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Foreword

Another year has quickly passed and we have completed one more year of our revised practice review and professional standards monitoring programmes. This report provides you with information about our work achievements and common findings identified under our two programmes in 2017 and our future plans.

We have again met our targeted number of practice reviews in 2017 despite our tight resources. As we have covered almost all practices that are given priority for reviews because they have listed or regulated clients or meet our pre-determined risk factors, we expect to do gradually more reviews on practices with normal risk profiles, usually smaller practices, in the next few years. We shall therefore be doing increasingly more desktop reviews although full scope (on site) reviews will still be the largest number of our reviews. In 2017, we developed a plan to shorten our review cycle for practices without listed clients to 6 years and hope to be able to achieve it in three years’ time. A cycle of 6 years is the benchmark used by many overseas regulators for similar reviews and we consider that having a fixed year review cycle would help set expectations and make practices better maintain their quality.

We believe that the effects of our efforts to implement various initiatives to enhance audit quality over the last few years are becoming more apparent as the percentage of closed cases has increased significantly from 56% in 2016 to 75% in 2017. Although the common findings identified in 2017 are more or less the same as previous years, the significance of many of those deficiencies has been reduced. For example we now very seldom see a practice that has not done a monitoring review, although we still hope to see more improvement in the quality of those reviews. Practices are now putting more efforts to address findings before the practice review is closed. The increase in practice review follow up visit and complaint cases in the past few years could be a contributing factor as practices are well aware that we now have less tolerance for practices not showing commitment to audit quality.

In 2017, the Mainland MOF again helped us review five cross border engagements. We thank the MOF for the support that it has given us and hope to be able to establish a mutually agreed approach with the MOF shortly to deal with access to working papers of cross border engagements.

As for professional standards monitoring, the findings identified in 2017 were mostly the same deficiencies as encountered in the past as there were no major changes to financial reporting standards in the last two years. However, 2018 will be a challenging year for preparers and auditors of financial standards as two new standards (i.e. one on revenue and the other on financial instruments) that will require some significant changes to the accounting in the relevant areas have come into effect. We shall cover a review of the application of these new standards in our future review work as application of new standards is a focus of our programme.

In January 2018, the Hong Kong government gazetted the Financial Reporting Council (Amendment) Bill 2018 which will establish the FRC as a fully fledged regulator of listed entity auditors and proposes transfer of responsibilities for practice reviews of listed engagements to the FRC. The FRC Bill has a proposed commencement date of 1 August 2019. We have anticipated this development for some time and have built in our assessment of the effect of the changes into our future work plans. We will continue to be responsible for regulation of all non-listed company auditors and audits so the Institute will retain a key role in ensuring that confidence in the quality of services provided by our members is maintained and valued.

Finally, I would like to take this opportunity to thank once again all practices and members for their support and cooperation in our reviews. I hope, with all our efforts, we are able to see even better review outcomes this year.

Elsa Ho
Director, Quality Assurance
March 2018
Oversight of our work

The Quality Assurance Department ("QAD") has two areas of responsibility, practice review and professional standards monitoring.

The responsibility for oversight of QAD activities rests with the Regulatory Oversight Board ("ROB") which oversees all the regulatory functions of the Institute.

The ROB ensures that QAD activities are carried out in accordance with strategies and policies determined by the Council of the Institute and in the public interest. The oversight work includes receiving and reviewing annual work plans and budgets and regular progress reports from management and reporting to the Council on observations and views in relation to performance and operations. Please refer to Annex for members of the ROB in 2017.
Our work and review outcomes – Practice review programme

Practice review is a quality assurance programme that monitors all the Institute’s practising certificate holders who engage in the provision of audit and other related assurance services. The Professional Accountants Ordinance (“PAO”) has empowered the Institute to carry out practice review since 1992. The approach to practice review was revised in 2006 to bring it up to international standards and it is regularly amended to maintain best practice.

The Practice Review Committee (“the PRC”) is a statutory committee responsible for exercising the powers and duties given to the Institute as the regulator of auditors in Hong Kong under sections 32A to 32I of the PAO. The QAD reports to the PRC which makes decisions on the results of practice reviews. Section 32A of the PAO stipulates that at least two thirds of the PRC members must hold practising certificates. The practising members of the PRC are drawn from the full spectrum of audit firms, representing smaller practices through to the Big Four. The composition of the PRC is reviewed by the Nomination Committee of the Institute every year to ensure a balanced composition. Please refer to Annex for members of the PRC.
Our work

The practice review process can be divided into three stages:

**Stage 1 – Preparation**
- Select practice for review
- Agree on visit date and request key documents
- Preliminary assessment of submitted key documents including, if applicable, the completed audit health screening checklist and the self evaluation checklist

**Stage 2 – On-site visit / inhouse desktop review**
- Opening meeting *
- Conduct interviews *
- Review compliance with HKSQC1 and review selected audit files
- Summarize findings and recommendations
- Exit meeting *

* These procedures, if needed, are carried out by telephone for desktop reviews

**Stage 3 – Reporting**
- Draft report to practice for formal response
- Review practice’s response
- Submit Reviewer’s report and practice’s response to the PRC for consideration
- Advise practice of the PRC decision
- Monitor follow up action, if needed

Selection of practices for review is based on their risk profiles, developed using information obtained from the electronic self-assessment questionnaire (“the EQS”) and other relevant sources. The frequency of reviews of each type of practices is set out below:

<table>
<thead>
<tr>
<th>Practices</th>
<th>Frequency of review</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big Four</td>
<td>Annually</td>
<td>1</td>
</tr>
<tr>
<td>Practices with a significant number of listed clients</td>
<td>Subject to a full review at least every three years and an interim review during the three-year cycle</td>
<td>2</td>
</tr>
<tr>
<td>Other practices with listed clients</td>
<td>Subject to a full review at least every three years and an additional interim review if certain risk factors exist</td>
<td>3</td>
</tr>
<tr>
<td>Other practices</td>
<td>Based on risk profiles and random selection</td>
<td>4</td>
</tr>
</tbody>
</table>
Note:

1. This recognizes the significance of listed and other public interest entities in Big 4 client portfolios.

2. Practices with 20 or more listed clients will receive an interim review in addition to a full review every three years.

3. The three-year review cycle is in line with international best practice. In order to address concerns over the quality of audits of listed companies by smaller practices, the selection approach has the following additional elements to increase the frequency of practice reviews of practices with less than 20 listed clients ("relevant practices"):
   a) Relevant practices that take on their first listed audit client will receive a practice review within a year of the date of the first audit report issued on that listed client.
   b) Relevant practices that have more than one listed engagement and have been the subject of a referral to the Financial Reporting Council ("the FRC") by the PRC or a complaint raised by the PRC or the FRC will receive an interim review within the next normal three year cycle.
   c) Relevant practices that have significant or regular changes in the number of listed engagements will receive an interim review within the normal three year cycle.

4. Practices with other public interest clients, for example, banks, insurance companies, securities brokers, insurance brokers are given priority for reviews. A number of practices are selected for reviews on a random basis to ensure that all practices will have a chance of being selected. Practices with few audit clients and without any predetermined risk factors ("small practices") are selected for desktop reviews. The Institute has plans to introduce a six-year review cycle for practices without listed clients within the next few years to improve the effectiveness of the practice review system and to benchmark to the practice used by many regulators worldwide.
The scope of each review includes obtaining an understanding of the practice’s system of quality control, assessing compliance with HKSQC1 “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements” and the practice’s policies and procedures, and reviewing completed audit engagements. The extent of review work that the QAD carries out varies from practice to practice depending on the size of the practice and the nature of its client base.

Desktop reviews are carried out for small practices with no predetermined risk factors. Desktop reviews take place at the Institute’s office and comprise a review of the latest monitoring report and one audit engagement. In 2017, an initial self-evaluation process was introduced as part of the desktop reviews for low risk practices with only a handful of private audit clients.

Matters identified during a review are fully discussed with the practice. The QAD is responsible for drawing conclusions and making recommendations to the PRC for consideration and decisions. The PRC having regard to the report and any response by the practice to the matters raised in the report may act under the power given by the PAO, to:

- conclude a practice review with no follow up action required (“direct closed”);
- make recommendations and specific requests to a practice, e.g. submission of a status report, to ensure appropriate follow up action is taken to address weaknesses and shortcomings (“required follow up action”);
- instruct that another visit is required (“required follow up visit”); or
- make a complaint to initiate disciplinary action.

Each practice is sent a formal notification of the PRC decision. The QAD monitors the progress of actions undertaken by practices at the direction of the PRC.

If an auditing, reporting or relevant irregularity is identified in respect of a listed company, the PRC may, via the Council of the Institute, refer the case to the FRC for investigation.
## Our review outcomes

The number of reviews carried out each year has increased from 83 in 2008 to 292 in 2017. The increase in the number of reviews in 2017 was mainly due to the increase in the number of desktop reviews.

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of desktop reviews</th>
<th>No. of follow up visits</th>
<th>No. of initial visits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>82</td>
<td>1 follow up visit</td>
<td>5 initial visits</td>
</tr>
<tr>
<td>2008</td>
<td>134</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>152</td>
<td></td>
<td></td>
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<tr>
<td>2010</td>
<td>181</td>
<td></td>
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<tr>
<td>2011</td>
<td>201</td>
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<td>2012</td>
<td>206</td>
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<td>2013</td>
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<td>2014</td>
<td>205</td>
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<td></td>
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<tr>
<td>2015</td>
<td>208</td>
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<td></td>
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<tr>
<td>2016</td>
<td>209</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>292</td>
<td></td>
<td></td>
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</tbody>
</table>
In 2017, the QAD carried out 27 visits to practices with listed clients. We referred five cross border engagements to the Ministry of Finance (“MOF”) in Mainland China for review. The MOF’s review reports and the responses from the practices formed part of the practice review reports on the practices. The Institute will continue to work with the MOF to enhance cooperation and coordination of review work on cross border engagements.

Since the launch of the revised practice review programme in 2007 up to December 2017, the QAD has performed 278 reviews of practices with listed clients covering 101 individual practices. For practices with listed clients where significant findings were identified, the PRC directed the QAD to conduct follow up actions or visits to ensure that findings had been properly addressed. The PRC has a policy to consider referral of significant findings identified in an audit engagement of a listed client to the FRC for further investigation. In the case that there is sufficient evidence of a significant audit failure, the PRC will consider raising a direct complaint as well. If the PRC decided to raise a direct complaint, the FRC will be notified of the decision.

Up to December 2017, a total of thirteen cases from reviews of twelve practices with listed clients have been referred to the FRC for investigation. Five investigations resulted in complaints and disciplinary actions against the relevant practices as a result of serious non-compliance with professional standards and serious technical failings. Three cases are still under investigation by the FRC. The remaining five cases are under consideration by the Institute for further regulatory action following the FRC investigations. In addition, three direct complaints against practices with listed clients were raised by the PRC.
The PRC met on ten occasions in 2017 and considered 261 practice review reports. The PRC concluded that 196 initial visits should be closed without requiring any follow up actions. For 54 initial visits, practices were required to undertake specific remedial actions and /or submit a status report on actions taken in response to practice review findings. Seven reviews required a follow up visit to assess the effectiveness of remedial actions taken. Four reviews of practices with listed clients proceeded to complaints and/or referrals to the FRC.

Four follow up visits were reported to the PRC in 2017. One follow up visit was closed on the basis that adequate remedial actions had been taken, two required further follow up actions and, one required another follow up visit.

Initial practice reviews reported to the PRC, which were directly closed, increased from 56% in 2016 to 75% in 2017. The improving results were mainly due to the steps that were implemented in the past few years to encourage practices to improve their audit quality and better prepare for a practice review and better efforts made by practices to promptly address the deficiencies identified in the practice reviews.
For practices with listed clients, directly closed reviews have increased from 50% in 2016 to 69% in 2017 while reviews requiring follow up action have decreased from 45% in 2016 to 16% in 2017. This is encouraging as the outcomes indicate improvement in the general quality of practices with listed clients.

