

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

**2017 Annual Report**

## **Table of Contents**

<u>Chapter 1</u> Background	P. 1 - 5
<u>Chapter 2</u> Work of the PRP in 2017	P. 6 - 8
<u>Chapter 3</u> The PRP's review of cases handled by the FRC	P. 9 - 22
<u>Chapter 4</u> Observations and way forward	P. 23 -24
<u>Chapter 5</u> Acknowledgement	P. 25
<u>Annex</u> Membership list	P. 26

## **Chapter 1 : Background**

### **Overview**

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

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

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

### **Functions of the PRP**

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

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

1.5 The internal procedures which the PRP would make reference to in reviewing the FRC's cases include guidelines on the handling of complaints, initiation and processing of investigations and enquiries, review of financial statements under its financial statements review programme, working protocols with other regulatory bodies, preservation of secrecy and identity of informers, and relevant legislative provisions.

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

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

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

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

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

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

### **Composition of the PRP**

1.10 In 2017, the PRP comprised six members, including the Chairman who is a non-accountant, a member from the accountancy sector, three other members from the financial sector and academia, and the FRC Chairman as an ex-officio member.

1.11 The membership of the PRP in 2017 is at **Annex**.

### **Follow-up on the PRP's observations made in the 2016 Annual Report**

1.12 In its 2016 Annual Report, the PRP observed that a relatively long time had been taken for handling investigation cases and a number of reasons were identified including the increase in the number of complaints, the resignation of subject case officers and the additional time required for the replacement case officers to familiarise themselves with the cases. Noting the practical difficulties and constraints faced by the FRC, the PRP suggested the FRC to explore ways to enhance efficiencies in handling investigation cases.

1.13 In response to the PRP's observations, the FRC had recruited more professional staff in 2017 to help with the increasing workload in

the FRC. In particular, two professional staff had been recruited to work with the existing staff to turn the financial statements review programme into an in-house exercise. Previously, the FRC had been relying on external reviewers on a *pro bono* basis to conduct the reviews on financial statements. The FRC revamped the financial statements review programme in 2016 to introduce “filters” in identifying areas of likely non-compliance and/or irregularity. The filters would focus on financial statements with certain attributes such as companies with a change of auditors due to disagreements or unresolved issues, financial statements with prior period adjustments suggesting that investors who relied on prior period financial statements might have been misled, financial statements with alleged non-compliance with accounting and/or auditing requirements based on media reports, etc. Since 2017, designated staff members would conduct the reviews in-house under the “filtering” mechanism. Initial results indicated that these arrangements were working well.

1.14 In addition, the FRC had reviewed the time required to handle a complaint. In particular, the FRC had set an internal benchmark of completing the assessment of an incoming complaint within 90 working days of receipt of the complaint, i.e. decision on how a complaint should be dealt with (e.g. initiating an investigation and/or enquiry, referring to other regulators, closing it with no further action, etc.). The FRC had also been critically looking at, with the assistance of external legal advisors, the procedures for conducting investigations and enquiries with a view to enhancing them. The objectives were to better adhere to the requirements set out under the FRCO while maintaining the quality of the investigations.

1.15 In response to the PRP’s question on whether the FRC had set or would consider setting any particular deadline for completion of investigation cases, the FRC replied that there was no specific deadline for the FRC as cases varied from one to another and it would be difficult to set a meaningful time frame. The FRC understood that this was in line with the practice of major overseas regulators. At present, on average it took the FRC about two and a half years to complete an investigation, which according to the FRC’s understanding was comparable to that of major overseas regulators such as the FRC of the United Kingdom.

