review.

### **Composition of the PRP**

1.10 In 2018, the PRP comprised six members, including the Chairman who is a non-accountant, a member from the accountancy sector, three other members from the financial sector and academia, and the FRC Chairman as an ex-officio member.

1.11 The membership of the PRP in 2018 is at **Annex**.

### **Follow-up on the PRP's observations made in the 2017 Annual Report**

1.12 In its 2017 Annual Report, the PRP observed that the number of complaints received by the FRC had been on the rise and the investigation cases in recent years had become more complex and substantive in nature. The PRP was pleased to learn that the FRC would recruit an additional Senior Director in 2018 to enable the FRC to re-shuffle certain duties amongst its executive team. On the other hand, to facilitate the PRP to consider whether the FRC's case handling procedures were consistent with and adhered to the guidelines set out in

the Operations Manual<sup>1</sup>, the PRP was of the view that it would be helpful if the PRP could be provided with succinct information before the Case Review Session which compared the actions taken by the FRC in respect of a case with the guidelines set out in the Operations Manual.

1.13 The FRC reported that it had taken some time to identify the suitable candidate for the post of the Senior Director. The new Senior Director who reported duty in September 2018 was an accountant-by-training and had held senior positions in multinational insurance companies before.

1.14 In response to the PRP's request at the last Case Review Session for additional information before the PRP meeting to be held in the future, the FRC had prepared specific case checklists for the current Case Review Session. The checklists set out the relevant dates and parties of the actions taken by the FRC and how these actions corresponded to the procedures and requirements so prescribed in the Operations Manual. The FRC was of the view that the checklists could provide useful supplemental information, in addition to the chronologies of events for each case, on how the FRC had adhered to the procedures as required in the Operations Manual and facilitated PRP's consideration of the cases.

1.15 The PRP noted the follow-up action taken by the FRC in the light of its observations made in the 2017 Annual Report and had no further question or comment.

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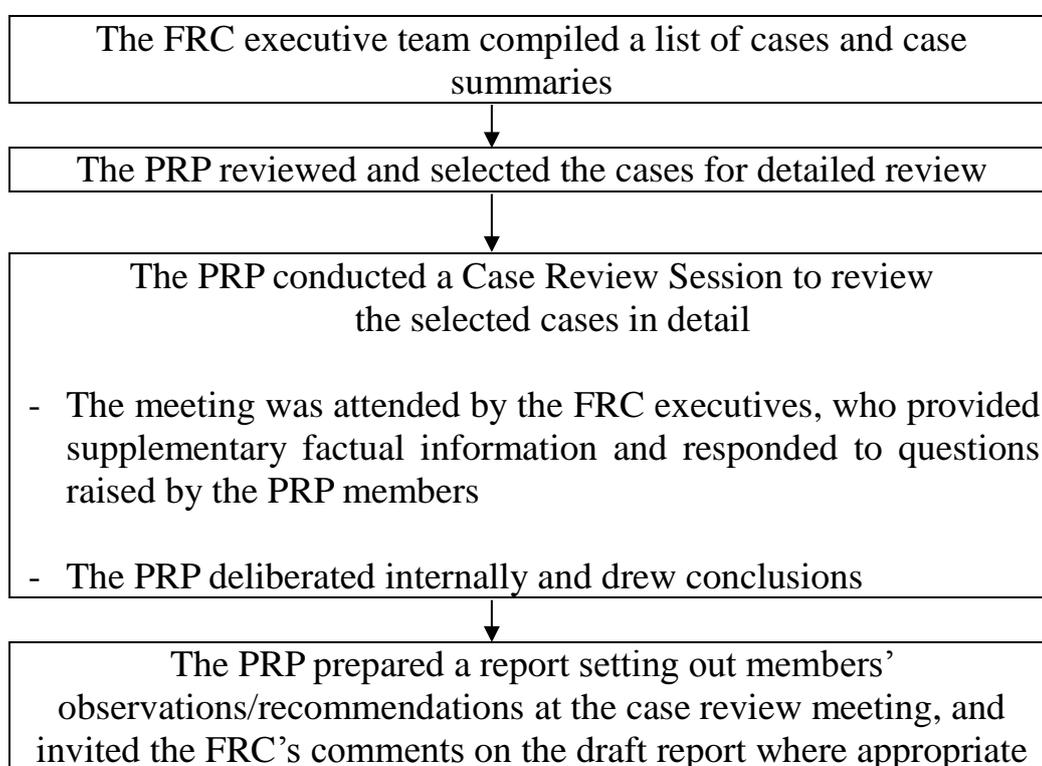
<sup>1</sup> The Operations Manual of the FRC sets out the internal procedures for handling complaints, investigations, enquiries and review of financial statements under its financial statements review programme.

