
QUALITY ASSURANCE

2021 ANNUAL REPORT



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Foreword

2021 was the second year since the start of the COVID-19 pandemic in Hong Kong. During the year, practice units continued to explore new ways to conduct audits and we continued to make arrangements such as replacing onsite practice review visits with reviews in the Institute office in the periods when reported COVID-19 cases were high. Despite the challenges, we have been working hard to ensure our review quality is maintained. This report sets out our work achievements, review outcomes and common findings identified under our quality assurance programmes throughout the year.

In 2021, the most impactful event on the Institute's regulatory work was the passing of the Financial Reporting Council (Amendment) Bill. The bill will result in the Institute transferring its regulatory functions, including practice reviews, to the Financial Reporting Council ("FRC") which will be renamed as the Accounting and Financial Reporting Council ("AFRC"). The commencement date of the new regime will be announced later through a notice in the Government Gazette, likely within 2022. The Institute is working closely with the Government and the FRC to address the transitional and operational issues. The Quality Assurance Department ("QAD") has commenced and will continue discussions with the Inspection team of the FRC to facilitate the transition process. However, the QAD will continue to fulfil its practice review responsibilities to monitor the audit quality of practice units until the function is transferred to the AFRC.

The QAD carried out reviews on 370 practice units in 2021, a 14% decrease as compared to 2020. The reduction reflected the change in the number of reviewers available during the year as the Institute experienced staffing issues like the rest of the profession. The 2021 review outcomes were more or less the same as in 2020 although there was a drop in complaint cases from 4% to 1%. However one disciplinary case decided in 2021 resulted in the practitioner being removed from the Institute's membership for 4 years. Practitioners should therefore be mindful of the consequences if they fail to properly discharge their duties as auditors.

During the year, the QAD completed the reviews on the two trial cases for which the Chinese Ministry of Finance (MoF) assisted the relevant practices to go through the vetting procedures necessary for the files to be provided for our review. We would like to thank the MoF for its support over the years. Access to Mainland working papers by Hong Kong regulators has been and will no doubt continue to be a topic that requires concerted efforts to address to the satisfaction of all parties.

On the work on AML/CTF compliance, in addition to the regular review work, the QAD had worked to develop a more robust plan for risk-based supervision of accounting professionals to follow up on the Financial Action Task Force's ("FATF") comments in its mutual evaluation of Hong Kong. However, since the announcement of the regulatory reform in June 2021, the Institute had put the work on hold. Nonetheless, the Institute will remain engaged with the Government and other parties regarding plans to meet FATF's expectations, until responsibility for this function is formally transferred to the AFRC.

Finally, I wish to express my gratitude to the practices for all their cooperation and support over the year for our quality assurance programmes. Despite the forthcoming transfer of work, the Institute will continue to contribute to the efforts to upkeep the quality of audit and financial reporting to enhance user confidence in corporate reporting in Hong Kong.

Elsa Ho
Director, Quality Assurance
March 2022

Our work and review outcomes – Practice review programme

Practice review is a quality assurance programme that monitors all practice units registered by the Institute, including individual practising certificate holders, firms and corporate practices, to determine whether they have observed, maintained and applied professional standards. The Professional Accountants Ordinance (“PAO”) has empowered the Institute to carry out practice review since 1992.

The Institute’s practice review programme consists of two elements: the audit quality assurance reviews and the Anti-Money Laundering and Counter-Terrorist Financing (“AML/CTF”) Compliance Monitoring Reviews (“ACMRs”). The purpose of the audit quality assurance reviews is to determine whether members and practices have observed, maintained and applied professional standards, including all the statements and guidelines of professional ethics, financial reporting standards and standards on auditing and assurance. The purpose of ACMRs, which were introduced in October 2018, is to monitor the level of compliance of practice units with the Institute’s Guidelines on AML/CTF for Professional Accountants (“AML Guidelines”) and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (“AMLO”).

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.

The responsibility for oversight of practice review activities rests with the Regulatory Oversight Board (“ROB”) which oversees all the regulatory functions of the Institute. The ROB ensures that practice review activities are carried out in accordance with strategies and policies determined by the Council of the Institute and in the public interest. The ROB receives and reviews annual work plans and budgets and regular progress reports from management and annual process review reports from the PRC; and reports to the Council its observations and views in relation to performance and operations. Please refer to Annex for members of the ROB.

In June 2021, the Government announced a further reform of the regulatory regime of the accounting profession. The proposed reform will empower the Financial Reporting Council (“FRC”) to regulate all practices including carrying out inspections of all practice units. The new regulatory regime will likely take effect on 1 October 2022. Until the practice review powers and duties are transferred, the Institute will continue to carry out practice review work to discharge its statutory responsibilities. The Institute will also work closely with the FRC to ensure there is a smooth transition of responsibilities and operations.