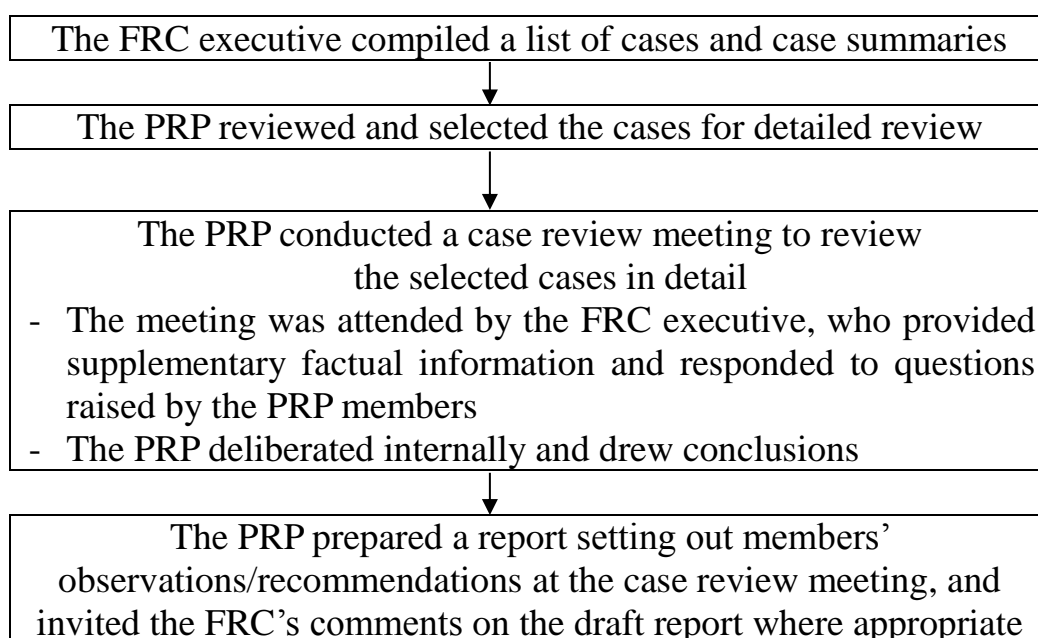
1.16 The PRP had noted the follow-up action taken by the FRC in the light of its observations made in the 2016 Annual Report and made no further comments.

## Chapter 2 : Work of the PRP in 2017

2.1 This Annual Report covers the work of the PRP in 2017, which reviewed reports from the FRC on cases completed by it during the ninth review cycle (i.e. from January to December 2016).

### Case review work flow

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



### Selection of cases for consideration/review

2.3 The FRC executive advised the PRP that the FRC had completed 129 cases during the ninth review cycle. There were also 28 cases for which the review of complaints/review of relevant financial statements under the financial statements review programme had been completed but the investigations were still ongoing. Among these 28 cases, 13 had lasted for more than one year by the end of the cycle. The PRP was provided with summaries of all the 157 cases for review as follows –



<u>Category</u>	<u>Distribution of cases</u>	<u>Number</u>
(I)	Ongoing investigations/enquiries which had lasted for more than one year	13
(II)	Completed investigation cases	9
(III)	Unsubstantiated cases	12
(IV)	Cases that were referred to other regulatory bodies for follow-up	4
(V)	Completed review of complaints/review of relevant financial statements with ongoing investigations	15
(VI)	Immaterial complaints	104
	<b>Total</b>	<b>157</b>

2.4 Out of the 157 cases, the PRP selected the following seven cases for review –

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

- (g) a case arising from review of financial statements with an ongoing investigation (i.e. selected from Category V).

The PRP considered that the selection of these seven cases reflected a good mix of the cases which fell within the ninth review cycle.

### **Case review session**

2.5 After the PRP selected the seven cases for review, and with the assistance of the FRC executive, the PRP Secretariat made preparation for the case review meeting which was held in November 2017 to review the selected cases.

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

2.7 The PRP's observations in respect of the selected cases and its suggestions to the FRC are set out in the following chapters.

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

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

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

#### *Case facts*

3.2 The PRP reviewed a complaint case which led to formal investigations into suspected auditing irregularities. The investigations, which were still in progress as at the end of the ninth review cycle, were initiated in May 2014 in respect of the audits of the consolidated financial statements of a listed entity from 2010 to 2012. It was alleged that the auditors concerned had failed to observe and apply the relevant professional standards required in their audits of the consolidated financial statements concerned.