## Chapter 2 : Work of the PRP in 2018

2.1 This Annual Report covers the work of the PRP in 2018, which reviewed reports from the FRC on cases completed by it during the tenth review cycle (i.e. from January to December 2017).

### 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 FRC executive team advised the PRP that the FRC had completed 143 cases during the tenth review cycle. Other than these 143 cases, there were 20 cases which had lasted for more than one year by the end of the cycle. The PRP was provided with summaries of all the 163 cases for review as follows –

<u>Category</u>	<u>Distribution of cases</u>	<u>Number</u>
(I)	Ongoing investigations/enquiries which had lasted for more than one year	20
(II)	Completed investigation cases	9
(III)	Unsubstantiated cases	17
(IV)	Cases that were referred to other regulatory bodies for follow-up	3
(V)	Completed review of complaints/review of relevant financial statements with ongoing investigations	11
(VI)	“Immaterial” complaints (i.e. complaints that are vexatious, abusive and/or of unreasonably persistent nature)	102
(VII)	Complaints against the FRC or its staff	1
	<b>Total</b>	<b>163</b>

2.4 Out of the 163 cases, the PRP selected the following seven cases for review –

- (a) two ongoing investigation cases which had lasted for more than one year (i.e. selected from Category I);
- (b) a completed investigation case arising from a review of complaint (i.e. selected from Category II);
- (c) an unsubstantiated case arising from a review of complaint (i.e. selected from Category III);
- (d) a case arising from a review of complaint with an ongoing investigation (i.e. selected from Category V);
- (e) a completed investigation case arising from a review of financial statements (i.e. selected from Category II); and

- (f) an unsubstantiated case arising from a review of financial statements (i.e. selected from Category III).

The PRP considered that the selection of these seven cases reflected a good mix of the cases which fell within the tenth review cycle. The PRP also took the opportunity to review a complaint against a member of staff of the FRC (i.e. selected from Category VII) during the Case Review Session.

### **Case Review Session**

2.5 After the PRP selected the cases for review, and with the assistance of the FRC executive team, the PRP Secretariat made preparation for the case review meeting which was held in November 2018 to review the selected cases.

2.6 The PRP Secretariat had invited all members to declare any potential conflicts of interest before the meeting. At the start of the Case Review Session, the PRP Chairman further reminded members to declare any possible conflict of interest in the cases to be reviewed. A PRP member had declared potential conflict of interests with regard to a case under review and was not present during the discussion of the case concerned at the meeting.

2.7 The FRC took the opportunity to provide the PRP with an overview of the current caseload and the aging analysis of the outstanding investigations. There would be 46 outstanding investigations and enquiries as at the end of 2018, an overwhelming majority of which (43 out of 46) were initiated in or after 2016. In fact, the FRC had initiated 21 investigations and enquiries in 2018 alone, which was a record high in a year. In 2018, the FRC had concluded 16 investigations, which was again a record high, and would target to complete around 20 investigations in 2019. The FRC was of the view that the ageing analysis showed that the FRC was progressing on the right track. The FRC was confident that it would manage to complete the investigations/enquiries within a reasonable time while producing high quality reports.

2.8 The PRP's observations in respect of the selected cases and its

suggestions to the FRC are set out in the following chapters.

## **Chapter 3 : The PRP’s review of cases handled by the FRC**

3.1 On the whole, having considered the seven cases reviewed in the tenth cycle, the PRP was of the view that the FRC had followed the internal procedures in handling the cases.

### **(1) Review of an ongoing investigation case which had lasted for more than one year**

#### *Case facts*

3.2 The PRP reviewed a complaint case which led to formal investigations into suspected auditing irregularities. The investigations, which were still in progress as at the end of the tenth review cycle, were initiated in September 2014 in respect of the audits of the consolidated financial statements for the years ended 31 March 2010 and 31 March 2011 respectively of a listed entity. It was alleged that the auditors concerned had failed to observe and apply the relevant professional standards required in their audits of the consolidated financial statements concerned.