However, in 2017, we also encountered specific cases that required us to take more robust actions. The PRC directed one follow up visit to a practice with listed clients. Two practices with listed clients proceeded to a complaint. A separate complaint was also raised against the external engagement quality control (“EQC”) reviewer from one of these practices due to his failure to act diligently in his role as the EQC reviewer. These two practices each have only one or a few listed clients. The results of reviews suggest that audits of listed entities demand a much higher level of resources and technical knowledge than some of the practices had anticipated.

In addition, two listed entity audits of another two practices were referred to the FRC. In both cases, the clients had entered into complex financial instrument transactions and the auditors did not perform sufficient audit procedures to assess the appropriateness of the related accounting treatments.
The review outcomes of practices (without listed clients) improved significantly in 2017. 76% of the reviews of other practices (without listed clients) were directly closed in 2017, representing an increase of 20% from 2016. The reviews that required follow up action have decreased from 38% in 2016 to 21% in 2017. The improving results reflected the outcomes of the new initiatives introduced in recent years which are set out in pages 11 to 12 and that practices are generally responsive to practice review findings.

In 2017, no reviews of other practices resulted in complaints being raised by the PRC. However, complaints against two practitioners were raised by the PRC due to non-compliance with PRC directions to deal with disputes arising from the inability to arrange a practice review.

### Practice review cases reported to PRC (other practices)

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct closed</th>
<th>Required follow up action</th>
<th>Required follow up visit</th>
<th>Direct complaints</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td></td>
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<td>2009</td>
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</tbody>
</table>
11

New initiatives and measures to uphold quality

In 2017, we see direct closed cases reached the record high of 75%. This was the result of the practices and the Institute working together to promote quality of the profession. In recent years, we implemented a number of new initiatives and measures to uphold quality. We also noted that more efforts are made by practices to prepare for practice reviews and to address deficiencies as soon as they are identified in a practice review. The following sets out the new initiatives and measures that have been introduced since 2014.

Letter to all practices concerning Top 5 findings

In 2014, a letter was sent to all practices setting out the PRC’s decision to take stronger action against the Top 5 findings (including no or insufficient quality control policies and procedures; no or ineffective monitoring; unsatisfactory subcontracting arrangements; inappropriate audit methodology; and misuse of modified opinion). If a practice is found to have made no or little attempt to avoid those common findings, the non-compliance will be regarded as serious professional misconduct and may result in disciplinary action, even for a first time review. Since the issue of this letter, a few cases that featured Top 5 findings were referred for disciplinary actions.

E-Seminar and Audit Health Screening Checklist

In 2014, we started to develop an e-Seminar “Improve audit quality – Practice review and common findings” and an Audit Health Screening Checklist to help practices identify common deficiencies and take appropriate actions to address those deficiencies. Practices that are identified to have a certain extent of common deficiencies by the Audit Health Screening process are notified and their practice review will be deferred for a short period of time such that they can take appropriate remedial actions to address the deficiencies. Robust actions will be taken against them if the level of improvement is assessed to be unsatisfactory in their subsequent practice review. We now include a link in our practice review notification letters to encourage practices to enroll for the e-Seminar in advance of their practice review so that they can gain knowledge of how to better prepare for a practice review. The e-Seminar is currently available for subscription at the Institute’s website and the link is set out below:


Desktop reviews

In late 2014, we introduced desktop reviews for small practices without any pre-determined risk factors to better utilize our resources and to enable us to carry out more reviews each year. Desktop reviews take place at the Institute’s office and entail a review of the latest monitoring report and a selected engagement of the practice.

After using desktop reviews for a few years, we believe they are effective for reviews of small practices. In 2017, we reviewed and extended the scope of desktop review to cover more practices without pre-determined risk factors. We also introduced an initial self evaluation process for low risk practices with only a handful of private audit clients as part of desktop reviews. A full scope review will however be scheduled for those practices once their number of clients has reached a certain level.
New elements in the practice review selection process

In 2016, to address concerns over the quality of audits of listed companies, we introduced additional elements to our selection process to ensure (1) practices are reviewed in the first year after they signed off audit reports on their first listed audit clients and (2) those practices that are the subjects of recent referrals to the FRC and complaints and that with significant or regular changes in the number of their listed audit clients will receive an additional interim review within their normal three-year review cycle. Through these additional visits, we will check whether practices have the required competency and resources to audit a listed client and have taken appropriate remedial actions to address deficiencies previously identified in a timely manner.

A six-year review cycle for practices without listed clients

In 2017, we introduced a plan to shorten our review cycle for practices without listed clients to 6 years. We hope to be able to achieve this target in three years’ time and to complete the reviews of practices that have not yet been reviewed under the revised practice review programme within that 3-year period. A cycle of 6 years is the benchmark used by many overseas regulators for similar reviews and we believe that having a fixed year review cycle would help set expectations and make practices better maintain their quality.

Other robust actions

During practice reviews, we encountered cases where working papers and documentation were prepared or added just before the start of the practice review. It is important to note that HKAS 230 requires documentation of any changes to working papers subsequent to the completion of file assembly and reasons for making the changes. Adding working papers in reaction to practice review notification is unprofessional and unacceptable and creates serious doubts as to whether sufficient and appropriate audit evidence has been obtained before the audit report is issued. Practices should be aware that if we encounter instances that suggest that additional working papers have been created for the pre-selected engagements, we will extend our review scope to spot check additional audit engagements.

Practices are required to complete a practice review electronic self-assessment questionnaire (EQS) every one to two years. During practice reviews, we also found some practices that had reported false information in EQS intentionally in an attempt to manipulate the chance of being selected for a practice review. Such acts raise concerns about the integrity and professional conduct of the practitioners. Practices should be aware that we will check the information reported in the EQS as part of our standard procedures in a practice review.

In 2017, we identified a few practices which had added working papers in reaction to practice review notifications and / or reported false information in EQS intentionally. The PRC decided to take disciplinary actions against these practices in early 2018.

We shall continue to enhance our review approach and introduce new initiatives and measures with an aim to promote further improvements in quality of the audit profession.
Our work and review outcomes – Professional standards monitoring programme

The programme is a non-statutory financial statements review programme set up in 1988 with the objective to enhance the quality of financial reporting and the application of professional standards in Hong Kong. It monitors compliance with professional standards by members engaged in the preparation or audit of listed company financial statements.

Under this programme, the QAD carries out reviews of Hong Kong listed company financial statements to identify if there are any matters that indicate possible non-compliance with professional standards. Enquiry letters are issued to members (primarily auditors of the listed companies) for the issues identified. Matters raised primarily focus on financial reporting but the QAD also looks into audit if significant issues are identified. The QAD determines if follow up actions are required on the issues raised with the auditors based on the reviews of the auditors’ replies to our enquiry letters. Follow up actions include issuing further enquiry letters and letters with comments to advise members of areas for future improvement. If the issues identified indicate significant potential non-compliance with professional standards that constitutes a “Relevant Irregularity” or “Relevant Non-compliance” as defined under the Financial Reporting Council Ordinance, the financial statements, and our concerns, will be referred to the Financial Reporting Council (“FRC”) for investigation unless evidence obtained is sufficient for the QAD to pursue a complaint itself.

Changes are often made to the subsequent financial statements in light of our comment letters. To ensure that members benefit from our programme so as to enhance the quality of financial reporting in Hong Kong, the QAD communicates significant or common weaknesses identified from the reviews to members through different channels such as annual joint financial reporting forums, technical articles published in the Institute’s publication (A-Plus) and the QAD annual reports.

The programme is supported by the Professional Standards Monitoring Expert Panel (“Expert Panel”) and independent external reviewers (“Independent Reviewers”). The Expert Panel is an advisory panel that gives advice to the QAD on the appropriate course of actions on significant, complex or controversial issues. The Expert Panel in 2017 comprised representatives from the Big Four firms, medium-sized practising firms and Hong Kong Exchanges and Clearing Limited (“HKEX”). Please refer to Annex for composition of the Expert Panel.
The Independent Reviewers as well as the QAD are involved in conducting initial reviews of financial statements. The QAD assesses the observations identified from initial reviews and determines whether an enquiry should be raised.

The Institute regularly communicates with the FRC and the HKEX which have similar financial reporting review programmes to avoid duplication of reviews.

*Our work*

The review process comprises three stages:

**Stage 1 – Initial review**
- Published financial statements assigned by the QAD to Independent Reviewers for initial reviews

**Stage 2 – QAD review**
- The QAD reviews observations identified in initial reviews and issues enquiry letters to members when necessary
- The QAD consults the Expert Panel on significant, complex or controversial issues

**Stage 3 – Follow up**
- In cases where enquiry letters are issued, the QAD reviews reply letters from members and decides whether further enquiry or other appropriate action is necessary
- The QAD consults the Expert Panel on significant, complex or controversial issues
The programme uses a risk-based approach to select financial statements for review. The following chart shows the basis of selection of financial statements reviewed in 2017.

The category “Companies with primary operations in Mainland China” included some financial statements which were prepared under China Accounting Standards for Business Enterprises.

Review of initial application of new financial reporting standards is a focus of our programme. However, as there were no major changes to financial reporting standards in the past two years, only a small portion of financial statements reviewed were for “Companies affected by new/revised standards” in 2017.
The following chart shows the distribution of auditors of the financial statements reviewed in 2017:

Distribution of auditors in respect of financial statement reviewed

- **Big 4**: 53% (2016: 57%)
- **Practices with 10 or more listed clients**: 44% (2016: 37%)
- **Practices with less than 10 listed clients**: 3% (2016: 6%)
**Our review outcomes**

In 2017, the QAD reviewed 70 sets of financial statements reviewed. The QAD also followed up 25 cases brought forward from the previous year. During the year, the QAD issued 38 letters enquiring about matters identified from reviews or making recommendations on improvements in presentation and disclosures. The QAD handled a total of 34 responses from auditors during the year.

The chart below shows that follow up action was not needed for the majority of financial statements reviewed in 2017.

Referrals are made to the FRC for investigation when the QAD identifies potential significant non-compliance with professional standards. Since 2010, a total of 14 cases have been referred to the FRC for investigation of which two cases were referred in 2017.
Our findings

Practice review programme

This is the eleventh annual report on our revised practice review programme. Every year, we use the annual report to communicate common findings identified in practice reviews. To be clear, it is not that all these findings arise in all practice reviews, but rather these findings recur more frequently and therefore it is worthwhile communicating them for practices’ particular attention. In 2017, significant improvements have been noted in terms of the efforts made by practices to address the common findings previously communicated, resulting in the significant increase in the percentage of closed cases in 2017. However, some of those findings still recur more often than we would expect to see and therefore more efforts are required from practices to rectify those deficiencies without delays.

We achieved our target of practice reviews for 2017, having carried out 214 onsite and 78 desktop reviews, including 5 follow up visits. Most practices were cooperative and willing to make improvements to their systems, policies and processes to address deficiencies identified in their practice reviews. The following section sets out the common deficiencies identified during our 2017 practice reviews. You will note that the common findings are more on the engagement level as the general standards of quality control have improved.

Common findings on quality control

Fee dependence

Through practice reviews and our regular publications, smaller practices with one or few listed clients are now more familiar with the requirements of the Code of Ethics (“COE”) that deal with situations when the total fee income from a listed client and its related entities has exceeded 15% of the total fees received by a practice for two consecutive years, in particular the safeguards required to reduce the relevant threat to an acceptable level.
Another fee dependence issue more commonly identified concerns outstanding audit fees brought forward that remain unpaid at the time when practices issue their current year’s audit reports. Some practices were not aware that this issue creates independence threats that should be addressed. According to section 290 of the COE, a self-interest threat may be created when fees due from an audit client remain unpaid especially when a significant part is not paid before the issue of the audit report for the following year. Practices should assess the significance of related threats and apply appropriate safeguards to eliminate or reduce the self-interest threats to an acceptable level e.g. having an additional professional accountant who did not take part in the audit engagement to provide advice or review the work performed. Under the requirement of the COE, practitioners should also consider whether the overdue fees might be regarded as being equivalent to a loan to a client and whether, because of the significance of the overdue fees, it is appropriate for them to be re-appointed or continue with the audit engagements.