Our work

Process

The process of a practice review (including an ACMR) or a separate ACMR 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 HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* and selected audit files (not applicable to a separate ACMR)
- Review compliance with AML Guidelines and selected customer due diligence (“CDD”) documents, if applicable
- Summarize findings and recommendations
- Exit meeting*

* *These procedures are usually 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

Practice selection

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 Institute applies a mixed risk-based-cycle approach for selection of practices for reviews. Within that approach, the Institute has a goal to review all active practices at least every 6 years. The frequency of practice reviews of practices with audit and assurance clients (“AA clients”) will be determined based on the following factors:

1. Size – based on the number of non-PIE AA clients^{Note} and practising partners or directors

2. Complexity – based on the number of regulated non-PIE AA clients ^{Note}.

Note:

Non-PIE AA clients are AA clients whose engagements fall outside the definition of PIE engagements specified in the Financial Reporting Council (Amendment) Ordinance and therefore are included in the scope of the Institute’s practice review programme. Non PIE-AA clients included in the following categories are considered regulated non-PIE AA clients for the above purpose:

- a. “authorized institutions” as defined under the Banking Ordinance
- b. “insurers” as defined under the Insurance Ordinance
- c. “insurance brokers” as defined under the Insurance Ordinance
- d. “licensed corporations” and “associated entities” as defined under the Securities and Futures Ordinance

Based on these factors, all active practices with AA clients are separated into categories with appropriate frequencies of practice reviews as follows:

	Practices	Frequency of review
Standard	With 500 or fewer non-PIE AA clients and with 10 or fewer regulated non-PIE AA clients	6 year cycle (a goal to achieve)
Tier 1	With more than (i) 500 non-PIE AA clients or (ii) 10 regulated non-PIE AA clients	3 year cycle
Tier 2	With more than (i) 1000 non-PIE AA clients and (ii) 10 regulated non-PIE AA clients	1.5 year cycle
Tier 3	With more than (i) 1000 non-PIE AA clients; (ii) 20 regulated non-PIE AA clients and (iii) 50 practising partners or directors	Annually

Practice reviews of practices without AA clients are subject to separate ACMRs normally on a six-year review cycle basis. ACMRs on these practices will be more frequent if a large proportion of their activities involve specified transactions as defined in the AML Guidelines.

As well as the above factors, other practice-specific information will be considered when determining the review frequency of individual practices. These factors include:

1. Previous regulatory history – based on past practice review results and regulatory actions taken by the Institute and other regulators
2. Other risk factors identified through the Institute’s regulatory system
3. A small number of reviews randomly selected every year

Audit quality assurance reviews

The scope of an audit quality assurance review includes obtaining an understanding of the practice’s system of quality control, assessing compliance with HKSQC 1 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. An initial self-evaluation process is included as part of the desktop reviews for low risk practices with only a handful of audit clients.

ACMRs

The scope of an ACMR includes obtaining an understanding of the practice’s relevant AML/CTF policies and procedures and inspecting documentary evidence to assess level of compliance with the AML Guidelines and relevant laws and regulations.

There are two types of ACMR, namely a full-scope ACMR and a desktop ACMR. Practices which have prepared for or carried out for clients transactions specified in Paragraphs 600.2.1 and 600.2.2 of the AML Guidelines (“Specified Transactions”) will be subject to a full scope ACMR. Other active practices will be subject to a desktop ACMR.

In order to make best use of resources and to cause less disturbance to practices, an ACMR has been included within every full scope and desktop practice review carried out on a practice with AA clients. Separate ACMRs are arranged for practices without AA clients. Full scope separate ACMRs are carried out on site whereas desktop separate ACMRs take place in the Institute’s office.

As mentioned in the 2020 QA report, the Institute has started to take actions to enhance the risk-based supervisory programme of AML / CTF compliance to address the recommendations made by the Financial Action Task Force (“FATF”) in its mutual evaluation report on Hong Kong. In 2021, the Institute continued to engage with stakeholders, including members and the Government, to explain its work plans and listen to their views. However, the enhancement plan has been put on hold since the Government announced the new regulatory reform in which the Institute’s regulatory role concerning accounting professionals’ AML / CTF compliance will also be transferred to the FRC. Nonetheless, the Institute will maintain dialogues with the Government and the FRC regarding plans to meet the FATF recommendations.

Reporting

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.