#### *The FRC’s actions*

3.3 After receipt of the complaint in January 2013, the FRC had contacted the listed entity and auditors concerned for information to facilitate its review of the complaint and preparation of the complaint assessment report. Having considered the complaint assessment report, the Council approved the initiation of two investigations in September 2014 and directed the AIB to investigate the alleged auditing irregularities. The FRC had requested the respective auditors, the engagement partners and the engagement quality control reviewers (“EQCRs”) concerned to provide information during the investigations. The investigations were still ongoing at the end of the tenth review cycle.

#### *The PRP’s areas of review*

3.4 The PRP focused its review on the long time taken by the FRC to complete the investigations. The PRP had reviewed this case in its eighth Case Review Session in December 2016, thus the PRP focused on

the procedures and handling of the case after November 2016. The FRC said that it was a complex case involving two years' audits and prior year adjustments relating to nine issues. The FRC explained that a relatively longer time had been taken to complete the investigations because extra time was incurred due to the reassignment of responsible executives and officers because of staff turnover, extended leave, conflicts of interests and preoccupation with other more imminent duties. The succeeding officers had taken some time to familiarise themselves with the investigation procedures and the case materials. Also, the succeeding case officer was exceptionally busy in dealing with the significant increase in the number of complaints in 2016 and 2017<sup>2</sup>.

3.5 The PRP asked about the latest progress of the investigations. The FRC replied that whilst the investigations had not been completed as at the end of 2017 (the end of the tenth review cycle), the two investigations had been completed in May 2018 and September 2018 respectively.

3.6 Noting that the FRC had requested external legal advice on potentially affected persons' written submissions on the draft investigation report in the present case, the PRP enquired about the details of this procedure and what it intended to achieve. The FRC replied that according to the FRCO, if the Council opined that any person named in the investigation report would be adversely affected by the publication or disclosure of the report, the FRC had to first give the person a reasonable opportunity of being heard. In practice, sometimes there might be a need for the FRC to seek legal advice to ascertain whether the investigation report had sufficiently addressed the comments raised by those parties. The FRC added that while the FRC normally would not publish an investigation report, the provision of a draft report to adversely-affected persons for comment was a procedure required under the FRCO.

3.7 The PRP followed up by asking whether the affected parties in the case had raised any objection to the draft investigation report. The FRC replied that all responses, comments and/or clarifications provided

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<sup>2</sup> In 2016 and 2017, the FRC received 97 and 101 complaints respectively from the same source and in relation to a single audit firm as detailed in paragraph 3.54. Due to the issue of conflict of interests, the review of those complaints could only be conducted by three executives including the case officer involved in this case.

by the parties that were relevant to the investigation had been addressed in the investigation report and these comments had been included in the case files for the Council's consideration in one-go.

3.8 Noting that the auditor's request for more time in providing comments to the investigation report had been rejected in this case, the PRP inquired whether there was an objective standard of "a reasonable period of time" for commenting on the report, and if not, whether the Operations Manual should specify such a standard. The FRC confirmed that there was an objective standard on what constituted "reasonable time" for responding to an investigation report. In general, the parties would be provided with one to two months to respond in the first place. If further extension was requested, it must be supported with very good reasons and the FRC would seek the approval from the Chairman of the Operations Oversight Committee ("OOC")<sup>3</sup> before granting the extension. The FRC added that while the auditor's request for further extension in the present case had been rejected, the auditor did manage to provide comments two days before the relevant Council meeting considered the matter. Therefore, the Council had had the chance to take into account the auditor's comments in making its decision for the present case.

3.9 The PRP noted that the company and the auditors had frequently requested for extensions in replying to the FRC's requirements during the investigation and asked whether these were their tactics to procrastinate the investigation process. The FRC said that since 2016, it had been taking measures to address the issue of repeated requests for extensions. The FRC would turn down a request for extension if insufficient justifications were provided by the party concerned.

3.10 The PRP was of the view that since this case had lasted for more than five years from receipt of the complaint to completion of the investigations, it would be appreciated if the FRC could provide more

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<sup>3</sup> The OOC assists the Council in formulating policies, strategies, guidelines and procedures for the operation of the FRC, provides advice to the Council and the FRC operational staff on technical and business issues, and considers, *inter alia*, reports on enquiry and investigation and complaint/review assessment reports before submission to the Council. It comprises members of the Council (one of whom would be the chair of the OOC) and co-opt members who have relevant experience and expertise in accounting-related matters.

information to the PRP on the reasons for taking such a long time to conclude the case, and whether there was a specific time limit for completing an investigation. The FRC reiterated that there were three major areas of difficulties in handling the current case. Firstly, the case was highly complicated as it involved multiple issues in two years' financial statements. Secondly, the FRC at the time was faced with staff shortage arising from staff turnover, leave taken or senior staff being preoccupied with other more imminent duties such as the auditor regulatory reform. Thirdly, the situation of staff shortage had become more acute by the fact that some staff members were conflicted out of the case in accordance with the conflict of interests provision in the FRCO.