File management and assembly

Although a decade has passed since HKSA 230 Audit Documentation became effective, some smaller practitioners still believed that we would accept oral explanations to support their work. Instances were found where no working papers were prepared for significant audit areas. Some practitioners, particularly those sole practitioners without staff, explained to us that they performed all audit procedures themselves and therefore there was not a real practical need to prepare comprehensive working papers to record the work done. This is non-compliance with HKSA 230. Documentation on audit files should be sufficiently detailed to give us a clear understanding of the work performed, the evidence obtained and the conclusions reached. Practices may provide oral explanations to clarify or explain information in the documentation. Practices should however document audit evidence, including that contradicts or is inconsistent with the audit conclusions on significant matters or issues and, where applicable, explain how they addressed the contradictions in forming the conclusions.

In some cases, practitioners explained that the missing working papers were kept at their home (particularly for part-time practitioners) or with members of the audit teams, as they were taken out from the relevant audit files for preparation of the subsequent years’ audits. When there are indications of file management and assembly issues (e.g. many non-assembled working papers in folders lying around in the office) and/or we are not convinced with the practitioners’ explanations, we would consider the need to select and review additional audit engagements on the spot at the practices’ offices for assessing the significance of those issues and whether they could have other audit implications (e.g. whether audit reports are adequately supported by sufficient appropriate evidence at the time they are issued).

Robust actions were taken by the Committee against practitioners with serious deficiencies in file management and assembly and documentary evidence to support that appropriate audit work had been performed before issue of the audit reports.
IES 8

IES 8 Professional Competence for Engagement Partners Responsible for Audit of Financial Statements is effective from 1 July 2016. The objective of IES 8 is to establish the professional competence that practitioners develop and maintain when performing the role of an engagement partner/director.

IES 8 identifies the responsibilities of individuals, firms and professional bodies in developing and maintaining professional competency of engagement partners/directors. It sets out how engagement partners/directors should develop and maintain relevant competencies and be able to demonstrate what has been undertaken by way of learning outcomes.

We noted that many small practitioners were not aware of IES 8 and therefore, did not have policies and procedures established to ensure the requirements of IES 8 are properly addressed.

Practices are reminded to develop policies and procedures and provide sufficient resources and aids, for example, training programmes covering learning outcomes required by IES 8, to facilitate individuals performing the role of an engagement partner/director and maintaining their individual competence and capabilities necessary to perform engagements in accordance with professional standards.

Engagement partners/directors are reminded to maintain relevant professional competence through CPD, practical experience and other learning activities to achieve the specified learning outcomes for technical competence, professional skills and professional values, ethics and attitudes as set out in IES 8.

Common findings on engagements

Modified audit opinions

It is common for practices to modify their first year audit reports because of the following:

- Clients fail to prepare consolidated financial statements and practices were unable to obtain sufficient appropriate evidence on investments in subsidiaries which were material to the financial statements;

- Clients did not have complete or proper records for practices to carry out the audit of significant account balances; and

- Clients did not invite practices to attend the year-end inventory count.
The following common shortcomings were identified when we reviewed qualified opinions on the financial statements:

- Practices did not consider whether effects of the qualifications on the financial statements were material and pervasive nor justify why issuing a qualified, instead of a disclaimer or an adverse report, was more appropriate;
- Practices did not have sufficient documentation of details on file to justify the type of qualified report issued; and
- Practices issued recurring modified reports that resulted from scope limitations year on year.

When audit qualifications resulting from scope limitations imposed by management had been recurring for a number of years, we would expect to see evidence on the audit file to demonstrate that the practices had made efforts to resolve the limitations and had given adequate consideration to the impact of the recurring audit qualifications on the practices’ ability to continue as clients’ auditors. When there is no such evidence on file, this could lead to concerns whether adequate steps had been taken to resolve the scope limitations and also begs a question whether there was a real limitation or it was simply an arrangement of convenience between client and auditor.

Practices should use best endeavors to obtain sufficient, relevant and reliable audit evidence to enable them to express an unqualified opinion. Where a scope limitation is truly imposed by a client, practices should consider alternative audit procedures and should issue a modified opinion only when there are no alternative procedures or where such alternative procedures fail. Paragraph A9 of HKSA 705 Modifications to the Opinion in the Independent Auditor’s Report states that limitations imposed by management may have other implications that need to be addressed by the auditor such as in engagement continuance. Section 410.52 of the COE also states that significant limitations imposed by a client may infringe on the practice’s statutory duties as auditor. Practices should normally not accept appointment or reappointment as auditor in those circumstances.

It is unacceptable not to carry out practicable audit procedures when they are available and the reason for issuing a modified report is merely to save cost and meet the reporting deadline. One review in 2017 where the practitioner was found to have expressed qualified opinions in most of its reports issued, resulted in a complaint being raised by the PRC and subsequent disciplinary actions despite it being a first time visit.
Key audit matters (“KAM”)

With effect from 15 December 2016, the content of auditor’s reports issued on a listed company’s financial statements changed significantly. In particular, practices are required to include a new section on KAM in the auditor’s report to highlight those matters that, in the auditor’s professional judgment, are of most significance in the audit of the current year/period.

In our reviews, the following shortcomings were identified regarding the identification and communication of KAM:

- The audit team did not check the accuracy of the descriptions of audit procedures performed to address KAM in the audit report, as we discovered inconsistencies between the descriptions in the audit report and the documentation on file;

- Although there were a few matters identified as potential KAM at audit planning, no documentation was provided to support why some of those matters were not ultimately communicated as KAM in the audit report; and

- Audit teams communicated KAM with those charged with governance only at the audit report date. There was no evidence to show that communication was also conducted earlier, most appropriately at audit planning.

According to HKSA 701 Communicating Key Audit Matters in the Independent Auditor’s Report, KAM are selected from matters communicated with those charged with governance and are determined by taking into account areas of higher risk and significant auditor judgement, and the effect on the audit of significant events or transactions. In most cases, KAM relate to significant complex matters disclosed in the financial statements, e.g. valuation of goodwill and other long-term assets, valuation of financial instruments, or accounting for significant acquisitions. In describing KAM in the audit report, the auditor is required to set out the reason a matter is considered a KAM and how the auditor deals with the matter. Practitioners should exercise professional judgement and consider relevant factors in determining whether or not to not communicate a matter as a KAM.

Audit teams should communicate their preliminary views about KAM when discussing the planned scope and timing of the audit, and further discuss such matters when communicating audit findings. Communication with those charged with governance enables them to be made aware of the KAM that audit teams intend to communicate in the audit report, and provides them with an opportunity to obtain further clarification where necessary.
Materiality

Materiality is an area to which many small practices still fail to pay enough attention. Common issues identified in relation to determination and application of materiality were as follows:

- Overall materiality, performance materiality and a clearly trivial amount were not determined at planning or applied during the audit;
- The materiality computed was not used for determining the nature, timing and extent of audit procedures;
- Performance materiality was set at an amount larger than overall materiality;
- No documentation was provided to justify the computation of materiality based on the average of the amounts determined by applying some percentages to different benchmarks (e.g. profit before tax, gross revenue, gross profit, etc); and
- No documentation was provided to support why the audit team considered the change in the amount of the chosen benchmark (e.g. profit before tax or total assets) from planning to completion did not warrant a revision to the materiality and a revisit to the sufficiency of audit work performed.

Practices should determine overall and performance materiality in accordance with HKSA 320 Materiality in Planning and Performing an Audit, as well as a clearly trivial amount in accordance with HKSA 450 Evaluation of Misstatements Identified during the Audit. According to HKSA 320, practitioners should make judgements about the size of misstatements that are considered material for an audit. Those judgements provide a basis for determining the nature, timing and extent of work to be performed.

Fraud risk assessment

HKSA 240 The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements requires practitioners to consider fraud risk in an audit and adopt a more critical and skeptical mind-set particularly during audit planning and evaluation of audit evidence, to identify, assess and appropriately respond to fraud risk. However, some practices failed to carry out appropriate work to address some basic requirements of HKSA 240 and the following deficiencies were still commonly identified in practice reviews:

- Insufficient work on journal entry testing to address fraud risks arising from management override of controls.

  During our reviews, we noted that some audit teams:
  
  i) only scrutinized the general ledgers to address the risk of management override of controls;
  
  ii) did not select transactions posted to control or suspense accounts in journal entry testing; or
  
  iii) only tested journal entries above overall materiality to address risk of management override of controls.
We would like to remind practitioners that, HKSA 240 specifically requires auditors to select journal entries and other adjustments made at the year-end (for example, non-routine entries; entries/adjustments made by personnel who typically do not make journal entries; and entries contain round numbers or consistent ending numbers) and consider the need to test journals and other adjustments throughout the year. These procedures are necessary as material misstatements of financial statements due to fraud often involve manipulation of the financial reporting process by using:

i) inappropriate or unauthorized journal entries which may occur throughout the year or at the period end; or

ii) adjustments to change amounts reported in the financial statements that are not reflected in journal entries e.g. consolidating adjustments and reclassifications.

Practices should carry out appropriate procedures to address risk of management override of controls as part of fraud assessment procedures and clearly document details of the procedures performed e.g. criteria used to identify significant and unusual journal entries and fraud discussions with the audit team and management.

• No evidence to support that audit teams discussed susceptibility of clients’ financial statements to material misstatement due to fraud.

HKSA 240 and HKSA 315 require audit teams to discuss susceptibility of an entity’s financial statements’ to material misstatements due to fraud. In planning an audit, the engagement partner/director and/or manager should communicate the potential for material misstatements due to fraud with other members of the audit team. Practices should document the discussions with team members on how and where the entity might be susceptible to fraud and ensure the appropriate level of professional skepticism is maintained on those specific areas.

• No or ineffective inquiry of management about fraud when gaining an understanding of the client.

Practices should inquire of management about its knowledge of fraud bearing in mind that auditors’ responsibility for detecting material misstatements caused by fraud is not directed to the detection of fraudulent activity and the responsibility to detect fraud is framed by the key concepts of materiality and reasonable assurance.

In a review of a group audit engagement, we noted that the group audit team had performed a legal search and its results showed that a subsidiary of the client had filed a civil claim as a result of theft by an employee. However, the group management did not inform the group audit team about this matter during the fraud enquiry. In this situation, the audit team should have considered making a fraud enquiry with management of the subsidiary and assessed the implications of this matter for the audit.
In cases where the resulting misstatement from a potential fraud risk matter is not considered to be material to the financial statements, audit teams should consider referring the matter to an appropriate level of management at least one level above those involved. If the matter can have a material effect on the financial statements, audit teams should follow up the matter with an appropriate level of management and then determine its effect on the financial statements and the auditor’s report.

When performing a listed entity audit, practices should also understand controls and programmes that management has established to mitigate specific risk factors and assess how well management monitors those controls and programmes. Those charged with governance in the entity, such as the board of directors and the audit committee, should assume an active role in oversight of the assessment of the risk of fraud. Audit teams should obtain an understanding of how the board of directors exercises its oversight activities. When the client has an internal audit function, the audit team should also inquire of the internal audit team about their assessment of fraud risk, including whether the management has satisfactorily responded to internal audit findings during the year.

**Evaluation of key internal controls**

We continue to find practices, particularly small ones, that did not perform appropriate risk assessment procedures, in particular on evaluation of the design and implementation of key controls, as required by HKSA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*. Typical examples include:

- Documentation briefly recorded that all transactions were approved by the director(s) and there were no further details of key controls that are specific to the business;

- Documentation showed that the audit team had checked payment and receipt documents to ensure that the control procedures existed in the business but there were no further details to show how the related internal control evaluation was performed; or

- Audit teams identified key controls in areas of sales, purchases, payments, receipts and financial reporting closing process but did not evaluate their design and implementation.