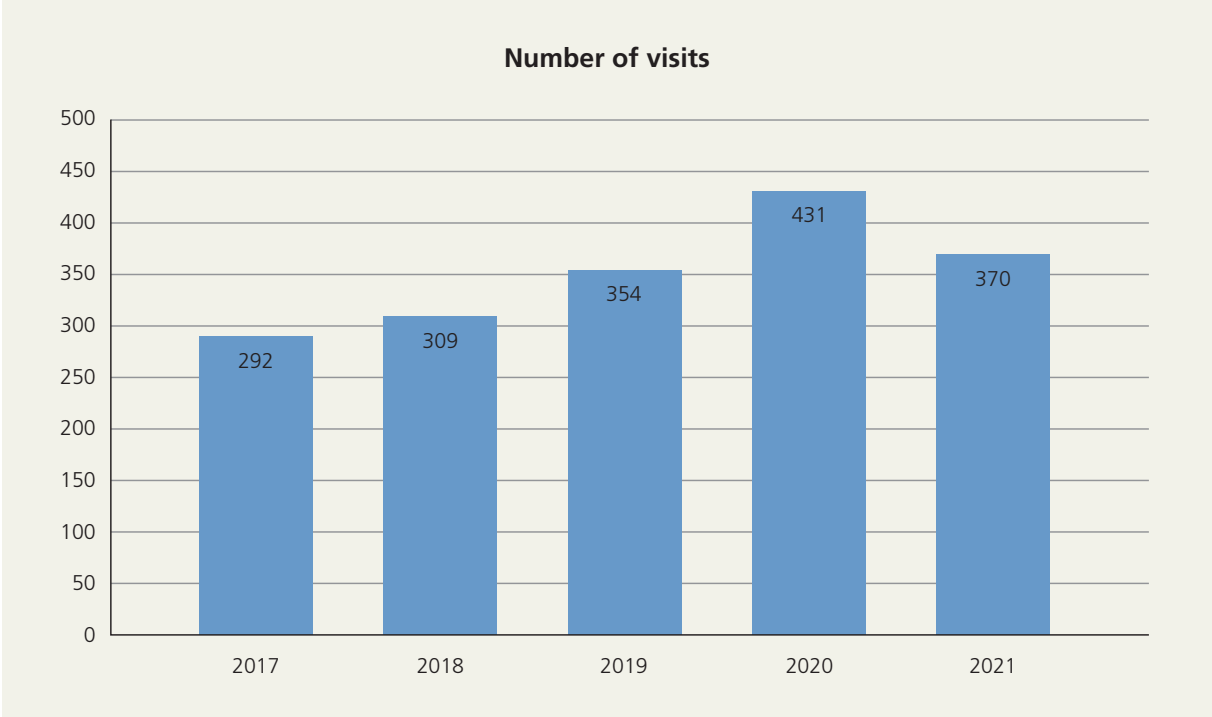
The PRC may also, via the Council of the Institute, make a referral to the FRC if an auditing, reporting and relevant irregularity is identified in a component of a PIE engagement.

Following a practice review, 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.

In May 2019, the QAD issued Alert Issue No. 29 “Initiatives and measures to strengthen actions to deal with non-compliance” to draw again attention to some of the matters which the PRC will take into account when determining whether the non-compliance matters identified warrant a complaint being raised even on a first time review. Those matters include failure to take proactive actions to avoid the Top 5 findings (comprising no or insufficient quality control policies and procedures; no or ineffective monitoring; unsatisfactory subcontracting arrangements; inappropriate audit methodology; and misuse of modified opinion) from occurring in their practices; adding and creating working papers and providing false information; and failure to cooperate in the practice review process. Practices should be mindful of the above.

Our review outcomes

The number of practice reviews carried out has decreased from 431 in 2020 to 370 in 2021. The reduction reflected the change in the number of reviewers available during the year as the Institute experienced staffing issues like the rest of the profession.



In 2021, ACMRs were included within all the practice reviews above. In addition, 28 separate ACMRs were carried out on active practices without audit and assurance clients.