#### *The FRC's actions*

3.3 After receipt of the complaint in July 2013, the FRC had contacted the listed entity and the auditors concerned for information to facilitate its review of the complaint and preparation of the complaint assessment report. Having considered the complaint assessment report, the Council approved the initiation of investigations in May 2014 and directed the AIB to investigate the alleged auditing irregularities. Another complaint on the same listed entity and two of the auditors concerned was received in September 2014. The Council approved the extension of the scope of two of the investigations in November 2015. The FRC had requested the listed entity and the auditors to provide information during the investigations. The investigations were still ongoing at the end of the ninth review cycle.

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

3.4 The PRP focused its review on the long time taken by the FRC to complete the investigations. The FRC indicated that the case was one of the longest in the FRC's records in terms of handling time given

its complexity and substantial amount of materials involved. The investigations involved three different auditors of the listed entity from 2010 to 2012 respectively. The listed entity and the auditors had requested a number of extensions in responding to the FRC's requirement and time had been taken to chase them for responses after the specified deadlines had lapsed.

3.5 Noting that the FRC had chased the listed entity several times by phone for response to its requests for information during September and October 2013, the PRP asked whether the FRC had issued warnings for failure to provide response. The FRC replied that it did send an email to remind the listed entity to respond after several phone calls. However, before a formal investigation was initiated pursuant to the FRCO, all requests sent by the FRC to the parties concerned were made on an informal basis, i.e. the company was complying with the FRC's requests on a voluntary basis. The FRC could not make use of any statutory provisions in the FRCO, such as applying to the Court for an order, to compel the company to comply with the FRC's request before a formal investigation was initiated, though in general most companies were willing to cooperate with the FRC. The FRC indicated that once a formal investigation was initiated, the listed entity and/or the auditor would be statutorily required to comply with the FRC's requirements for information.

3.6 The PRP followed-up by asking whether, if the company or auditor concerned was not cooperative during the pre-investigation stage, there would be fundamental concerns that the FRC might not possess enough information to justify the initiation of an investigation, and whether non-cooperation itself would be a sufficient ground for initiating an investigation. The FRC explained that the thresholds for it to initiate investigations were stipulated in section 23 of the FRCO. The FRC would be able to initiate an investigation if it appeared that there were circumstances suggesting that there was a relevant irregularity in relation to the listed entity. Therefore, generally speaking there would be sufficient materials for the FRC to initiate an investigation even if the listed entity or the auditor was not cooperative. For example, for the present case, while the listed entity had been slow in responding, the auditors were more helpful in replying to the FRC's requests. Based on the information gathered, the FRC had sufficient information to seek the Council's approval to initiate the investigations

in May 2014.

3.7 Noting that multiple extensions had been granted to the auditors for responding to the FRC's requirements during the investigations, the PRP asked if the auditors had provided reasons for seeking the extensions. The FRC explained that according to the FRC's internal Operations Manual<sup>1</sup>, the party concerned would be given three weeks' time for replying to a specific requirement for information. If the party requested for extension with a valid reason, an extra three weeks would be granted. However, if further extension was requested, the party concerned would need to provide justifications and the approval would be sought from the Chairman of the Operations Oversight Committee ("OOC")<sup>2</sup>. The FRC added that it would turn down any requests for extension if insufficient justifications were provided by the party concerned.