HKSA 315 requires risk assessment procedures to be undertaken regardless of the size and complexity of the client. Practices are required to obtain an understanding of controls relevant to the audit and perform appropriate work to evaluate the design and implementation of controls. In smaller and less complex entities, controls are typically informal and undocumented, and often compromised by a lack of segregation of duties. However, the involvement of the owner-manager in the day-to-day running of the business can have both a positive and a negative effect on the evaluation of risk. While the owner-manager’s ability to closely supervise and oversee the business is potentially a strong control, in some situations this dominance can lead to the override of controls and the manipulation of financial data and company assets for personal objectives. Tax implications are usually important to owner-managers and may provide a motive for bias in or manipulation of the financial statements. Practices need to critically assess risks relating to the completeness of recorded assets and income when carrying out an audit.
Communication with those charged with governance

Practices with listed company audits were generally well aware of the requirements to communicate the following with management and those charged with governance:

- Planned scope and timing of audits
- Information about threats to auditors and the safeguards applied
- Significant findings from the audit

Some practices have developed templates to assist audit teams’ communication with audit committees. However, the templates were not always used properly and therefore audit teams failed to address certain requirements. Other deficiencies identified in communication with those charged with governance included the following:

- No evidence of communication with the audit committees (e.g. planned audit scope, written representations given by the client’s management, key audit matters, etc) including when and to whom the audit teams had communicated;
- Audit teams did not communicate their planned scope, identified significant risks and timing of the audit to the audit committees but rather requested management to communicate those matters to the audit committee members after their audit planning meetings with management;
- Audit documentation did not show whether audit teams had made inquiries of management and audit committees to determine whether they had knowledge of any actual, suspected or alleged fraud affecting the client; and
- Audit teams did not (i) disclose fees charged for all professional services provided by the practices or (ii) provide breakdowns of non-assurance services in their communication with audit committees to assist audit committees in assessing the effect of provision of non-assurance services on the practices’ independence.

Written communication that usually takes the form of a report to the audit committee provides value to clients by informing management and those charged with governance about significant matters arising from the audit so that appropriate action can be taken to address them. Appropriate communication will also help enhance the general efficiency and effectiveness of an audit.
Audit confirmations

We again identified a number of instances where confirmation requests were arranged by client personnel e.g. allowing clients to mail confirmation requests. When performing confirmation procedures, practices should ensure their audit teams adequately control the confirmation process e.g. sending out the confirmation requests themselves and requesting replies to be sent directly to them. When replies are in the form of a fax or other electronic means, practices should perform all reasonable steps to verify the identity of the sender as required by HKSA 505 External Confirmations. A failure to properly assess the reliability of the confirmations (i.e. ensure they are genuine and from a third party) may result in drawing wrong conclusions on the matters confirmed.

In some cases, circularization was carried out but there was no proper follow up action, e.g. consideration of potential implications of information disclosed in bank confirmations. Practices should perform sufficient alternative audit procedures when confirmations are not returned or are returned with material exceptions.

Audit of construction contracts

Auditing construction contracts can be complex, in particular, when clients used the percentage-of-completion method to account for long-term contracts. The following deficiencies were identified in audits of construction contracts:

- The client’s financial statements showed that a debit amount of “increase in recognized profits of contract in progress” was recognized as other income. The audit team was not aware of the fact that the treatment of recognizing contract revenue and contract costs on a net basis was not appropriate. Contract revenue and contract costs associated with a construction contract should be recognized separately as revenue and costs by reference to the stage of completion of the contract activity at the balance sheet date;

- Contract revenue and costs were recognized based on settlement dates rather than according to the stage of completion of the contracts at the year-end date. However, the audit teams did not challenge their clients’ accounting treatment which does not appear to have complied with the relevant standards;

- Clients did not recognize contract revenue and contract costs in the income statement for contracts whose outcome could not be reliably estimated. However, the audit teams were not aware that such treatment did not comply with the relevant standards which require that when the outcome of a construction contract cannot be estimated reliably, contract revenue should be recognized to the extent of contract costs incurred that is probable to be recovered and contract costs should be recognized as an expense in the period in which they are incurred;

- No audit work was performed to assess effects of variation orders on projects that might cause changes to contract revenue and costs;
No audit work was performed to verify the estimated total contract costs used to determine the stage of completion based on the proportion of contract costs incurred for the work performed to date to the estimated total contract cost. There was also no documentation to show how the contract costs incurred to date were verified;

No audit work was performed to assess whether the total contract costs had exceeded total contract revenue such that expected losses would arise and required to be expensed immediately; and

Documentation of the contract revenue cut off test showed that the audit team had checked the projects’ stage of completion to the quantity surveyors’ certified reports issued before the year end, but it was unclear whether the percentages of completion certified in those reports were up to or close to the financial year end. The audit team should also consider reviewing the certified reports issued shortly after the year end to ensure that there were no material issues on cut off of contract revenue and related contract costs.

Practitioners should be mindful of the above shortcomings when they audit construction contracts.

Audit of inventories

Issues on auditing inventories have been covered in previous reports and forums but still keep recurring year on year. The following are common deficiencies identified in the audit of inventories:

Audit teams did not attend the year-end inventory counts without a valid reason to support why such arrangements were impracticable;

When the year-end inventory count was carried out at a date other than the year end date, audit teams failed to perform audit procedures to test transactions during the intervening period to ensure the movements were properly recorded;

Audit teams attended the year-end inventory count but did not check whether the count results agreed with the client’s final inventory records;

Discrepancies between actual quantities observed by audit teams during the year-end inventory count and those shown in the final inventory count lists provided by clients were noted but there was no follow up work by the audit teams to evaluate the financial impact on the audit;

Unit price tests on inventory items were limited to checking the latest supplier invoices without considering whether the costing method was properly applied. Audit teams need to understand the costing method, e.g. first-in-first-out or weighted average, adopted by clients and design appropriate audit procedures to test whether costs of inventories are properly determined;
• No follow up procedures for inventory items without subsequent sales (e.g. to understand the reasons and check last/ subsequent actual selling prices) to ensure inventories are not stated at above their net realizable value;

• Insufficient or no audit procedures to assess the appropriateness of or need for an inventory provision were noted. Audit teams should 1) understand clients’ policies for determining inventory provision; 2) evaluate whether the policies are appropriate and reasonable; 3) review clients’ calculations; 4) obtain evidence to verify whether the information used by clients in their calculations is appropriate and reasonable; and 5) review the aging analysis of inventory and the condition of inventories during the physical stock counts; and

• No consideration of the financial impact of not absorbing costs of conversion (e.g. direct labor and production overheads) into work-in-progress and finished goods was noted. Audit teams should request clients to quantify the effect and perform audit procedures to ensure client’s quantification is reasonable. If the effect is material, audit teams should request their clients to make appropriate adjustments to their financial statements.

Practices might recognize that some of the shortcomings set out above also exist in their approach to the audit of inventories. Practices are strongly advised to take appropriate actions to address the shortcomings relevant to them.

Impairment assessment

We continued to have concerns about the quality of audit evidence on audit files to support auditor’s judgement on areas such as impairment of goodwill and other assets. In general, we considered that the level of challenge by audit teams to key assumptions adopted by clients was not rigorous enough to support their conclusions on whether impairment was adequately made or not required. The following are some examples:

• Projected growth rates set by client appeared unrealistically high compared to client’s historical performance but there was no evidence that they were critically questioned by the audit team;

• Discount rate applied by client appeared unreasonably low but the audit team did not critically evaluate whether the rate reflected current market conditions as well as the risks specific to the client’s asset;

• Amounts due to related companies, employees and directors were included in the carrying amount of the cash generating unit used to compare with its value in use but the audit teams did not evaluate whether these liabilities were of a trade nature such that it would be appropriate to include them in the carrying amount for assessment; and

• Goodwill was wrongly allocated to cash generating units which were larger than an operating segment but the audit teams did not evaluate the impact of non-compliance with HKAS 36.
Practices often explained that they tried their best and used all information available to audit asset impairment within the tight reporting timeframe. When practices believe that they are not able to carry out a proper impairment assessment of those assets before the reporting timeframe, they should liaise with their client, carry out the test earlier in the year and only update the test at the year-end if there is an indication that the assets might be impaired.

In general, practices should heighten the level of professional skepticism when assessing evidence on an asset impairment assessment that involves significant estimation or judgment by the client. Persuasive audit evidence should be obtained on these areas. Practices should ensure there is sufficient audit evidence on file to reduce the risk of being challenged by external reviewers or regulators in relation to their audit procedures performed or conclusions reached.

**Highest and best use measurement**

HKFRS 13 *Fair Value Measurement* includes new concepts and guidance on how fair value is measured for financial reporting purposes and “highest and best use” is one of those concepts. The Standard requires fair value be determined by reference to the highest and best use of a non financial asset such as land and property.

In determining the highest and best use, an entity should consider whether the use of the asset is physically possible (e.g. location or size of the site), legally permissible (e.g. zoning regulations applicable to the site) and financially feasible (e.g. producing a net positive return after taking into account the costs of converting the asset to that use) as required by HKFRS 13. The highest and best use is determined from the perspective of market participants, even if the entity intends a different use.

The Standard also requires the reporting entity to presume that the current use of the asset is its highest and best use unless market or other factors suggest that a different use by market participants would maximize the value of the asset. Instances were noted where such factors existed e.g. a change in land use for redevelopment purposes had been granted by relevant government authorities. In some of those cases, the entities continued to use the current use as the highest and best use of the relevant assets but the practices did not follow up to assess whether proper consideration had been given to all relevant information before concurring with the treatment. Practices are also reminded to document their assessment to support why the current use represented the highest and best use if there had been indications or evidence showing otherwise.
Audit evidence

The primary objective of an audit is to enable the auditor to obtain sufficient appropriate audit evidence in order to draw reasonable conclusions on the matters on which the auditor is to report. Practice review findings often raise questions about the sufficiency and appropriateness of audit evidence.

In carrying out audit tests many smaller practices still relied solely on documents generated by the client without giving due consideration to their reliability. For example, practices only checked internally generated sales invoices or service billings in carrying out transaction and cut-off tests. Clients’ accounting policies for revenue should be reviewed to determine when revenue should be recognized and, based on the assessment and understanding of the clients’ financial reporting system, documents with third party evidence to support the recognition of revenue, e.g. goods delivery documents with acknowledgement of goods received by customers, should be inspected.

We also found that some practices were not sufficiently involved in the work of component auditors and some did not even communicate with component auditors when they carried out group audits. Common issues identified are:

- Inability to participate adequately in the work of component auditors, such as their risk assessment process to identify significant risks of material misstatements relevant to the group financial statements;

- No documentation to justify the scoping of work and materiality established for components;

- No assessment of (1) competence and qualification of the component auditor; (2) the audit methodology adopted by the component auditor; and (3) the appropriateness and sufficiency of work performed by the component auditor; and

- No assessment of whether the financial information of overseas components prepared under local accounting standards conformed with the accounting standards used for group reporting.

HKSA 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) makes it clear that the group audit partner/director is responsible for the direction, supervision and performance of the group audit and ensuring that sufficient appropriate audit evidence is obtained. If sufficient appropriate audit evidence cannot be obtained on the components, the group auditor should modify the group audit opinion.
Shortcomings were also identified in engagements that involved work of experts. We still found that some practitioners merely obtained a copy of the valuation report as audit evidence without performing any evaluation work as required by HKSA 620 Use the work of an Expert. We also still encountered cases where there was insufficient work to challenge the assumptions used by experts. In one review, a client appointed a valuer to determine the fair value of an investment property located in Mainland China. As there was no recent market transaction of a similar property available, the valuer determined the market value of the investment property based on the average offering price of comparable properties with some discount. However, the audit team did not challenge the reliability of the offering prices of comparable properties, and the reasonableness of the discount applied.

The usual explanation we heard from practitioners was that the expert had more solid experience in carrying out valuations in relevant industries so they did not feel able to challenge the professional competence of the expert. In some cases, practitioners argued that they did not possess the same expertise and knowledge so that they were unable to challenge the expert’s assumptions and methods used.

Practices are reminded that, when the engagement involves the use of work of the client’s expert, the auditor has the responsibility to evaluate whether the professional valuation is reliable for audit purposes. HKSA 500 Audit Evidence contains guidance on work to be done when using the work of the client’s expert as audit evidence.

**Expectation**

Practices are facing new challenges every year, e.g. new financial reporting standards on leases and revenue from contracts with customers. Practitioners and their audit staff should keep themselves abreast of developments in professional standards and to ensure that their quality control and audit policies and procedures remain adequate to maintain the quality of audit work. Practices might find that some of the deficiencies set out in this report also exist in their own quality control systems and / or audit methodology. Practices are advised to take appropriate action to remediate the deficiencies relevant to them promptly.
Our findings

Professional standards monitoring programme

Under our professional standards monitoring programme, we carry out regular reviews of the financial statements of Hong Kong listed companies to assess their compliance with professional standards, particularly on the application of financial reporting standards. We highlight below those more significant or common findings that were identified from our review in 2017. Some of those findings are issues which have been repeatedly found in our past reviews. Therefore we advise members to pay particular attention to those issues and make efforts to avoid them from recurring in future financial statements.