3.11 The FRC continued to explain that there had been a notable increase in complexities concerning the cases under the FRC's investigations in recent years. It would be difficult to set a standard time for completing an investigation as cases varied from one to another in terms of complexity. Nevertheless, the FRC was of the view that on average two years would be a reasonable length of time in completing an investigation without major or difficult issues. Taking the process of ensuring a reasonable opportunity of being heard for adversely affected parties named in the draft investigation reports as an example, this process alone could easily take up to six or more months. The Council would first need to identify the persons who would be affected. The FRC would then need to seek and await responses from the parties concerned. After receipt of the comments from the parties, the FRC staff would need to study the comments, revise the report if necessary and where appropriate seek the advice of the Honorary Advisors and legal adviser and then the OOC before submitting the case to the Council for approval.

### ***Conclusion***

3.12 Having reviewed the FRC's handling of the case and in the light of the above clarification, the PRP expressed an understanding of the reasons for the relatively long time taken in the conduct of the investigations, and agreed that the FRC had been handling the case in accordance with its internal procedures.

**(2) Review of an ongoing investigation case which had lasted for more than one year**

***Case facts***

3.13 The PRP reviewed a complaint case which led to a formal investigation into suspected reporting and auditing irregularities by the reporting accountant and auditor of the listed entity. It was alleged that the reporting accountant and auditor concerned had failed to observe or otherwise apply the relevant professional standards in their preparation of the accountant's report and audits of the relevant consolidated financial statements.

***The FRC's actions***

3.14 Having reviewed the complaints received in August 2013 from more than one source including another regulator, the Council in October 2013 approved the initiation of a formal investigation against the reporting accountant and the auditor concerned. It was a very complex case involving significant volume of working papers and supporting documents. The investigation was still in progress as at the end of the tenth review cycle.

***The PRP's areas of review***

3.15 The PRP focused its review on the long time taken by the FRC to complete the investigation. The FRC explained that it was a very complex case involving the company's accountant's report for an initial public offering and the company's three years' audits of financial statements after listing. These involved significant volume of working papers and supporting documents. Because of the complexity of the case, in the earlier stage of investigation, the FRC had spent considerable time to review the documentation to refine the scope of the investigation, understand the relevant transactions, and identify the key subsidiaries that were involved in the problematic transactions. In mid-2016, the FRC decided to reallocate the case from the original director to another director because the former was heavily involved in other matters including the auditor regulatory reform. The new case director took additional time to study and pick up the case. The

drafting of the preliminary findings was completed in April 2017 and the CEO undertook the quality control review of the preliminary findings in January 2018.

3.16 In response to the PRP's inquiry on the latest progress of the case, the FRC said that the case was currently under legal vetting by the General Counsel and the preliminary findings would be sent out to parties concerned for comment shortly. The case was expected to be completed in 2019.

3.17 Noting that the CEO undertook the "quality control review" of the preliminary findings, the PRP asked whether such "quality control review" was performed on each case by the CEO and how "quality" was measured. The FRC explained that "quality control review" was not a mandatory requirement in the FRCO but a procedure in the Operations Manual for reviewing complex cases to ensure that the draft findings or reports were up to standard. The quality control review could be done by the CEO, as in the current case, or assigned to the Deputy CEO or the Senior Directors. The quality control review was a process to provide an objective evaluation on the judgments and technical consideration of relevant matters in the draft findings or reports for complex cases. This process might not be required for cases which were less complex.

3.18 The PRP noted that another regulator was carrying out its own investigations at the same time, and the FRC had requested for information from it on a number of occasions. The PRP asked whether and how the other regulator's investigation might have any impact on the FRC's on-going investigation and how the two regulators might interact. The FRC replied that the focus of the investigation by the two regulators were different and they could be conducted in parallel and normally the other regulator's work would not preclude the FRC's investigation from moving forward.