Work progress in 2021

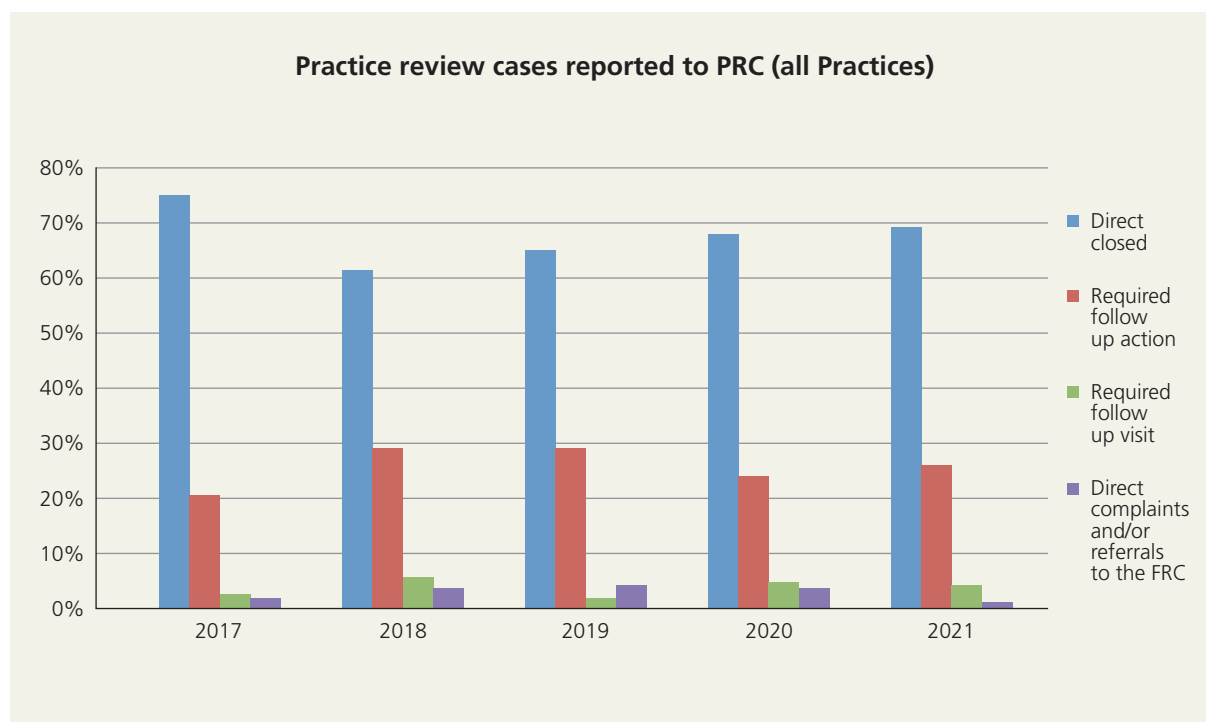
2021 was another challenging year to our quality assurance department. Due to the COVID-19 pandemic, some scheduled on-site practice review visits did not take place. To prevent major disruption to our practice review process, site visits were replaced with in-house reviews and files were taken from practices for review. Virtual meetings were arranged with practices to discuss issues identified in the review. Despite the challenges, we were able to ensure that the quality of our work was maintained.

In 2021, 370 practice review site visits on practices were carried out. The PRC met on eleven occasions and considered 363 practice review reports and 31 separate ACMR reports.

The PRC concluded that 242 initial visits should be closed without requiring any follow up actions. For 90 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. Fifteen reviews required a follow up visit to assess the effectiveness of remedial actions taken. Four reviews resulted in complaints being raised due to serious audit failures.

Twelve follow up visits were reported to the PRC in 2021. Nine follow up visits were closed on the basis that adequate remedial actions had been taken, and three required further follow up actions.

The review outcomes improved slightly in 2021. 69% of the reviews of practices were directly closed in 2021, representing an increase of 1% from 2020. However, the reviews that required follow up action have slightly increased from 24% in 2020 to 26% in 2021



In 2021, four reviews (including one first time review) of the practices resulted in a complaint being raised by the PRC. The first time review identified matters that showed issues about the professional conduct, competence and/or integrity of the practitioner of the practice (e.g. fabrication of work papers, provision of false information / representation to the practice reviewer, and significant deficiencies identified in quality control procedures, monitoring function and audit methodology that are three of the Top 5 findings). The other three reviews identified failure to perform adequate audit procedures and obtain sufficient and appropriate evidence to support the audit opinions issued.

In addition, one case resulted in a complaint due to non-compliance with the PRC's direction to deal with the dispute arising from the inability to conduct a practice review. Another case resulted in a referral to the FRC for further investigation.

For complaints based on unsatisfactory practice review results and un-cooperation in the practice review process, in particular those showed serious professional misconduct, recently completed disciplinary cases show that disciplinary committees are prepared to cancel a member's practising certificate for up to four years. Practices should bear in mind the serious consequences that may result from a complaint being raised by the PRC.

Our findings

Practice review programme

This is the fifteenth annual report on our practice review programme. In 2021, the COVID-19 pandemic continued to pose challenges to reporting entities and auditors. In particular, practices are experiencing difficulties in gathering audit evidence, and facing increased audit risks in carrying out work on areas such as impairments, valuations, expected credit loss assessments and going concern evaluations. During the practice reviews, we gave due consideration to the audit approach and relevant work performed by practices to address the heightened audit risks identified particularly in the above areas if those areas are critical to the audits selected for review.

This report outlines the more common findings identified from our inspections carried out in 2021. To be clear, it is not that these findings arise in all practice reviews but rather these findings occur more frequently and therefore it is worthwhile communicating them for practices' particular attention.

In Part I, we cover the findings from **firm level reviews** on areas, including (1) ethical requirements, (2) acceptance and continuance, (3) human resources, (4) engagement performance, (5) monitoring, and (6) file assembly. In Part II, we draw attention to the findings from **engagement reviews**, including those concerning: (1) group audits, (2) work on regulated clients, (3) professional skepticism, (4) audit methodology, and (5) audit documentation and audit evidence. Drawing attention to these findings should alert practitioners to take care to avoid the same deficiencies occurring in their practices.