During the periods of financial statements under our reviews in 2017, only one new HKFRS, HKFRS 14 Regulatory Deferral Accounts, and some amendments to the existing HKFRSs had come into effect. These HKFRS and amendments did not have a material effect on the financial statements reviewed. In Section I of this report, we provide you with detailed discussions of the significant or common issues identified in the application of HKFRSs. The HKFRSs covered this year are HKAS 33 Earnings Per Share, HKFRS 10 Consolidated Financial Statements, HKFRS 11 Joint Arrangements and HKAS 7 Statement of Cash Flows. In addition to financial reporting issues, we identified some issues relating to the application of the new auditing standard HKSA 701 Communicating Key Audit Matters in the Independent Auditor’s Report. Since this year is the year of launch of the long form audit reports for listed entities, we consider it worthwhile to also share the issues identified with members in this report.

In our 2017 reviews, recurring issues concerning the application of HKFRS 3 (Revised) Business Combinations and HKAS 36 Impairment of Assets continued to be identified. Those issues have already been discussed in depth in our previous reports and therefore detailed discussions of those issues are not repeated this year. The key issues are, however, summarized in Section II as a reminder for members to pay attention in their audit/preparation of financial statements.

In Section III, we will give you an overview of common disclosure deficiencies identified from our 2017 reviews.
Section I – Significant or common findings on HKSAs and HKFRSs

1. HKSA 701 Communicating Key Audit Matters in the Independent Auditor’s Report

HKSA 701, which is a new auditing standard effective from December 2016, requires auditors of listed entities to describe in their audit reports the key audit matters (“KAMs”) that they have identified and how they responded to them during their audit. The purpose of communicating KAMs is to enhance the communicative value of the auditor’s report by providing greater transparency about the audit that was performed and assist intended users of the financial statements (“intended users”) in understanding those matters, that in the auditor’s professional judgement, were of most significance in the audit. Communicating KAMs may also assist intended users in understanding the entity and areas of significant management judgement.

HKSA 701 deals with key matters identified during the audit, including but not limited to, the issues identified by auditors in relation to their clients’ application of HKFRSs. HKSA 701 paragraph A30 recognizes that determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial statements is a matter of professional judgement. However, from reviews of KAMs disclosed in the auditor’s reports and the information provided in the financial statements, questions may arise as to whether the auditors properly identified KAMs and based on the descriptions of KAMs, whether the auditors applied the relevant HKFRSs appropriately.

The following are some examples:

(i) A reporting entity had significant goodwill at the year end that arose from the acquisitions of two subsidiaries including one which was acquired during the year. The KAMs in the auditor’s report only described the impairment assessment of the goodwill arising from the acquisition of the subsidiary that took place in the previous year even though the goodwill arising from the current year acquisition of another subsidiary was much more significant and that subsidiary was in a net liability position and had been incurring losses for the past few years.

(ii) Another reporting entity reported that its goodwill at the year end related to two cash-generating units (“CGUs”), CGU A and CGU B. The goodwill allocated to CGU A was brought forward from last year and was fully impaired in the current year. CGU B consisted of a group of subsidiaries which were acquired in the current year and no impairment was determined to be necessary after assessment. The KAM in the auditor’s report however only covered the impairment assessment of the goodwill arising from CGU B but not CGU A even though (1) CGU A’s goodwill was fully impaired during the year; (2) the amount of impairment loss recognized was significant to the financial statements; and (3) the relevant operating segment reported an increase in profit during the year.

(iii) The financial statements of another reporting entity showed that its current year’s revenue increased by more than 5 times of the previous year. The entity was engaged in a project construction business and recognized revenue based on contracts signed with customers and there had been no changes in the entity’s business operating model in the current year of reporting. Accounting for construction
contracts is usually an area that requires significant professional judgement. The substantial increase in revenue raised further questions as to why revenue recognition was not identified as a KAM by the auditor.

HKSA 701 paragraph 9 requires that, in determining KAMs, auditors shall take into account areas of higher assessed risk of material misstatements; significant auditor judgements relating to areas in the financial statements that involved significant management judgement; and the effect on the audit of significant events or transactions. HKSA 701 paragraph 10 further requires auditors to determine which matters are of most significance in the audit of financial statements so as to report them as KAMs in the auditor’s report. In the above examples, it was unclear why the auditors did not report the above matters (i.e. goodwill of the new subsidiary in Example (i), the fully impaired goodwill of the subsidiary in Example (ii) and revenue recognition in Example (iii)) as KAMs under the requirements of HKSA 701; and that they had properly addressed the risk of material misstatements arising from those particular areas by designing and performing sufficient appropriate audit procedures to make sure that the related items (i.e. goodwill and revenue as discussed) were fairly stated in the financial statements.

Members, especially auditors, should be conscious that the matters disclosed as KAMs in the auditor’s report should be matters that have been previously communicated with those charged with governance and management of the reporting entities. Where we consider an enquiry is warranted, auditors may also be asked to provide information about their communication with those charged with corporate governance and management of the reporting entities.

Apart from the above three examples, in our 2017 reviews, we also identified the following deficiencies in the application of HKSA 701:

(i) The description of KAMs in the auditor’s report did not include a reference to the related disclosures in the financial statements as required by HKSA 701 paragraphs 13 and A40.

(ii) The auditor inappropriately reported the material uncertainties about the entity’s ability to operate as a going concern as one of the KAMs in its auditor’s report. This does not comply with HKSA 701 paragraph 15 which states that although such matters are by nature one of the KAMs, they shall not be described in the KAM section in the auditor’s report. Instead, the auditor shall report on the matter in accordance with HKSA 570 (Revised) Going Concern and include a reference to the “Basis for Qualified (Adverse) Opinion” or the “Material Uncertainty Related to Going Concern” sections(s) in the KAMs section.

It is also worth noting that, when the auditor concludes in accordance with HKSA 570 (Revised) that no material uncertainty exists relating to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern, it may nevertheless determine that one or more matters relating to this conclusion arising from its work effort under HKSA 570 (Revised) are KAMs. In such circumstances, the auditor’s description of such KAMs in the auditor’s report could include aspects of the identified events or conditions disclosed in the financial statements, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or non-compliance with loan agreements, and related mitigating factors (HKSA 701 paragraph A41).
First year review of revised auditor’s reports

The Institute’s Standard Setting Department published in October 2017 a research report on the first year experience of the revised auditor’s report. The research observed how auditors implemented HKSA 701 based on a review of audit reports issued on Hong Kong listed entities. The research report shows that the number of KAMs reported by entities listed on the Main Board ranged from 1 to 8 KAMs. It reported that impairment of receivables, property valuation, goodwill, impairment of non-financial assets and revenue recognition are the top 5 KAMs reported. These areas are common risk areas that require significant professional judgement in their accounting and therefore demand significant auditor attention and focus.

The full research report can be downloaded from the link below: [http://www.hkicpa.org.hk/file/media/section6_standards/standards/Audit-n-assurance/kamrp1017.pdf](http://www.hkicpa.org.hk/file/media/section6_standards/standards/Audit-n-assurance/kamrp1017.pdf)

2. HKAS 33 Earnings per Share

Earnings per share (“EPS”) is a ratio calculated by dividing the earnings measured in terms of profits available to ordinary shareholders (the numerator) by the weighted average number of ordinary shares outstanding during the period (the denominator). Although the concept of EPS might be easy to understand, the calculation might sometimes not be so straightforward in particular on the determination of the denominator.

a. Issuance of shares under an open offer

It is not uncommon for a Hong Kong listed entity to raise additional capital through a rights issue or an open offer. We occasionally found some reporting entities not to have properly considered the implication of an open offer for EPS. We would like to remind members that, if an open offer contains a bonus element and the ordinary shares are to be issued to all existing shareholders on a pro-rata basis, such open offer, by its nature, could be similar to a rights issue and when it is so confirmed the calculation guidelines on a rights issue under HKAS 33 (i.e. HKAS 33 paragraph A2) would apply and the basic and diluted EPS for all periods presented would be adjusted retrospectively as required by HKAS 33 paragraphs 26 and 27. However, all relevant facts and circumstances (e.g. see the second example below) shall be considered before arriving at the conclusion on whether or not the open offer contains a bonus element.

HKAS 33 paragraph 26 states that “The weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources” (underline added).

HKAS 33 paragraph 27 states that “Ordinary shares may be issued, or the number of ordinary shares outstanding may be reduced, without a corresponding change in resources. Examples include: … (b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders” (underline added).
A reporting entity issued ordinary shares through an open offer. The prospectus of the open offer mentioned that the open offer would be available to all existing shareholders on the basis of one offer share for certain existing shares held (i.e. a pro-rata basis) and that the subscription price represented a discount to the theoretical ex-entitlement price based on the closing price of the share as quoted on the Stock Exchange on the last trading day. In the financial statements, the reporting entity disclosed that the effect of the open offer was taken into account in the weighted average number of ordinary shares outstanding in calculating the EPS for the current year. That means no restatement was made to prior periods.

As stated, the matter in question is whether the above open offer contained a bonus element. If that was the case, the entity should have referred to the guidelines (HKAS 33 paragraph A2) on a rights issue to calculate the EPS since shares were issued to all existing shareholders on a pro-rata basis. In particular, HKAS 33 requires retrospective adjustments to the denominator for all periods before the rights issue. The bonus element inherent in a rights issue is measured by a prescribed formula set out in HKAS 33 paragraph A2. The number of ordinary shares to be used in calculating basic and diluted EPS for all periods before the rights issue is the number of ordinary shares outstanding before the issue, multiplied by the following factor:

\[
\text{Fair value per share immediately before the exercise of rights} \times \frac{1}{\text{Theoretical ex-rights fair value per share}}
\]

A discounted price being offered to all existing shares suggested that there could be a bonus element in the open offer. If, after a thorough assessment of all relevant facts and circumstances including the terms and conditions of the open offer, it was concluded that there was a bonus element, the entity's EPS for all periods presented should be adjusted for the effect of the open offer according to HKAS 33 paragraphs 26 and 27.

In another set of the financial statements reviewed, the reporting entity launched an open offer as part of an acquisition transaction to acquire the entire equity interest of a company. The transaction constituted a reverse acquisition. The legal acquirer, i.e. the reporting entity, was treated as the accounting acquiree whereas the legal acquiree, the company being acquired, was treated as the accounting acquirer. The subscription price was offered at a discounted value to the last published share price of the reporting entity (before suspension of share trading) and shares were to be issued to all existing shareholders on a pro-rata basis. However, in this case, the shares of the reporting entity had been suspended for more than five years. Management was therefore of the view that the last published share price of the reporting entity, which was already more than five years ago, did not represent the fair value of the shares when the open offer was launched. Instead, it considered that the open offer share price represented the fair value of the reporting entity's shares and therefore no bonus element was involved in the open offer. Nevertheless, we would expect the auditor to have obtained sufficient appropriate evidence before it concurred with the management's view that the open offer share price represented the fair value of the shares of the reporting entity.

1 The theoretical ex-rights fair value per share is calculated by adding the aggregate fair value of the shares immediately before the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights.
The above two examples illustrate that, in determining whether or not an open offer contains a bonus element, detailed and careful assessment should be performed on a case-by-case basis after taking into account all relevant facts and circumstances.

b. Convertible preference shares

A reporting entity disclosed in its financial statements that its “Issued share capital” consisted of “Ordinary shares, issued and fully paid” and “Convertible preference shares, issued and fully paid”. In calculating the basic and diluted EPS, the reporting entity included the convertible preference shares when determining the weighted average number of ordinary shares outstanding (the denominator).

The question is whether and how the convertible preference shares would have impacted the EPS calculation under the above entity’s circumstances. In particular, whether it was appropriate to include the convertible preference shares in the basic EPS calculation, or should they only be included in the diluted EPS calculation when the convertible preference shares were in fact potential ordinary shares under HKAS 33 paragraph 7(a).