3.19 Noting that an entry in the case chronology stated that the FRC had asked the auditor "for specific audit documentation which *had been previously provided*", the PRP queried if the audit documentation had been provided before, why the FRC needed to ask for it again. The FRC clarified that the entry meant it had requested the auditor concerned to provide further audit documentation in respect of those which had been provided to the FRC earlier.

## *Conclusion*

3.20 Having reviewed the FRC's handling of the case and in the light of the above clarification, the PRP expressed an understanding of the reasons for the relatively long time taken in the conduct of the investigation, and agreed that the FRC had been handling the case in accordance with its internal procedures.

### **(3) Review of a completed investigation case arising from a review of complaint**

#### *Case facts*

3.21 The PRP reviewed a complaint case which led to a formal investigation into suspected auditing irregularities by the auditor of a listed entity. The investigation was initiated in May 2014 in respect of the audits of the consolidated financial statements of the listed entity in 2011 and 2012. It was alleged that the auditor concerned had failed to observe or otherwise apply the relevant professional standards required in its audits of the consolidated financial statements. The investigation was completed in around 32 months' time.

#### *The FRC's actions*

3.22 Upon receipt of the complaint in August 2013, the FRC sought information from the listed entity and the auditor concerned. Having considered the complaint assessment report, the Council approved the initiation of an investigation in May 2014 and directed the AIB to investigate the alleged auditing irregularities. The Council adopted the investigation report in January 2017 which was subsequently referred to the Hong Kong Institute of Certified Public Accountants ("HKICPA") to determine if any disciplinary action was warranted.

#### *The PRP's areas of review*

3.23 Based on the case facts outlined above, the PRP reviewed the following steps taken by the FRC in handling the complaint case –

- (a) initial screening;

- (b) liaising with the listed entity and the auditor concerned to review the allegations;
- (c) preparation and submission of a complaint assessment report to the OOC and the Council;
- (d) initiating a formal investigation;
- (e) issuing directions by the Council to the AIB to conduct the investigation;
- (f) preparation and issue of the investigation report by the AIB;
- (g) adoption of the investigation report by the Council; and
- (h) referral to another regulatory body for follow-up.

3.24 In response to the PRP's query that it took more than two years to complete the investigation, the FRC admitted that the 32 months' completion time was slightly longer than the target. However, the FRC explained that it had been experiencing staff shortages during the course of the investigation due to staff turnover and leave, etc., as mentioned earlier during the review of Case No.1.

3.25 Noting an entry in the case chronology indicated that the EQCR of the auditor had sought the FRC's consent to contact the auditor for information in relation to the investigation, the PRP asked whether consent had been given to the EQCR. The FRC advised that the EQCR in this case was a former employee of the auditor and the consent, so requested, was given right away.

3.26 The PRP inquired whether materials referred to the HKICPA for any follow up action included the investigation report only. The FRC confirmed that only the investigation report (including annexes to the report and comments from parties on the report) would be provided to the HKICPA. The FRC supplemented that under the FRCO, the FRC's investigation reports would become *prima facie* admissible evidence in the HKICPA's disciplinary proceedings and court proceedings.

3.27 In response to the PRP's query as to whether the FRC would take any further action after the investigation reports had been referred to the HKICPA, the FRC said that it had regular liaison meetings with the HKICPA to monitor the development of the cases after referral but it had no influence on their progress. The FRC added that after the Financial Reporting Council (Amendment) Bill 2018 ("the Bill") had

been enacted, the FRC would become a full-fledged regulator and would henceforth take on the disciplinary functions of auditors of listed entities. The FRC would take the opportunity to improve and strengthen the mechanisms and procedures through which it discharged the new statutory functions.

### ***Conclusion***

3.28 Having reviewed the FRC's handling of the case, the PRP concluded that the FRC had handled the case in accordance with its internal procedures.

#### **(4) Review of an unsubstantiated case arising from a review of complaint**

### ***Case facts***

3.29 The PRP reviewed an unsubstantiated case arising from a complaint received by the FRC in May 2013. The complainant referred the case to the FRC alleging that there might be non-compliance with accounting requirements by the listed entity concerned in its 2007 financial statements and 2008 interim financial statements. It took the FRC around 53 months' time from receipt of the complaint to closing the case.