3.8 The PRP noted that the listed entity had not made any response when the FRC sent the draft investigation report to it for comment and the FRC eventually decided to submit the draft report to the Council for approval on the ground that "a reasonable opportunity of being heard" had already been given to the listed entity. The PRP asked how the FRC drew a line on "a reasonable opportunity of being heard". The FRC replied that the principle was to ensure that natural justice was done or seen to be done. For the present case, more than five months had been given to the listed entity to provide its comments on the draft investigation report and the FRC had stated in its reminder letter to the entity that it would proceed with the investigation report if no comment had been received by the specified deadline. The FRC believed that a reasonable opportunity had been given to the entity under the circumstances. The FRC added that the arrangements were provided under section 35 of the FRCO, which stipulated that the Council shall give any person named in the draft investigation report a reasonable

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

<sup>2</sup> The OOC assists the Council in formulating policies, strategies, guidelines and procedures for the operation of the FRC, provides advice to the Council and the FRC operational staff on technical and business issues, and considers, *inter alia*, reports on enquiry and investigation and complaint/review assessment reports before submission to the Council. It comprises members of the Council (one of whom would be the chair of the OOC) and co-opt members who have relevant experience and expertise in accounting-related matters.

opportunity of being heard if it considered that such person might be adversely affected by the publication or disclosure of the report.

3.9 The PRP asked about the latest progress of the investigations. The FRC replied that the investigations against the auditors of 2010 and 2011 financial statements were completed, and the remaining investigation against the auditor of 2012 financial statements was still in progress but it should be able to conclude the investigation soon.

### ***Conclusion***

3.10 Having reviewed the FRC's handling of the case and in the light of the above clarification, the PRP expressed an understanding of the reasons for the conduct of the investigations to last for more than one year, and agreed that the FRC had been handling the case in accordance with its internal procedures.

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

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

3.11 The PRP reviewed a complaint case which led to a formal enquiry into possible non-compliance with accounting requirements in the financial statements of a listed entity and formal investigations into suspected auditing irregularities by the auditors of the listed entity. Because of the potential non-compliance with the accounting requirements, it was alleged that the auditors concerned had failed to observe or otherwise apply the relevant professional standards in their audits of the consolidated financial statements.

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

3.12 Having reviewed the complaint received in July 2013 and obtained information from the listed entity and the auditor concerned, the Council in January 2015 initiated an enquiry into the 2013 financial statements and an investigation against the auditor concerned of the same set of financial statements. With more evidence gathered, the Council decided in May 2015 to extend the scope of the enquiry to cover the 2009 to 2014 financial statements of the listed entity and initiate

investigations in respect of the audits of these financial statements. The enquiry and the investigations were still in progress as at the end of the ninth review cycle.

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

3.13 The PRP focused its review on the long time taken by the FRC to complete the enquiry and the investigations. The FRC explained that longer time had been taken to handle the enquiry and the investigations given their complexity. Same as Case No.1, this case involved three different auditors and six years' financial statements. The issues involved were also highly technical that there were fervent discussions among FRRC members as to whether the non-compliance with accounting requirements by the listed entity was substantiated.

3.14 The PRP asked whether the enquiry and the investigations were conducted simultaneously, and whether the investigations would have to depend on the results of the enquiry. The FRC confirmed that for the present case, the enquiry into whether there was non-compliance with the accounting requirements in the relevant financial statements was conducted simultaneously with the investigations against the auditors concerned. The FRC indicated that an enquiry and an investigation could be conducted at the same time in general. Nevertheless, in certain cases, the outcome of an enquiry might have an impact on an investigation and it was therefore necessary to wait for the completion of the enquiry before concluding the relevant investigation. The FRC added that if the Council decided to appoint a FRRC to conduct an enquiry into possible non-compliance, the FRCO required that the FRRC should consist of at least five members (including a convenor) drawn from the Financial Reporting Review Panel appointed by the Government. The FRRC was required under the FRCO to submit an enquiry report to the Council for adoption. Since these members worked on a *pro bono* basis, it usually took some time to complete an enquiry.

3.15 Noting that the draft investigation report had been sent to a lawyer for legal vetting, the PRP asked why the FRC needed to seek external legal services to vet the draft investigation report for the case. The FRC replied that as the post of in-house legal counsel was vacant at that time, the report was sent to external legal advisers for vetting. The

FRC supplemented that an in-house General Counsel had reported duty in November 2017, and thereafter, the General Counsel would be consulted on investigation reports and the FRC would only send an investigation report for external legal advice as and when necessary.