A key point to consider is whether the convertible preference shares have a “participating feature” such that they constitute “ordinary shares” under HKAS 33. The holder of preference shares may be given a right to participate in the profit with ordinary shares according to a pre-determined formula, but with an upper limit or cap on the extent of participation by the preference shares (HKAS 33 paragraph A13(a)). For example, the preference shares may entitle its holder to receive a fixed rate of dividend (e.g. HK$2.1 per share) and participate in any additional dividends declared (e.g. on a 20:80 ratio with ordinary shares) up to a maximum of a specified amount. HKAS 33 describes this kind of preference shares as “participating equity instruments”.

Sometimes an entity may also have a class of ordinary shares with a different dividend rate from that of another class of ordinary shares but without prior or senior rights. They are described as “two-class ordinary shares” (HKAS 33 paragraph A13(b)).

As required by HKAS 33, if an entity has participating preference shares and/or two-class ordinary shares, for the purposes of calculating basic and diluted EPS, it shall follow the steps set out in HKAS 33 paragraph A14 to allocate the earnings (the numerator) to different classes of shares and participating equity instruments in accordance with their dividend rights or other rights to participate in undistributed earnings. In situations where the participating preference shares are convertible into ordinary shares, conversion is assumed if the effect is dilutive and accordingly, the conversion shares will be included in the number of outstanding ordinary shares (the denominator) for the purpose of calculating diluted EPS.
HKAS 33 paragraph 66 requires entities having more than one class of ordinary shares to calculate and present the EPS for each of the classes. HKAS 33 paragraphs A13 and A14 also require EPS to be disclosed for each of different classes of ordinary shares and participating equity instruments. Members may refer to Example 11 appending to HKAS 33 which provides a worked example of how basic and diluted EPS should be calculated and presented based on distributed and undistributed earnings allocated to participating equity instruments and two-class ordinary shares.

Back to the above example, the financial statements of the reporting entity disclosed that (i) the holder of the convertible preference shares is entitled to receive the same rate of dividends / distributions as the holders of ordinary shares; and (ii) the holder of the convertible preference shares ranks pari passu with other holders of the ordinary shares in respect of its entitlement to dividend or other distribution. Such disclosures suggested that the convertible preference shares are “participating equity instruments” and therefore it appears to be appropriate to include the convertible preference shares in the basic EPS calculation. It should be noted that HKAS 33 requires entities to separately present basic and diluted EPS based on distributed and undistributed earnings allocated to each class of ordinary shares and convertible preference shares if they have different rights to share in the profit for the period.

The above example also reveals the essence of a careful review of the terms and conditions of the preference shares in order to identify features which may have an implication for the EPS calculation. Accordingly, it would not be appropriate to simply jump into a conclusion that convertible preference shares may only affect the diluted EPS calculation as they may have participating features that affect the basic EPS calculation.

c. Share consolidation

A set of financial statements disclosed that the weighted average number of ordinary shares in issue during the year used in the basic earnings per share was about four times the number of ordinary shares outstanding at the year end. The above information appears not to be reasonable. It was noted that during the year there was a share consolidation in which five shares were consolidated into one share.

HKAS 33 paragraph 26 states that “The weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources” (underline added). HKAS 33 paragraph 28 also states that “The number of ordinary shares outstanding before the event is adjusted for the proportionate change in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period presented” (underline added).
In the above example, as the weighted average number of ordinary shares was much more than the ordinary shares outstanding, this suggested that the reporting entity did not follow the above requirements of HKAS 33 to adjust for the effect of share consolidation as if the share consolidation had occurred at the beginning of the earliest period presented. In response to our enquiry, the auditor admitted that there was a calculation error in determining the weighted average number of ordinary shares and that the share consolidation had not been adjusted for the proportionate change in the number of ordinary shares outstanding as if the share consolidation had occurred at the beginning of the earliest period presented. We noted that the reporting entity subsequently published an announcement to show that corrections had been made to both basic and diluted EPS because of the share consolidation.

d. Other disclosure deficiencies

Apart from the above issues identified regarding the calculation of basic and diluted EPS, we also noted the following disclosure deficiencies in respect of application of HKAS 33:

(i) A reporting entity presented diluted loss per share in prior year but disclosed “N/A” for the current year. This does not comply with HKAS 33 paragraph 67 which requires diluted EPS to be reported for all periods presented even if it equals basic EPS.

(ii) A reporting entity omitted to present basic and diluted earnings per share for profit from continuing operations in the statement of comprehensive income as required by HKAS 33 paragraph 66.

e. Other references

The Compliance Department of the Institute published an article in A-Plus about real cases of EPS errors encountered in handling complaints and the root causes of those errors. The article covers areas relating to share split/share subdivision, share capitalization, share consolidation and rights issue. Members are advised to read this article to understand more about how HKAS 33 should be applied in practice. The article is available from the link below:

https://aplusmag.goodbarber.com/previous-issues/c/2/i/17334285/technical-update
3. HKFRS 10 Consolidated Financial Statements, HKFRS 11 Joint Arrangements and HKFRS 3 (Revised) Business Combinations

In determining an appropriate accounting treatment for a transaction, or a series of transactions, there might be times where multiple financial reporting standards need to be considered. Therefore, members need to be conversant with the requirements of all relevant HKFRSs. The following case involving a series of acquisition and disposal transactions is a common example of the application of HKFRS 3 (Revised), 10 and 11.

A reporting entity held respectively 65%, 51% and 95% equity interests in three investees which were accounted for as joint ventures in its consolidated financial statements. During the year (i.e. 2016), the reporting entity entered into some equity transfer agreements to acquire the remaining equity interests in the three investees from independent counter-parties. After the acquisitions, the three investees became wholly-owned subsidiaries of the reporting entity. Upon the acquisition transactions, the reporting entity recognized a significant gain in its consolidated profit or loss from remeasuring its originally held equity interests in the three investees.

In respect of the three investees mentioned above, we noted that they were previously wholly-owned subsidiaries of the reporting entity and some equity interests in those subsidiaries were partially disposed of by the reporting entity in 2014. Following the partial disposals in 2014 and before reacquiring their interests in 2016, the investees were accounted for as joint ventures of the reporting entity. In accounting for the partial disposals, the reporting entity measured and recognized its remaining interests (i.e. 65%, 51% and 95% as referred to in the above) in the three investees at fair value, and as a result, significant gains arising from disposal and remeasurement of the remaining interests in the investees (“disposal and remeasurement gains”) were recognized in the 2014 consolidated financial statements. It was further noted that the reporting entity had provided significant guarantees to the counter parties for their loans granted to the investees.

a. Compliance with HKFRS 10 and HKFRS 11

In view that the reporting entity (i) retained significant interests (65%, 51% and 95% i.e. all over 50%) in the three investees after the partial disposals and (ii) provided guarantees to the counter parties for their loans granted to the investees, concerns were raised as to whether the reporting entity indeed had lost control over the investees in 2014 such that it was appropriate to account for the investees as joint ventures and recognize disposal and remeasurement gains from the retained interests in 2014 upon the partial disposals and to recognize another remeasurement gain upon reacquiring the interests in the same investees subsequently in 2016. Enquiries were therefore raised with the auditor to obtain more information about the arrangements and the audit evidence obtained to support the accounting treatments.
Loss of control

In determining whether an entity has control over an investee, it shall look into the requirements of HKFRS 10. In particular, HKFRS 10 paragraph 7 states that “an investor controls an investee if and only if the investor has all the following: (a) power over the investee (see paragraphs 10–14); (b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and (c) the ability to use its power over the investee to affect the amount of the investor’s returns (see paragraphs 17 and 18)” (underline added). In other words, if any of the above three conditions is not met, the investor is not considered to have control over the investee.

HKFRS 11 paragraph 4 states that “A joint arrangement is an arrangement of which two or more parties have joint control”. HKFRS 11 paragraph 7 further states that “Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control” (underline added).

In response to our enquiry, the auditor provided more details regarding the above transactions to support the management’s view that the reporting entity had lost control upon the partial disposals of the three investees in 2014 but from then gained joint control over them.

The auditor advised that based on the legal documents they had reviewed during the audit (e.g. the relevant investment agreements entered into between the reporting entity and the counter-parties and the articles of association of the three investees), before the re-acquisition transactions, the board of directors of each of the three investees consisted of 5 to 6 directors and that the reporting entity was entitled to appoint 3 to 5 directors to each of them. However, the relevant activities of the investees required unanimous approval at the board of directors. Therefore the counter parties’ seats on the boards of directors of the investees gave them rights to prevent decisions over relevant activities being approved and directed by the directors appointed by the reporting entity. Based on the above fact patterns, it appears that upon the partial disposals of the equity interests in the three investees, the reporting entity only shared joint control with the counter parties. As described in HKFRS 11 paragraph 8, under a joint arrangement, all the parties, or a group of the parties, control the arrangement collectively and they must act together to direct the activities that significantly affect the returns of the arrangement (i.e. the relevant activities).

Members are advised that a thorough assessment of all relevant facts and circumstances, including obtaining an understanding of the reasons for the disposals, evaluating the purpose and design of the investees, the activities of the investees and how decisions of those activities are made and the rights held by each of the investor, is required for determining whether control exists or not and the subsequent accounting treatment of the investees after the disposals (in this case all three investees were accounted for as joint ventures). Significant judgement may be needed in some cases. There
might be also cases where it may be difficult to determine whether an investor’s rights are sufficient to give it power over an investee and vice versa. In such cases, to enable an assessment of power to be made, the investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally (HKFRS 10 paragraph B18). Consideration should be given to the guidelines under HKFRS 10 paragraph B18 and the indicators in HKFRS 10 paragraphs B19 and B20 in assessing whether the investor's rights are sufficient to give it power over the investee. Auditors should critically challenge the appropriateness of their clients’ accounting treatment based on detailed assessment of the audit evidence obtained in addition to the legal documents provided by the clients.

Calculation of disposal and remeasurement gains

HKFRS 10 paragraphs 25 and B97 to B99 set out the requirements for the accounting for the loss of control. Under the requirement, the parent shall (i) derecognize the assets and liabilities of the former subsidiary from its consolidated statement of financial position; (ii) recognize any investment retained in the former subsidiary at its fair value when control is lost and (iii) recognize the gain or loss associated with the loss of control attributable to the former controlling interest.

In the above example, the reporting entity measured its retained interests in the investees in 2014 and calculated the disposal and remeasurement gains by following the above guidelines under HKFRS 10. In this regard, the auditor was expected to have reviewed the reporting entity’s calculation and perform adequate work to assess whether the reporting entity’s fair value measurement of its retained interests in the investees was appropriate and in accordance with the requirements of HKFRS 13 Fair Value Measurement.

We have discussed other issues identified in relation to application of HKFRS 10, HKFRS 11 and HKFRS 12 Disclosure of Interests in Other Entities in our 2014 QAD annual report. Some of those issues were still identified in our 2016 reviews (e.g. lack of disclosures to support why the reporting entity had control over the other entity even though it had less than 50% interest in that entity). Members may refer to the following link for more details:


b. Compliance with HKFRS 3 (Revised)

It is common for an entity to have previously held an equity interest in an investee before gaining control over it. Such kind of transaction is sometimes referred to as a “step acquisition” and its accounting treatment is addressed in HKFRS 3 (Revised) paragraphs 41 and 42. In a step acquisition, the acquirer shall remeasure any previously held equity interest in the acquiree immediately at its acquisition-date fair value and recognize any resulting fair value gain or loss in profit or loss (“remeasurement gain”).
In the above example, the reporting entity engaged independent valuers to conduct valuations of the identifiable assets and liabilities of the investees at the dates of reacquiring control. Based on the independent valuations, the reporting entity recognized significant remeasurement gains that were attributable to the percentage of the reporting entity’s previously held interests in the investees. Auditors were expected to have gained an adequate understanding of the basis for the valuations and challenged the fair value measurement including the assumptions used by the client (e.g. whether the increase in fair value of the assets of the investees was justifiable) before arriving at the audit conclusion that the remeasurement gains recognized by the client were appropriate. Critical judgement and estimates used in the fair value measurement should be disclosed in the financial statements.