### ***The FRC's actions***

3.30 After receipt of the complaint, the FRC had sought information and explanations from the listed entity and the auditors concerned. Longer time had been taken to handle the case as a number of executives of the FRC and members of the Council and OOC had declared interests in this case and had been conflicted out. The subsequent release of a relevant external report provided further information and enabled the finalisation of the complaint assessment report, in which it was recommended that no follow up action would be taken but letters of advice would be sent to the listed entity and the auditors concerned suggesting more information should be disclosed in the financial statements. The OOC endorsed the complaint assessment report in October 2017 and letters of advice were subsequently issued to the listed entity and the auditors concerned.

### *The PRP's areas of review*

3.31 Against the above background, the PRP reviewed the following steps taken by the FRC in handling the case –

- (a) initial screening;
- (b) liaising with the listed entity and the auditors concerned to review the allegations;
- (c) preparation and submission of a complaint assessment report to the OOC; and
- (d) closing the case.

3.32 The PRP noted that the FRC had sought information from another auditor (Auditor B), which was not the auditor of the company's financial statements (Auditor A), and inquired what the role of Auditor B was. The FRC explained that Auditor B was the auditor of a number of foreign subsidiaries under the entity. Information of Auditor B was necessary in order to assess the relevant allegations against Auditor A. The FRC admitted that the involvement of Auditor B had made the issues more complicated and caused a number of the Council members and FRC executives to be conflicted out from this case. The PRP asked whether the FRC had powers to obtain information from a foreign company or auditor. The FRC replied that it did not have extra-territorial powers over foreign auditors and these foreign auditors were not obliged to respond to the FRC's requirements.

3.33 Noting that the FRC had circulated the draft inquiry letters to the OOC for consideration before issuing them to the listed entity and the auditor, the PRP asked whether there was a prescribed procedure in the Operations Manuals that draft inquiry letters should be vetted by the OOC before issue. The FRC replied that circulation of draft inquiry letters to the OOC before issue was not a prescribed procedure in the Operations Manual. However, given the high sensitivities surrounding this case and the fact that the inquiry letters were suggested by the OOC for obtaining further information from the listed entity and the auditor, comments from the OOC on the draft letters were specifically sought before issue.

## ***Conclusion***

3.34 Having reviewed the FRC's handling of the case, the PRP concluded that the FRC had handled the case in accordance with its internal procedures.

### **(5) Review of a case arising from a review of complaint with an ongoing investigation**

#### ***Case facts***

3.35 The PRP reviewed a complaint case which led to a formal investigation into suspected reporting irregularities by the reporting accountant of a listed entity. The investigation was initiated in November 2017 in respect of the preparation of the accountant's report of the listed entity. It was alleged that the reporting accountant concerned had not obtained sufficient appropriate evidence in relation to its preparation of the accountant's report. The investigation was still ongoing as at the end of the tenth review cycle.

#### ***The FRC's actions***

3.36 After receipt of the complaint in July 2015, FRC sought information from the listed entity and the reporting accountant concerned. Having considered the complaint assessment report, the Council approved the initiation of an investigation in November 2017 and directed the AIB to investigate the alleged reporting irregularities.

#### ***The PRP's areas of review***

3.37 Based on the case facts outlined above, the PRP reviewed the following steps taken by the FRC in handling the case –

- (a) initial screening;
- (b) liaising with the listed entity and the reporting accountant concerned to review the allegations;
- (c) preparation and submission of a complaint assessment report to the OOC and the Council;
- (d) initiating a formal investigation; and

- (e) issuing directions by the Council to the AIB to conduct the investigation.

3.38 The FRC explained that the investigation was currently held up as the FRC was awaiting the finalisation of a Memorandum of Understanding (“MoU”) with the Ministry of Finance (“MoF”) for gaining access to audit working papers kept in the Mainland. In response to the PRP’s request for elaboration, the FRC said that the Mainland laws and regulations required that consent of Mainland regulators be obtained before audit working papers kept in the Mainland could be produced to a foreign regulator. Over the years, the FRC had maintained good communication with the MoF on cross-boundary regulatory co-operation matters. The two bodies were discussing an MoU on the cooperation agreement on access to audit working papers kept in the Mainland. The MoF recognised the importance of allowing access by the FRC to relevant audit working papers. There had been good progress on the discussion, and both sides hoped to conclude the agreement as soon as possible. Prior to the conclusion of the agreement, the FRC would not request audit firms to produce the relevant audit working papers kept in the Mainland.

3.39 The PRP acknowledged that there was no further action that the FRC could take pending the finalisation of the MoU with the MoF. For monitoring purpose, the PRP invited the FRC to keep the PRP informed of the progress of its discussion with the MoF on this issue and to report to the PRP through the PRP Secretary when the case was completed.