Part I: Firm level reviews

1) Ethical requirements

It is common for practices to provide or arrange for their affiliated service companies to provide non assurance services, including company secretarial, accounting and book-keeping, or taxation services, to their audit clients. Providing such services to audit clients are likely to create threats to independence, such as self-review threats, that should be addressed by the auditor. In our reviews, we found a number of instances where practices failed to effectively identify, evaluate and address threats to independence when non-assurance services were provided to their audit clients. Practices are reminded that, before taking up a new or recurring audit engagement of a client to which non-assurance services had been or would be provided, an evaluation should be made as to the nature of services provided or to be provided to ensure that appropriate safeguards can be and will be put in place to mitigate the threats and that the threat evaluation, including the thought process and the conclusion, is properly documented. Section 600 of Part A of the Code of Ethics sets out the relevant requirements and application material.

Payments of referral fees to individuals who are not a professional accountant nor an employee, in return for the introduction of a client, is a breach of Section 900.13 of Chapter C of the Code of Ethics. In our reviews, we found instances where practices had paid referral fees to parties other than their employees or other professional accountants for introduction of clients to the practices. Practices typically took immediate actions to terminate the referral fee arrangements after such arrangements were identified. However, there was still non-compliance with the Code of Ethics in the first place. Practices should adhere strictly to the Code of Ethics to avoid the possibility of facing regulatory actions by the Institute.

2) Acceptance and continuance

According to paragraphs 26 to 28 of Hong Kong Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* (HKSQC 1), all practices should establish policies and procedures governing client acceptance and continuance. The following are the key deficiencies identified from reviews related to the practices' implementation of client acceptance and continuance procedures:

- Accepting appointments as auditors without carrying out adequate procedures to obtain professional clearance from the previous auditors as required by Section 200 of the Code of Ethics.
- Failing to evaluate and/or document the appropriateness of accepting appointments or re-appointments as auditors when there were client-imposed limitations of audit scope.
- Failure to adequately assess independence and technical capabilities of the audit team, and integrity of the client management before accepting or reaccepting an audit client.

Practices shall communicate with the preceding auditors to determine whether there are circumstances that should be taken into account when reaching the acceptance decisions. It is also important for practices to document clearly the procedures performed to reach the acceptance and continuance conclusions.

3) Human resources

Practices' human resource policies and procedures are important elements to achieve high quality audits. In some instances, we found that practices did not:

- Provide sufficient and adequate technical training to keep their engagement partners and staff up-to-date on the requirements of professional standards.
- Properly assign engagement partners and staff based on their experience and competence levels to engagements, particularly regulated or specialized industry engagements.

Practices should provide continuing technical training for all levels of audit personnel and keep proper records to demonstrate the compliance of their staff with the practice's policies and procedures on continuing professional development and that engagement partners have achieved the learning outcomes required for their role. Practices should properly evaluate the necessary competence and time requirements before assigning staff to engagements that require special knowledge, skills and competence.

4) Engagement performance

Practices commonly rely on staff at manager to partner levels to perform engagement file reviews. We occasionally found that the responsible engagement partners and managers did not perform effective file reviews nor provide adequate evidence of their reviews on engagements, including reviews of work performed by subcontractors and component auditors. Some practices also did not keep any time records of the time spent by the engagement partners and engagement quality control review partners on engagements. All these raised doubts about the adequacy and sufficiency of the review work performed on the engagements. Practices should put emphasis on the robustness of engagement file reviews and set appropriate policies and procedures to ensure that effective and adequate file reviews are carried out and documented before issuing the relevant reports.

5) Monitoring

Practices' monitoring functions remain a key area of focus for our reviews. In our reviews, we sometimes found that the frequency of monitoring reviews carried out did not meet the requirements of HKSQC 1. Very often, we found that the monitoring reviews were not effectively carried out as the monitors did not identify the issues that were found in the practice reviews when the same or related engagements were reviewed. Practices shall ensure that:

- A review of the system of quality control should be carried out on an annual basis, and a review of at least one completed engagement for each engagement partner performed under an inspection cycle, which ordinarily spans no more than three years.
- The monitors (internal or external) to be engaged have sufficient and appropriate experience, competence and authority to carry out such reviews.

- All deficiencies identified from monitoring reviews are properly followed up and addressed. A root cause analysis would also help to prevent similar deficiencies from occurring again in future.

6) File assembly

File assembly is an important step to close out an audit. In our reviews, we found cases where:

- Some key work papers were not retained and some outdated working papers were retained in the assembled engagement files.
- Assembly of the final engagement files (either in electronic or paper file format) was not completed within the 60-day time period after the audit reports were issued.
- Engagement work papers were modified after the file assembly completion date without documented reasons and trails.