4. HKAS 7 Statement of Cash Flows

HKAS 7 requires all entities to prepare a statement of cash flows in accordance with the requirements of HKAS 7 and present it as an integral part of its financial statements for each period for which financial statements are presented (HKAS 7 paragraph 1). There are no exemptions provided under HKAS 7 from the preparation of such statement. Cash flow information is useful for users of the financial statements (e.g. existing and potential investors, lenders and other creditors) to assess the ability of the entity to generate cash and cash equivalents and to utilize those cash flows (HKAS 7 objective paragraph).

HKAS 7 also enhances the comparability of the reporting of operating performance of different entities because it eliminates the effects of using different accounting treatments for the same transactions and events (HKAS 7 paragraph 4).

In previous years’ QAD annual reports, presentation and disclosure deficiencies in respect of the application of HKAS 7 were generally summarized in the disclosure deficiency section. In this year, we have chosen a few more significant and/or common deficiencies for discussions in this section in the hope to draw more members’ attention.

a. Non-cash transactions

A cash flow statement should report only transactions that involve a cash inflow or outflow. In other words, transactions that do not involve a cash flow shall not be reported in the statement of cash flows. Under HKAS 7 paragraph 43, investing and financing transactions that do not require the use of cash or cash equivalents must be excluded from the statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities. However, we occasionally found that some entities did not comply with the above requirement.

A reporting entity disclosed in its note to the financial statements that during the year, it acquired property, plant and equipment at a total cost of HK$23 million. However, the amount of “purchase of
property, plant and equipment” shown in the consolidated statement of cash flows was only HK$9 million. This suggested that some of the property, plant and equipment acquired were not purchased by cash. From the Management Discussions and Analysis (“MD&A”) section of the reporting entity’s annual report, it was noted that some machineries were purchased through finance leases.

The above example appears to involve some non-cash financing transactions, which should have been disclosed elsewhere in the financial statements (i.e. note disclosures). However, no such disclosure was found in the financial statements. Members should be aware that MD&A section of the annual report is not part of the financial statements. Therefore having covered the required information in the MD&A section does not mean that it is not required to be disclosed again in the financial statements.

HKAS 7 paragraph 44 provides examples of non-cash investing and financing activities, which do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. Those examples include the acquisition of assets by assuming directly related liabilities, the acquisition of an entity by means of an equity issue and the conversion of debt to equity.

b. Classification of cash flows – operating, investing or financing

Cash flows reported in a statement of cash flows are classified by activities, i.e. operating, investing and financing activities. As defined in HKAS 7 paragraph 6, investing activities are the acquisition and disposal of long-term assets and investments that are not cash equivalents. Financing activities are activities that result in changes in equity capital and borrowings of the entity. Operating activities are the principal revenue-producing activities of the entity and all activities that are not investing or financing.

Entities shall, based on the management’s judgement and the requirements of HKAS 7, classify and report its cash flows from operating, investing and financing activities in a manner that is most appropriate to its business. For example, a non-financial entity may classify interest paid as operating or financing activities and dividend received and interest received as operating or investing activities (HKAS 7 paragraphs 33 and 34). However, in some occasions, it was unclear as to how management determined the classification of cash flows. The following are some issues encountered during our reviews in relation to classification of cash flows:

(i) A reporting entity classified the cash flows arising from “temporary funding activities” as operating activities. In relation to the entity’s “temporary funding activities”, notes to the financial statements provided the following information: (1) the reporting entity had significant temporary funding receivables from non-related parties; (2) it had significant amount due from a joint venture as a result of entrusted loans granted to the joint venture; (3) it had a significant amount due to related parties which represented temporary funding borrowed from those related parties; and (4) its principal activities were development and investment in real estate projects (i.e. not a financial institution engaging in money lending activities).
As the above “temporary funding activities” were not part of the principal activities of the reporting entity, it might be more appropriate to classify the respective cash flows as investing (for the receivables from the non-related parties and the entrusted loans granted to the joint ventures) or financing (for the funds borrowed from related parties) in the consolidated statement of cash flows.

(ii) A reporting entity classified its cash flows relating to purchases and disposal of trading securities as investing activities. However, as required by HKAS 7 paragraph 15, the above cash flows should have been classified as operating activities as the relevant securities were held for trading purposes, similar to inventories acquired specifically for resale.

c. Reporting cash flows on a gross or net basis

Apart from the two exceptions provided in HKAS 7 paragraphs 22 and 24 (see below), cash flows shall be reported on a gross basis. Under HKAS 7, cash flows from investing and financing activities are reported in the same manner, regardless of the method used for reporting the cash flows from operating activities. Operating cash flows shall be reported by either the direct method (i.e. showing major classes of gross cash receipts and gross cash payments) or the indirect method (i.e. adjusting profit or loss to determine the operating cash flows), although entities are encouraged to use the direct method (HKAS 7 paragraph 19).

A reporting entity presented an item “Net increase in restricted cash relating to financing activities” under the section of financing activities in its consolidated statement of cash flows. However, HKAS 7 paragraph 21 states that “An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis” (underline added).

Since the above item was classified under the financing activities section, the reporting entity should have followed the requirements of HKAS 7 to present gross cash receipts and gross cash payments of the restricted cash in its consolidated statement of cash flows, unless those cash flows had met the limited exceptions provided in HKAS 7 paragraphs 22 and 24.

HKAS 7 paragraph 22 states that “Cash flows arising from the following operating, investing or financing activities may be reported on a net basis: (a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and (b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short”.

HKAS 7 paragraph 24 states that “Cash flows arising from each of the following activities of a financial institution may be reported on a net basis: (a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date; (b) the placement of deposits with and withdrawal of deposits from other financial institutions; and (c) cash advances and loans made to customers and the repayment of those advances and loans”.

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d. Other voluntary disclosures

As stated in HKAS 7 paragraph 50, additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosing such additional information, together with a commentary by management is encouraged. For instance, in a case where a reporting entity had a significant amount of borrowings, disclosure of the amount of undrawn borrowing facilities that may be available for future use would be useful to users in understanding the liquidity of the entity. Further examples of additional information can be found in HKAS 7 paragraph 50.

e. Other reference

In December 2010 QAD published an alert concerning the key principles and application issues of HKAS 7. It is available at:


Section II – Common or significant findings on other HKFRSs

The number of issues identified in relation to the application of HKFRS 3 (Revised) Business Combinations and HKAS 36 Impairment of Assets continues to rank top in our list for 2017. Many of those issues are recurring issues and discussed in detail in our prior years’ QAD annual reports. The following is a highlight of some deficiencies that we came across during the 2017 reviews.

1. HKFRS 3 (Revised) Business Combinations

HKFRS 3 (Revised) applies to a transaction or event that meets the definition of a business combination (HKFRS 3 (Revised) paragraph 2). A business combination is defined as “A transaction or other event in which an acquirer obtains control of one or more businesses”. If the transaction is a business combination, then the acquirer shall follow the requirements of HKFRS 3 (Revised) to account for the transaction, unless the transaction falls within the exceptions identified in HKFRS 3 (Revised) paragraphs 2 or 2A. Under HKFRS 3 (Revised), all business combinations shall be accounted for by applying the acquisition method.

Based on the above, the most common issues are:

(i) whether the transaction was appropriately determined as an acquisition of a business as opposed to an acquisition of assets by reference to the definition of a business under HKFRS 3 (Revised); and

(ii) whether goodwill or a gain from a bargain purchase was appropriately measured and recognized in accordance with HKFRS 3 (Revised).
In respect of (i), an entity shall start by considering whether the acquisition transaction falls into the scope of HKFRS 3 (Revised), i.e. whether the transaction is a “business” combination. If not, it shall apply other applicable HKFRS. In 2017 reviews, we came across instances where it was unclear how the management justified that the transaction was a business combination and therefore supported that it was appropriate to account for the transaction under HKFRS 3 (Revised). In one case, the acquired group had no material assets and liabilities and, save for some minimal incorporation fee, also did not generate any revenue or profit during the period. In the relevant financial statements, there was no disclosure of the critical judgement applied by management to justify how the transaction had met the definition of a business combination under HKFRS 3 (Revised).

On the contrary, there were also cases where it was unclear why the transaction was considered as an acquisition of assets and liabilities, rather than an acquisition of a business although the acquiree appeared to have the inputs and processes that were capable of producing outputs. It is worth noting that, the lack of outputs such as revenue or a product, does not prevent the entity from being considered as a business (HKFRS (Revised) paragraph B7).

In respect of (ii), the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree (HKFRS 3 (Revised) paragraph 10) as of the acquisition date. Following on from this requirement, the acquirer may recognize some assets and liabilities that the acquiree had not previously recognized in its financial statements (HKFRS 3 (Revised) paragraph 13).

Based on our review experience, the assets that were often overlooked by members for recognition are intangible assets (e.g. brand name, patents, customer relationships and in-process research and development costs). This is because those assets might not have been recognized as assets in the financial statements of the acquiree as they were developed internally and the related costs incurred were charged to expenses as incurred (HKFRS 3 (Revised) paragraph 13). Examples of identifiable intangible assets are provided in HKFRS 3 (Revised) paragraphs IE18 to IE44 under five headings, marketing-related, customer-related, artistic-related, contract-based and technology-based intangible assets.

In one case, significant goodwill was recognized from an acquisition of a subsidiary which was in a net liability position at the acquisition date. As there was no disclosure of the factors that contributed the goodwill, it was questionable why the reporting entity was willing to pay a significant amount to acquire the acquiree with a net liability position as of the acquisition date, e.g. whether the acquiree in fact had any intangible assets which qualified for recognition under HKFRS 3 (Revised). Enquiries were therefore raised with the auditors.
On the other hand, a bargain purchase is a business combination in which the net fair value of the identifiable assets acquired and liabilities assumed exceeds the aggregate of consideration transferred, the non-controlling interest and the fair value of any previously held interest in the acquiree. Unless an acquisition is a forced sale transaction as described in HKFRS 3 (Revised) paragraph 35, it might sometimes be difficult to envisage why the seller of the acquiree is willing to sell its interest in the acquiree at a discounted price. Some cases reported that the bargain purchase gains recognized were significant, but there were no disclosures of the circumstances that gave rise to a bargain purchase to support the recognition.

In response to our enquiries, the auditor explained that the management considered that the reasons giving rise to a bargain purchase had involved some sensitive information and therefore they were not willing to disclose them in the financial statements. Therefore proper disclosures should be made as required by HKFRS 3 (Revised). In this case, the auditor should have considered whether there was any audit implication with regard to the management’s refusal to disclose the required information under HKFRS 3 (Revised).

2. HKAS 36 Impairment of Assets

All assets that are within the scope of HKAS 36 require an impairment test when there is an indication of impairment at the reporting date (HKAS 36 paragraph 9) but certain assets (e.g. goodwill acquired in a business combination) require an annual impairment test irrespective of whether there is any indication of impairment (HKAS 36 paragraph 10). The assets that are outside the scope of HKAS 36 are specified in HKAS 36 paragraph 2, such as financial assets which are within the scope of HKAS 39 Financial Instruments: Recognition and Measurement. However, it is worth noting that, although investments in subsidiaries, associates and joint ventures are financial instruments, they are included in the scope of HKAS 36 unless they are accounted for in accordance with HKAS 39 (HKAS 36 paragraph 4).

The purpose of an impairment test is to ensure that an asset is carried at no more than its recoverable amount. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less cost of disposal and its value in use, reflecting the highest amount expected to be recovered through its sale or use. When it is not feasible to calculate the recoverable amount of an individual asset, the entity should measure the recoverable amount of the cash-generating unit to which that asset belongs and determine the amount of impairment loss to be recognized. (HKAS 36 paragraphs 22 and 66)

Recurring issues relating to the impairment tests performed and relevant disclosures were identified in the 2017 reviews. In respect of the impairment tests, the issues mainly related to inappropriate measurement of the recoverable amount arising from the following circumstances:

- Use of an inappropriate measurement basis to determine the recoverable amount (e.g. using the replacement cost method which was not considered an appropriate method according to HKAS 36 BCZ29);
• Use of unreasonable assumptions in the cash flow projections prepared based on the financial budgets or forecasts approved by management for determining the recoverable amount (e.g. a higher or increasing level of output was used although the performance of the asset or cash generating unit is declining);

• Use of a budget or forecast that covered a period longer than five years without a justification disclosed in the financial statements;

• Inappropriate determination of the cash-generating unit to which goodwill was allocated (e.g. the determined cash-generating unit was larger than an operating segment determined in accordance with HKFRS 8 Operating Segments); and

• Use of a post-tax discount rate in the value in use calculation, instead of a pre-tax discount rate as required by HKAS 36.