3.16 The PRP asked about the latest progress of the enquiry and investigations. The FRC replied that the enquiry and the investigations were drawing to a close. The FRC had sent out the draft investigation reports to parties for comments and was preparing the draft enquiry report. For monitoring purpose, the PRP requested the FRC to report to the PRP through the PRP Secretary when the case was completed.

### ***Conclusion***

3.17 Having reviewed the FRC's handling of the case and in the light of the above clarification, the PRP expressed an understanding of the reasons for the conduct of the enquiry and investigations to last for more than one year, and agreed that the FRC had been handling the case in accordance with its internal procedures.

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

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

3.18 The PRP reviewed a complaint case which led to formal investigations into suspected auditing irregularities by the auditors of a listed entity. The investigations were initiated in November 2014 in respect of the audits of the consolidated financial statements of the listed entity in 2011 and 2012. It was alleged that the auditors concerned had failed to observe or otherwise apply the relevant professional standards required in their audits of the consolidated financial statements. The investigations were completed in around 20 months' time.

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

3.19 Upon receipt of the complaint in June 2014, the FRC sought information from the listed entity and the auditors concerned. Having considered the complaint assessment report, the Council approved the initiation of investigations in November 2014 and directed the AIB to



investigate the alleged auditing irregularities. The Council adopted the investigation reports in July 2016 which were subsequently referred to the Hong Kong Institute of Certified Public Accountants (“HKICPA”) to determine if any disciplinary action was warranted.

### ***The PRP’s areas of review***

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

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

3.21 Noting that it took the FRC more than a year to compile the draft investigation reports, the PRP inquired if there was any difficulty in preparing the investigation reports. The FRC replied that the issues involved in the case were quite complex and it took time for the FRC to prepare the investigation reports as the Council expected high-quality investigation reports as these reports would likely become *prima facie* admissible evidence in the HKICPA’s disciplinary proceedings. Looking from a wider perspective, it took the FRC around two years’ time from receipt of the complaint to conclusion of the investigations for the present case which was not unreasonable as on average it took the FRC two and a half years to complete an investigation. The FRC further added that as issues involved in recent years had become more complex and technical, a reasonable timeframe for completing a relatively straight forward investigation was about two years.

3.22 The PRP noted that, in selecting cases for review, the Terms of Reference of the PRP currently had a benchmark of “investigations/enquiries lasting for more than one year”. Given that

most investigations were going to last for more than one year according to the FRC, considerations might be given to changing the one-year benchmark or providing PRP members with information regarding the stage that these cases were in so as to facilitate them in selecting the cases for review. The meeting discussed and agreed that the PRP Secretary should explore with the FRC executive whether it was appropriate to include, starting from the next review cycle, information /indications on the stage of completion with respect to those cases lasting for more than one year so as to facilitate PRP members to select the cases for review.

3.23 Noting that the FRC had sent letters to the auditors, the engagement partners and the engagement quality control reviewers (“EQCR”) concerned during the investigations to confirm whether they were being subject to legal proceedings, the PRP asked the purpose of making such an inquiry. The FRC replied that according to section 35(6) of the FRCO, whether there were on-going legal proceedings was one of the several factors that the Council should take into account when it decided whether to publish the investigation report or not. The Council was very cautious about publication so as not to adversely affect any on-going legal proceedings or the reputation of any persons named in the report. Therefore, the FRC would always ask the parties concerned whether there were any on-going legal proceedings in each and every investigation case.

### ***Conclusion***

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

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

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

3.25 The PRP reviewed an unsubstantiated case arising from an anonymous complaint received by the FRC in June 2015. The complainant referred the case to the FRC alleging that the auditor concerned might not have obtained sufficient audit evidence in their

audits of the 2013 and 2014 financial statements of the listed entity. It took about eight months' time from receipt of the complaint to closing the case.