It is important for practices to ensure that all audit work to support the audit opinion is complete and documented before the audit report date and the engagement files are assembled within the timeline required. Practices should implement measures to monitor completion of the assembly of final engagement files within the time limit and any subsequent changes to the files.

Part II: Engagement reviews

1) Group audits

HKSA 600 *Special Consideration - Audits of Group Financial Statements (Including the Work of Component Auditors)* requires the group auditor to identify significant components and, depending on the risks of material misstatement, conduct necessary procedures on those components. Those procedures often involve conducting an audit of the component information using component materiality. For components that are not significant, the group auditor might choose to only perform analytical procedures at the group level.

In our reviews, we identified issues in relation to group audits, including:

- No or insufficient assessment of the risks of material misstatements of the components, and insufficient or inappropriate audit procedures performed to address the assessed risks.
- No or insufficient work to evaluate the sufficiency and appropriateness of audit work performed by the component auditors.
- No consideration was given to whether the financial information of the components were prepared using the same accounting policies applied to the group financial statements or whether differences in accounting policies were identified and appropriate adjustments were made to bring alignment with the group's financial reporting framework.

- The subsequent event review procedures of the components were not updated to the group audit report date.

The more significant the component is to the audit of the group financial statements, the more direct involvement is expected from the group auditor in the work of the component auditors and thus the more documentation should be prepared by the group auditor itself.

2) Work on regulated clients

Work on regulated clients very often involves not only audits of their financial statements but also reporting on compliance with relevant laws and regulation. In respect of work on the Securities and Futures Commission (“SFC”) licensed corporations and insurance brokers, we identified the following more common shortcomings that practices should pay particular attention to:

a) SFC licensed corporations

- No or insufficient evidence of work done on tests of controls over client assets as suggested by PN 820 (Revised) *The Audit of Licensed Corporations and Associated Entities of Intermediaries*, including control testing over:
 - (1) deposits of client money into trust bank accounts within one business day and withdrawals of client money only for prescribed purposes;
 - (2) margin calls for shortfall of payments;
 - (3) depositing and transferring client securities and securities collateral;
 - (4) reconciliation of clients’ money and securities (including physical securities, if any); and
 - (5) sending standing authority renewal notices within one week after expiry.
- Failure to check the appropriateness of the haircut percentage applied to the value of collaterals when calculating the liquid capital reported in the financial returns.
- No audit procedures performed to assess the reliability of confirmations received from customers such as verification of the customers’ signatures on confirmations against client agreements.
- Failure to evaluate the effectiveness and reliability of the information technology system before placing reliance on the reports generated by the system for other work.
- No consideration of relevant fraud related factors (such as backlogs in key reconciliations and inadequate segregation of duties) as suggested by paragraph 45 of PN 820 (Revised).

b) Insurance brokers

- Failure to appropriately check the adequacy of the professional indemnity insurance (“PII”) coverage where more than one PII policy had been in force during the year in accordance with PN810.1 (Revised) *Licensed Insurance Broker Companies – Compliance with the Insurance (Financial and Other Requirements for Licensed Insurance Broker Companies) Rules (the “Rules”)*
- No or insufficient procedures performed to:
 - (1) test, on a sample basis, transactions both from the bank statements and from the ledgers to establish whether monies received from clients had been deposited into the client account without delay;
 - (2) test the client monies reconciliation statements and relevant supporting documents on a sample basis to determine whether comparison and reconciliation of client monies were properly performed; and
 - (3) validate the physical existence of accounting records to ensure that those records had been retained for at least seven years.
- Failure to perform procedures to establish that the minimum amounts of paid-up capital and net assets specified by the Rules were maintained as of the year end date and two other dates in the year for which the intervening periods must not be shorter than three months.
- Failure to carry out procedures (such as review of bank statements and correspondence) to check whether there had been any material claims during the year.
- Failure to properly evaluate the changes brought by new accounting standards e.g. HKFRS 15 *Revenue from Contracts with Customers*, and HKFRS 16 *Leases*.

Before taking up regulated client engagements, practices should ensure their engagement teams are familiar with the relevant laws, regulation and audit guides, including practice notes issued by the Institute. Mapping of the compliance work and procedures undertaken with the requirements of relevant practice notes (e.g. PN820 (Revised) and PN810.1 (Revised)) would help the practices to ensure the completeness of work to achieve compliance with the relevant practice notes.

3) Professional skepticism

Lack of or insufficient professional skepticism has been a major theme of engagement findings in our reviews as well as reviews by other local and overseas regulators. Findings during the year included:

- No or insufficient work to challenge the appropriateness of management’s assumptions in key areas of audit judgement such as impairment testing of cash-generating units (including goodwill) and intangible assets, and asset valuations or fair value measurements despite there being indications that the assumptions were too aggressive.