Amongst the above, the use of inappropriate assumptions in the impairment testing was the most commonly found issue. HKAS 36 requires the cash flow projections used to measure value in use to be based on reasonable and supportable assumptions that represent management’s best estimate of the economic conditions that will exist over the remaining useful life of the asset (HKAS 36 paragraph 33(a)). We understand that this is challenging and might require significant judgement. In this regard, HKAS 36 paragraph 34 provides that management should assess the reasonableness of the assumptions by examining the causes of differences between past cash flow projections and actual cash flows; and ensure that the assumptions determined are consistent with past actual outcomes.

The commonly omitted disclosures relating to impairment include: the events and circumstances that led to the recognition or reversal of the impairment loss; the recoverable amount of the assets (or cash-generating units) and how such amount was determined (fair value less costs of disposal or value in use). Members are advised to refer to HKAS 36 paragraphs 126 to 136 for details of the relevant disclosure requirements.

**Section III – Common disclosure deficiencies**

Save for the disclosure deficiencies as discussed in Section I and Section II of this report, the following is an overview of the other common disclosure deficiencies identified in our 2017 reviews.

1. HKFRS 7 *Financial Instruments: Disclosures*

The following disclosures were often missing or incomplete:

• information about (a) the fair value of the collateral held, (b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and (c) the terms and conditions associated with its use of the collateral when an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral (HKFRS 7 paragraph 15);
• information of each type of risk arising from financial instruments specified under HKFRS 7 paragraphs 33 and 34;

• information about the credit quality of financial assets that are neither past due nor impaired (HKFRS 7 paragraph 36(c));

• a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably (HKFRS 7 paragraph 30(b));

• a maturity analysis for issued financial guarantee contracts (HKFRS 7 paragraph 39(a)); and

• a sensitivity analysis for each type of market risk (e.g. other price risk) to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date (HKFRS 7 paragraph 40(a)).

2. HKFRS 8 Operating Segments

The following disclosures were often omitted:

• the judgements made by management in applying aggregation criteria in HKFRS 8 paragraph 12 when the reporting entity had aggregated operating segments. This includes a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics (HKFRS 8 paragraph 22(aa));

• the identity of the segment or segments reporting the revenues if revenues from transactions with a single external customer amount to 10 per cent or more of the reporting entity’s revenues (HKFRS 8 paragraph 34);

• the nature of any differences between the measurements of the reportable segments’ profits or losses and the entity’s profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations described in HKFRS 8 paragraph 28) (HKFRS 8 paragraph 27(b)); and

• entity-wide disclosures (i.e. information about products and services, information about geographical areas and information about major customers). The amounts reported in entity-wide disclosures shall be based on the financial information that is used to produce the entity’s financial statements, rather than using the management approach. (HKFRS 8 paragraphs 31 to 34).

There was an instance that the reporting entity had reported only one operating segment that was engaged in manufacture and sales of metal products. During the year, the reporting entity acquired a group of associates at a significant consideration and the principal activities of the associates were different from that of the reporting entity. In this case, the auditor should question its client about the
basis for determination of operating segments and assess whether the entity’s investment in associates and its share of results from the associates should be reported under a separate segment (see HKFRS 8 paragraphs 23 and 24) or disclosed as part of the reconciliations of the segment results and assets to the corresponding amounts of the entity (see HKFRS 8 paragraph 28).

For more information see the alert published in September 2010 concerning the key principles and application issues of HKFRS 8, available at:


3. HKFRS 13 Fair Value Measurement

The following disclosures were often omitted:

- information as required by HKFRS 13 paragraph 93, for example:
  - for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period; and the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3);
  - for recurring and non-recurring fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique, a description of the change and the reason(s) for making it;
  - for recurring fair value measurement categorized within Level 3 of the fair value hierarchy, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement; and
  - for recurring and non-recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used (e.g. how an entity decides its valuation policies and procedures).

4. HKAS 1 (Revised) Presentation of Financial Statements

The following presentation disclosures were sometimes omitted:

- critical judgements applied by management in the process of applying the entity’s accounting policies (HKAS 1 (Revised) paragraph 122);
• information about the assumptions that management makes about the future and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year (HKAS 1 (Revised) paragraph 125);

For example, there were no disclosures of the key sources of estimation uncertainty in relation to a significant write-down of inventories to their net realizable value.

• the amount of dividends recognized as distributions to owners during the period and the related amount of dividends per share, presented either in the statement of changes in equity or in the notes (HKAS 1 (Revised) paragraph 107), e.g. the special dividends distributed during the year;

• the amount expected to be recovered or settled after more than twelve months for each asset and liability (e.g. properties under development recorded in the consolidated statement of financial position) (HKAS 1 (Revised) paragraph 61);

• a description of the nature and purchase of each reserve within equity (HKAS 1 (Revised) paragraph 79(b)); and

• the additional information on nature of expenses (e.g. depreciation and amortization and employee benefits expense) as required by HKAS 1 (Revised) paragraph 104 when the reporting entity classifies expenses by function.

In addition to the above, we identified instances where exchange differences arising on translation of financial statements of subsidiaries were presented as an item that would not be reclassified subsequently to profit or loss in the other comprehensive income section in the consolidated statement of profit or loss and other comprehensive income. It was however unclear as to how those exchange differences were derived. Members should note that, if exchange differences relate to a foreign operation as defined under HKAS 21 paragraph 8, the differences are required to be reclassified from equity to profit or loss upon disposal of the foreign operation. Therefore members should identify the origination of the exchange differences in determining their classification in the consolidated statement of profit or loss and other comprehensive income.

As required by HKAS 1 (Revised) paragraph 17(c), an entity shall provide additional disclosures when compliance with the specific requirements in HKFRS is insufficient to enable users to understand the impact of particular transactions. HKAS 1 (Revised) paragraph 112(c) also requires an entity to provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them. Instances were identified where the disclosures were not sufficient to enable users to understand the transactions, e.g. no disclosures were made to explain the basis for transferring significant funds from share premium to retained earnings. There were also instances where there were no disclosures of the nature of the major components of significant balances such as prepayments and deposits, other payables and accrued charges.
5. HKAS 17 Leases

The following disclosure was sometimes omitted or incomplete:

- a general description of the lessee’s significant leasing arrangements, including but not limited to, (i) the basis on which contingent rent payable is determined; (ii) the existence and terms of renewal or purchase options and escalation clauses; and (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt and further leasing (HKAS 17 paragraph 35(d)).

6. HKAS 23 (Revised) Borrowing Costs

The following disclosure was sometimes omitted:

- the capitalization rate used to determine the amount of borrowing costs eligible for capitalization (HKAS 23 (Revised) paragraph 26(b)).
Communication with members

The results of both programmes are communicated to members to improve their understanding and application of professional standards and raise the quality of auditing and financial reporting. More common and significant matters found in the review programmes were communicated to members through different channels:

- The QAD hosted two forums, one in June and one in September 2017, which drew a combined total of around 530 attendees. The forums covered common findings from practice reviews and recommended actions that could be taken by practices to enhance audit quality. A webcast of the forum has been available on the Institute’s website from October 2017.

- On 22 November 2017, the QAD held a joint financial reporting forum with the FRC and HKEX which drew approximately 280 attendees. The representatives of the three bodies shared common or significant observations identified from reviews of financial statements of listed companies. A web-cast of the event has been available on the HKICPA’s website from January 2018.

- The DQA participated in the practice review session of the 2017 SMP Symposium in November 2017 which attracted approximately 310 attendees.

Findings from the reviews have also been used by the Institute’s technical team to provide relevant support for members through regular technical training sessions.
### Members of the Regulatory Oversight Board in 2017

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Company</th>
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<tbody>
<tr>
<td>Ms. BROWN, Melissa</td>
<td>Chairman</td>
<td>Daobridge Capital</td>
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<tr>
<td>(Appointed 1 February 2017)</td>
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<tr>
<td>Mr. TAM Wing Pong</td>
<td>Deputy Chairman</td>
<td>Retired</td>
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<td>(Appointed 1 February 2017)</td>
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<tr>
<td>Mr. CHAN, Kam Wing, Clement</td>
<td>Member</td>
<td>BDO Limited</td>
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<td>(Appointed 1 February 2017)</td>
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<tr>
<td>Ms. CHUNG, Lai Ling</td>
<td>Member</td>
<td>Gov’t of HKSAR</td>
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<td>Mr. HO, Chiu Ping, Dennis</td>
<td>Member</td>
<td>PricewaterhouseCoopers</td>
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<td>Miss KWAN, Angelina</td>
<td>Member</td>
<td>Hong Kong Exchanges and Clearing Limited</td>
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<td>Mr. LAM, Chi Yuen, Nelson</td>
<td>Member</td>
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<td>Ms. LAU, Wai Yin, Susanna</td>
<td>Member</td>
<td>Securities and Future Commission</td>
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<td>(Appointed 1 February 2017)</td>
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<td>Mr. POGSON, Timothy Keith</td>
<td>Member</td>
<td>Ernst &amp; Young</td>
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<td>(Appointed 1 February 2017)</td>
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### Members of the Practice Review Committee in 2017

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<tr>
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<tr>
<td>Ms. YAM, Hoi Yin, Cecilia</td>
<td>Chairman</td>
<td>BDO Limited</td>
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<tr>
<td>Mr. HEBDITCH, Paul Donald</td>
<td>Deputy Chairman</td>
<td>Ernst &amp; Young</td>
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<td>Mr. BROADLEY, Derek Thomas</td>
<td>Member</td>
<td>Deloitte Touche Tohmatsu</td>
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<td>Mr. CHAN, Shu Kin, Albert</td>
<td>Member</td>
<td>Ting Ho Kwan &amp; Chan</td>
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<td>Mr. CHAN, Tze Kit</td>
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<td>Grant Thornton Hong Kong Limited</td>
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<td>Miss CHAN, Wai Ching</td>
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<td>Mr. FAN, Chun Wah, Andrew</td>
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<td>C.W. Fan &amp; Co. Limited</td>
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<td>Mr. LAI, Tak Shing, Jonathan</td>
<td>Member</td>
<td>HLB Hodgson Impey Cheng Limited</td>
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<td>Mr. LIU, Eugene</td>
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<td>RSM Hong Kong / RSM Nelson Wheeler</td>
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<tr>
<td>Mr. LO, Charbon</td>
<td>Member</td>
<td>CCIF CPA Limited / Crowe Horwath (HK) CPA Limited</td>
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<td>(Appointed 1 February 2017)</td>
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<td>Miss NG, Shun Yin</td>
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<td>KPMG</td>
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<tr>
<td>Mr. OR, Ming Chiu</td>
<td>Member</td>
<td>Mazars CPA Limited</td>
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<td>Mr. PANG, Wai Hang</td>
<td>Member</td>
<td>SHINEWING (HK) CPA Limited</td>
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<td>Mr. WONG, Ho Yuen, Gary</td>
<td>Member</td>
<td>C K Yau &amp; Partners CPA Limited</td>
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<tr>
<td>Mr. YAU, Yin Kwun, Joseph</td>
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## Members of the Professional Standards Monitoring Expert Panel in 2017

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<tr>
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<td>Ernst &amp; Young</td>
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<td>Member</td>
<td>BDO Limited</td>
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<td>Mr. KWONG, Kam Wing, Kelvin</td>
<td>Member</td>
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<tr>
<td>Mrs. MORLEY, Catherine Susanna</td>
<td>Member</td>
<td>KPMG</td>
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<tr>
<td>Mr. ONG, Wei Dong (Appointed 1 February 2017)</td>
<td>Member</td>
<td>Hong Kong Exchanges and Clearing Limited</td>
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<tr>
<td>Mr. PANG, Wai Hang, Arthur</td>
<td>Member</td>
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<td>Mr. TAYLOR, Stephen</td>
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