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

3.26 After receipt of the complaint, the FRC had sought information and explanations from the listed entity and the auditor concerned. Based on the information and explanations obtained, the FRC executive concluded that there was no evidence suggesting that there was an auditing irregularity in respect of the audits of the financial statements. With the OOC's approval of the complaint assessment report, the case was closed in February 2016. Nevertheless, the FRC sent an advice letter to the listed entity and the auditor concerned in relation to certain disclosure deficiencies for educational purpose.

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

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

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

3.28 In response to the PRP's question of whether the FRC would inform the anonymous complainant of the outcome of the case, the FRC replied that the conclusion letter had been sent to the email address from which the complaint was lodged. The FRC also added that it would follow-up the case as appropriate should the complainant come back with more evidence.

### ***Conclusion***

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

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

***Case facts***

3.30 The PRP reviewed a complaint case which led to a formal investigation into suspected auditing irregularities by the auditor of a listed entity. The investigation was initiated in July 2016 in respect of the audits of the consolidated financial statements of the listed entity in 2011 and 2012. It was alleged that there was possible auditing irregularities in the 2011 and 2012 financial statements as a total of 40 prior year adjustments had been made in the 2013 financial statements (the audit of which was carried out by another auditor) to correct certain non-compliance with accounting requirements in the 2011 and 2012 financial statements. The investigation was still ongoing as at the end of the ninth review cycle.

***The FRC's actions***

3.31 After receipt of the complaint in February 2014, FRC sought information from the listed entity and the auditor concerned. The FRC also sought assistance from the auditor of the 2013 financial statements to prepare the complaint assessment report. Having considered the complaint assessment report, the Council approved the initiation of investigation in July 2016 and directed the AIB to investigate the alleged auditing irregularities.

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

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

- (a) initial screening;
- (b) liaising with the listed entity and the auditors concerned to review the allegations;
- (c) preparation and submission of a complaint assessment report to the OOC and the Council;
- (d) initiating a formal investigation; and
- (e) issuing directions by the Council to the AIB to conduct the

investigation.

3.33 The PRP noted that the FRC had been taking more than a year to conduct the investigation, and asked for the latest progress of the case. The FRC replied that the investigation involved 40 prior year adjustments and a substantial amount of materials. It also indicated that the case was held up for some time as the investigation involved access to audit working papers kept in the Mainland. Subsequently, having found other evidence to substantiate the allegations, the FRC dispensed with the need to access the audit working papers kept in the Mainland. The FRC confirmed that it would be able to conclude the investigation very shortly.

### *Conclusion*

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

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

### *Case facts*

3.35 The case arose from a proactive review of financial statements by the FRC under the financial statements review programme. The investigation was initiated in September 2014 in respect of the audits of the consolidated financial statements of a listed entity in 2011 and 2012. It was alleged that the auditor concerned had failed to observe or otherwise apply the relevant professional standards in the audits of the consolidated financial statements. The investigation was completed in around 16 months' time.

### *The FRC's actions*

3.36 After reviewing the relevant financial statements of the listed entity under the financial statements review programme, the FRC made a number of requests to the listed entity and the auditor concerned to provide information before submitting a review assessment report to the Council for consideration. Having considered the review assessment

report, the Council approved the initiation of an investigation in September 2014 and directed the AIB to investigate the alleged auditing irregularities. The Council adopted the investigation report in January 2016 which was subsequently referred to the HKICPA to determine if any disciplinary action was warranted

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

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

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

3.38 The PRP noted that the listed entity had sent a letter to the FRC in June 2014, claiming that information could only be provided to the FRC pursuant to a statutory requirement, and asked about the meaning of the listed entity's statement. The FRC said that this was an example where companies did not cooperate with the FRC voluntarily as they were not obliged to respond to the FRC's requests for information until a formal investigation or enquiry was initiated. In the present case, the FRC also asked the auditor for information, which was more cooperative, and the Council approved the initiation of the investigation in September 2014.