### ***Conclusion***

3.40 Having reviewed the FRC’s handling of the case and taking into account the clarifications made by the FRC, the PRP agreed that the FRC had handled the case in accordance with its internal procedures.

## **(6) Review of a completed investigation case arising from review of financial statements**

### ***Case facts***

3.41 The case arose from a proactive review of financial statements

by the FRC under the financial statements review programme. Having considered the review assessment report, the Council approved the initiation of an investigation against the auditor of the listed entity in July 2016. It was alleged that the auditor concerned had not obtained sufficient appropriate audit evidence in the audit of the consolidated financial statements. The investigation was completed in around nine months' time.

### ***The FRC's actions***

3.42 After reviewing the relevant financial statements of the listed entity under the financial statements review programme, the FRC made a number of requests to the listed entity and the auditor concerned to obtain information before submitting a review assessment report to the Council for consideration. Having considered the review assessment report, the Council approved the initiation of an investigation in July 2016 and directed the AIB to investigate the alleged auditing irregularities. The Council adopted the investigation report in May 2017 which was subsequently referred to the HKICPA to determine if any disciplinary action was warranted.

### ***The PRP's areas of review***

3.43 Based on the case facts outlined above, the PRP reviewed the following steps taken by the FRC in handling the case –

- (a) initial screening;
- (b) liaising with the listed entity and the auditor concerned to review the allegations;
- (c) preparation and submission of a review assessment report to the OOC and the Council;
- (d) initiating a formal investigation;
- (e) issuing directions by the Council to the AIB to conduct the investigation;
- (f) preparation and issue of the investigation report by the AIB;
- (g) adoption of the investigation report by the Council; and
- (h) referral to another regulatory body for follow-up.

3.44 The PRP noted that the case chronology did not show whether the auditor concerned had replied to the FRC's first informal request for

information, the PRP asked whether the auditor had responded in the end. The FRC confirmed that the auditor concerned had replied to the FRC's first informal request. The FRC supplemented that as the request for information was made before a formal investigation was initiated, the request was made on an "informal" basis and the auditor was complying with it on a voluntary basis.

### ***Conclusion***

3.45 Having reviewed the FRC's handling of the case, the PRP was satisfied that the FRC had handled the case in accordance with its internal procedures.

### **(7) Review of an unsubstantiated case arising from review of financial statements**

#### ***Case facts***

3.46 The case arose from a proactive review of financial statements by the FRC under the financial statements review programme. The case concerned recognition of financial guarantee contracts and disclosure of pledge of assets. After obtaining relevant information and explanations, the FRC decided not to pursue the case further. It took around six months' time from initiation of the review to closing the case.

#### ***The FRC's actions***

3.47 After reviewing the relevant financial statements, the FRC had contacted relevant regulators for information before submitting a review assessment report to the OOC for consideration. With the OOC's approval of the review assessment report, the case was closed in May 2017.

#### ***The PRP's areas of review***

3.48 With the above background, the PRP reviewed the following steps taken by the FRC in handling the case –

- (a) initial screening;
- (b) liaising with other regulators to review the allegations;

- (c) preparation and submission of a review assessment report to the OOC; and
- (d) closing the case.

3.49 In response to the PRP's inquiries, the FRC said that there was clear evidence that the auditor concerned did not possess knowledge about the contracts in question.

3.50 Noting that the FRC had not contacted the listed entity or the auditor concerned at all during the assessment, the PRP inquired why communication with the listed entity and the auditor was not necessary in this case. The FRC replied that it was because it had managed to obtain the necessary information/documents from other regulators and the information/documents so obtained showed clearly that there were no apparent auditing irregularities in this respect.

### ***Conclusion***

3.51 Having reviewed the FRC's handling of the case, the PRP was satisfied that the FRC had handled the case in accordance with its internal procedures.

### **(8) A.O.B.**

#### ***Complaint against the FRC's staff***

3.52 Noting that the FRC had received a complaint against one of its staff in 2017, the PRP took the opportunity to review the case under the A.O.B. item. In the case, the complainant alleged that the staff concerned was biased against small and medium-sized audit firms in the staff's discharge of duties. The PRP noted that the Council had reviewed the complaint and the action by the staff and did not find the staff's action to have departed from the Council's stated principles and practice. A reply was sent to the complainant in August 2017, around two months after receiving the complaint.