- Undue reliance placed on the work performed by experts (internal or external) without performing necessary procedures, including evaluating the methods, assumptions and data, in particular where there were clear disclaimers on the scope of work stated in the relevant experts' reports.
- Failing to challenge the appropriateness of accounting treatments used by the clients despite there being evidence to show that the relevant new professional standards (e.g. HKFRSs 15 and 16) might not have been properly applied.
- Failing to obtain independent audit evidence to corroborate verbal representations or internally generated documents provided by the clients.

When conducting audits, the audit teams should have a questioning mind, be alert to anything that may indicate misstatement due to error or fraud, and critically assess the audit evidence obtained to determine whether further audit procedures are required to support the audit opinions to be given.

4) Audit methodology

Practices use audit tools and aids to help them comply with auditing standards and the Code of Ethics. Those tools, aids and approaches are collectively referred to as audit methodologies. Small and medium practices usually adopt the Institute's Audit Practice Manual as their audit manuals. In our reviews, we often identified areas where improvements were required in practices' audit methodology. Key findings include:

- Insufficient work to identify audit risks pertaining to specific assertions and failure to perform specific audit procedures to address the assessed audit risks.
- Inadequate understanding of the client's business operations (including the nature of revenue and basis of revenue recognition) and related internal controls, and no or insufficient evaluation of design and implementation of key controls.
- No work performed to (i) test the completeness of journal entries, (ii) identify and test journal entries with fraudulent characteristics, and (iii) appropriately document the selection criteria and samples checked, in the journal entry testing.
- No consideration of the assessed audit risks, performance materiality, and extent of reliance on the client's internal controls when determining sample size for substantive testing.
- No evaluation of the effect of the uncorrected misstatements identified during the audit on the financial statements, nor communication of those misstatements to the client management.
- No or insufficient alternative procedures performed for non-replied receivable and payable confirmations.

Practices should update their audit methodology regularly with reference to the latest developments of auditing and other professional standards and improvement areas identified through internal or external monitoring and regulatory reviews, and provide adequate training to their audit personnel.

5) Audit documentation and audit evidence

In our reviews, we assess whether sufficient evidence and documentation had been provided on file to support the key account balances and audit judgements. Key findings during the year include:

- No or insufficient documentation of the extent of work performed and details of the samples checked in substantive testing.
- No or insufficient evidence of work to assess the reasonableness of the default rates and forward looking factors used in the expected credit loss assessments under HKFRS 9 Financial Instruments.
- No or insufficient work to assess whether the performance obligations included in the sales contracts were properly identified, and whether revenue was recognised when the performance obligations were satisfied in accordance with HKFRS 15.
- No or insufficient assessment of the potential financial impact arising from COVID-19, including the impact on business operations, disclosure of non-adjusting events, impairments and valuation of assets, and going concern.
- No or insufficient work to identify any extension or termination options in the tenancy agreements, and assessment of their impact on the determination of the lease periods and the calculation of lease liabilities in the HKFRS 16 assessments.

Practices should ensure that the audit documentation on file is sufficient to enable an experienced auditor to understand the nature, timing and extent of the procedures performed; the results of the procedures performed, and the audit evidence obtained; and the significant matters arising during the audit, the conclusions reached thereon, and the significant professional judgements made in reaching those conclusions. Practices should, before issuing the audit reports, revisit whether sufficient appropriate evidence had been obtained to enable reasonable conclusions to be drawn on key audit areas including areas significantly affected by new professional standards, in order to ensure the audit opinions to be given would be adequately supported.

Expectation

Practitioners should be aware that the new quality management standards (Hong Kong Standard on Quality Management 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* and Hong Kong Standard on Quality Management 2 *Engagement Quality Reviews*) are coming into effect from 15 December 2022. By the effective date, practices need to have established their quality objectives, identified and assessed the risks to meeting those objectives, and designed and implemented their responses to address such risks. Practices are also expected to have designed and implemented their monitoring and remediation activities to identify any deficiencies in the design or operation of their quality system and take appropriate action on a timely basis. Moreover, practices should have taken steps to enhance the robustness of the requirements for the appointment and eligibility of the engagement quality reviewer, and the engagement quality reviewer's responsibilities relating to the performance and documentation of an engagement quality review. In order to achieve the above, by now, practices are expected to have already gained knowledge about the new quality management standards and developed plans to fully implement those standards. Practices that have not done so are advised to act quickly as time is running short before the effective date.