### ***Conclusion***

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

**(7) Review of a case arising from review of financial statements with an ongoing investigation**

*Case facts*

3.40 The case arose from a proactive review of financial statements by the FRC under the financial statements review programme. An investigation was initiated in November 2016 in respect of the audit of the consolidated financial statements of a listed entity in 2014. The investigation was ongoing as at the end of the ninth review cycle.

*The FRC's actions*

3.41 After reviewing the relevant financial statements, the FRC made a number of requests to the listed entity and the auditor concerned to provide information before submitting a review assessment report to the Council for consideration. Having considered the review assessment report, the Council approved the initiation of an investigation in November 2016 and directed the AIB to investigate the alleged auditing irregularities.

*The PRP's areas of review*

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

- (a) initial screening;
- (b) liaising with the listed entity and the auditor concerned to review the allegations;
- (c) preparation and submission of a review assessment report to the OOC and the Council;
- (d) initiating a formal investigation; and
- (e) issuing directions to the AIB to conduct the investigation by the Council.

3.43 Noting that there was a nine-month gap between the receipt of a response from the auditor concerned by the FRC and the FRC requesting for further information from the auditor, the PRP asked why the FRC needed to contact the auditor concerned again after nine months and whether the request could be made to the auditor earlier. The FRC

replied that when it became necessary, further information could be requested at any stage of the investigation, including during the preparation of the investigation report.

3.44 The PRP asked about the latest progress of the investigation. The FRC replied that the investigation had been going smoothly, and it expected that the investigation report could be submitted to the Council for approval in the first half of 2018.

### ***Conclusion***

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



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

4.1 On the seven cases selected for review during the ninth review cycle, the PRP concluded that the FRC had handled the cases in accordance with its internal procedures. Arising from the discussion of the selected cases, the PRP observed that the number of complaints received by the FRC had been on the rise and the investigation cases in recent years had become more complex and substantive in nature. The PRP was delighted to learn that the FRC had sought the Government's approval to recruit an additional Senior Director in 2018 which would enable the FRC to re-shuffle certain duties amongst its executive team. On the other hand, to facilitate the PRP to consider whether the FRC's case handling procedures were consistent with and adhered to the guidelines set out in the Operations Manual, the PRP was of the view that it would be helpful if the PRP could be provided with succinct information before the case review session which compared the actions taken by the FRC in respect of a case with the guidelines set out in the Operations Manual.

4.2 The FRC took note of the PRP's observations above and undertook to share with the PRP the new structure of the FRC executive team after the reshuffling of duties at the next case review session. The FRC would also consider, starting from the next review cycle, preparing a short summary for each selected case which compared the actions taken by the FRC in respect of the case with the guidelines set out in the Operations Manual.

4.3 The PRP will continue its work on the review of cases handled by the FRC to ensure that the FRC adheres to its internal procedures consistently. For 2018, the PRP will select cases that the FRC has handled during the period between January and December 2017 for review.

4.4 Comments on the work of the PRP can be referred to the Secretariat of the PRP for the FRC by post (Address: Secretariat of the PRP for the FRC, 15<sup>th</sup> Floor, Queensway Government Offices, 66 Queensway, Hong Kong) or by email (email address:

[frcprp@fstb.gov.hk](mailto:frcprp@fstb.gov.hk))<sup>3</sup>.

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<sup>3</sup> For enquiries or complaints not relating to the process review work of the FRC, they should be made to the FRC directly –

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

## **Chapter 5 : Acknowledgement**

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

**Secretariat of the Process Review Panel  
for the Financial Reporting Council  
May 2018**

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

**2017 Membership**

**Chairman**

Mr. Anthony CHOW, SBS, JP

**Members**

Ms. Florence CHAN

Mr. Vincent KWAN<sup>4</sup>

Prof. CK LOW

Mr. KK TSE

Dr. John POON, BBS, JP (ex-officio member)

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

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<sup>4</sup> The term of appointment of Mr. Vincent KWAN expired on 31 December 2017. Ms. Edith SHIH was appointed to the PRP with effect from 1 January 2018.