3.53 Having reviewed the FRC's handling of the case, the PRP was satisfied that the FRC had handled the case in accordance with its internal procedures.

### *Immaterial complaints*

3.54 Noting the large number of “immaterial” complaints against a single audit firm (around 100) in the cases completed by the FRC in 2017, the PRP would like to know whether it was a concerted effort to create trouble for the firm or whether these were genuine complaints. The FRC responded that these complaints appeared to have come from a single person. The FRC had performed a review of the allegations and found that they were mostly related to omission of disclosures, inadequate disclosures, inconsistencies in amounts disclosed, presentation and terminology used and typo mistakes. On the basis that the misstatements involved were not material to the relevant financial statements and the deficiencies were not of such significance as would be expected to affect the validity of the unqualified audit opinion expressed by the audit firm on the relevant financial statements, the allegations relating to these complaints were not pursued further with the approval of the Council. Nonetheless, the Council had referred these complaints to the HKICPA for their attention and appropriate action, if any.

3.55 The PRP was satisfied with the FRC’s explanation on these complaints and raised no further questions. However, it commented that the term “immaterial complaints” might not be an appropriate description for the cases involved.

## **Chapter 4 : Observations and way forward**

4.1 On the seven cases selected for review during the tenth review cycle, the PRP concluded that the FRC had handled the cases in accordance with its internal procedures. Arising from the discussion of the selected cases, the PRP opined that the situation of having a large number of case backlog, which was a problem in the past few years, appeared to have improved. The problem of staff shortage (due to various reasons) had also become less serious. The PRP expressed appreciation to the efforts and improvements made by the FRC in clearing the backlog of cases and resolving the problem of staff shortage.

4.2 The PRP also looked forward to the implementation of the new auditor regulatory regime, under which the FRC would become a full-fledged auditor regulator and be responsible for the inspection, investigation and discipline of auditors of listed entities. The PRP commented that amongst the new functions of the FRC, inspection could be a major area of concern to the regulatees as in other professions. The regulatees would be concerned about the procedures of the FRC to carry out inspections. The inspection function would also probably use up a significant portion of the FRC's resources in the future.

4.3 The PRP had made the following requests to the FRC –

- (a) the FRC was invited to keep the PRP informed of the progress of its discussion with the MoF on the MoU and when the investigation of Case No. 5 could be completed;
- (b) the FRC was invited to consider a better description to replace the current term “immaterial complaints”; and
- (c) the FRC was invited to keep the PRP informed of the progress of implementing the new auditor regulatory regime and its preparatory work including formulation of procedural guidelines for its new functions.

4.4 The FRC undertook to take actions to address the PRP's observations above.

4.5 The PRP will continue its work on the review of cases handled

by the FRC to ensure that the FRC adheres to its internal procedures consistently. For 2019, the PRP will select cases that the FRC has handled during the period between January and December 2018 for review.

4.6 Comments on the work of the PRP can be referred to the Secretariat of the PRP for the FRC by post (Address: Secretariat of the PRP for the FRC, 15<sup>th</sup> Floor, Queensway Government Offices, 66 Queensway, Hong Kong) or by email (email address: [frcprp@fstb.gov.hk](mailto:frcprp@fstb.gov.hk))<sup>4</sup>.

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<sup>4</sup> For enquiries or complaints not relating to the process review work of the FRC, they should be made to the FRC directly –

By post : 29<sup>th</sup> Floor, High Block, Queensway Government Offices, 66 Queensway,  
Hong Kong  
By telephone : (852) 2810 6321  
By fax : (852) 2810 6320  
By email : [general@frc.org.hk](mailto:general@frc.org.hk) or [complaints@frc.org.hk](mailto:complaints@frc.org.hk)

## **Chapter 5 : Acknowledgement**

5.1 The PRP would like to express its gratitude to the FRC 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 Financial Reporting Council  
May 2019**

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

**2018 Membership**

**Chairman**

Dr. Anthony CHOW, SBS, JP

**Members**

Ms. Florence CHAN

Prof. CK LOW

Ms. Edith SHIH

Mr. KK TSE

Dr. John POON, BBS, JP (ex-officio member)<sup>5</sup>

(With Secretariat support provided by  
the Financial Services and the Treasury Bureau)

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<sup>5</sup> Dr John POON stepped down as the Chairman of the FRC on 15 December 2018. The new Chairman, Dr Kelvin WONG assumed as the ex-officio member of the PRP starting from 15 December 2018.