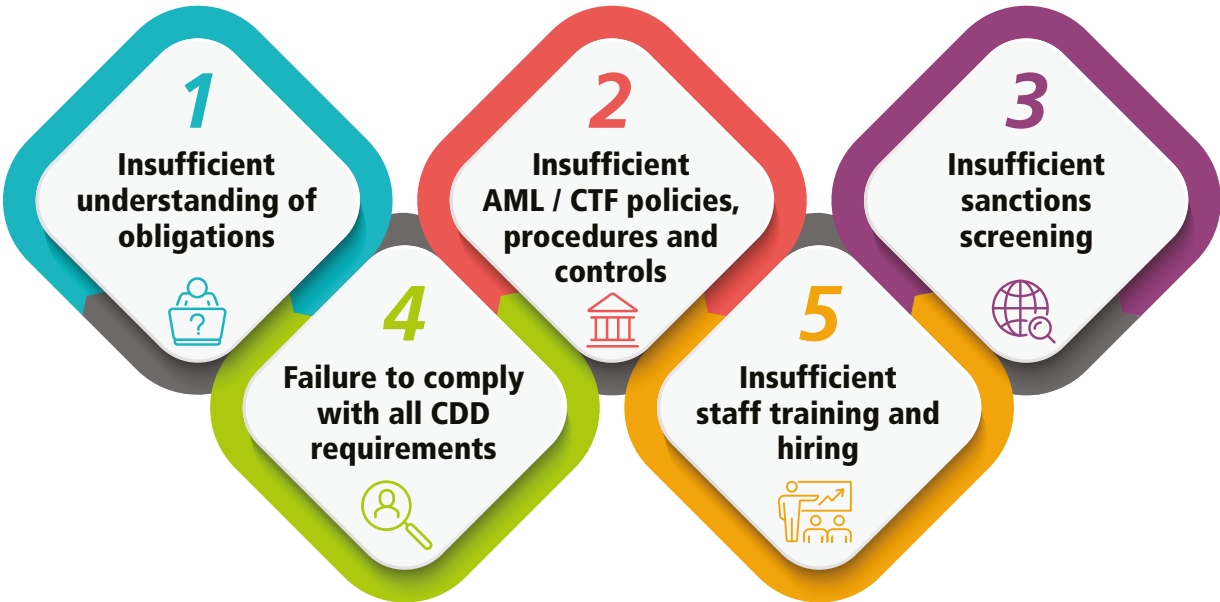
The Institute provides extensive guidance and support to help practices prepare for the implementation of the new quality management standards, including a webinar series, articles, implementation guides, and videos. Practices can find pronouncements, guides and articles that are relevant to quality management for firms and engagements in the Institute's website through the following link: <https://www.hkicpa.org.hk/en/Standards-and-regulation/Standards/New-and-major-standards/New-and-Major-Standards/Quality-Management-for-Firms-and-Engagements>.

Our findings

ACMR programme

The Institute’s AML Guidelines (Chapter F of the Code of Ethics) were introduced in March 2018. We launched the ACMR programme in October 2018 to assess practices’ level of compliance with the AML Guidelines. In an ACMR, we assess the appropriateness of the practice’s AML / CTF policies, procedures and controls; review example documents including sanctions screening and CDD, if applicable; and interview the practitioner(s) and staff members of the practice to evaluate their knowledge concerning AML Guidelines compliance.

We have identified the following five common weaknesses in practices’ AML Guidelines compliance:



We set out below reminders for practices to avoid the common weaknesses. Further details of these weaknesses can be found in the 2020 QA report.

Applicable to all practice units regardless of services provided

Understand your obligations

- ✓ Identify if your practice provides services involving Specified Transactions ^(Note A). If any of your services involve Specified Transactions, your practice has to comply with all the requirements set out in Sections 610 – 670 of the AML Guidelines.
- ✓ Where a bundle of services (e.g. audit, company secretarial, registered office etc.) is provided to a client by your practice and your affiliated trust or company service provider (“TCSP”) licensee(s), determine whether your practice (i) provides any Specified Transaction works itself and / or (ii) arranges for your affiliated TCSP licensee(s) to provide Specified Transaction works as stated in paragraph 600.2.2 (b), (d) and (e) to the client. If either of the above is yes, all requirements set out in Section 610 - 670 of the AML Guidelines have to be complied with by your practice. Based on the business arrangement, your practice and your affiliated TCSP licensee(s) should issue separate engagement letters or service agreements and fee notes to differentiate their respective services provided to the client.
- ✓ Ensure your practice has sufficient resources to address all relevant requirements of the AML Guidelines if it chooses to apply good practices ^(Note B).
- ✓ Develop appropriate and specific AML / CTF policies, procedures and controls for your practice. If your practice neither provides Specified Transaction works nor adopts good practices, your practice should establish and implement, at a minimum, policies and procedures for suspicious transactions reporting and financial sanctions and terrorist financing.

Notes:

A. A Specified Transaction is any of the transactions specified in paragraphs 600.2.1 and 600.2.2 of the AML Guidelines.

B. Unless a practice provides Specified Transaction works, it is not mandatory to comply with sections other than Sections 640 and 650 of the AML Guidelines (e.g. CDD, ongoing monitoring, record keeping, etc.). The practice however may choose to comply with those non-mandatory sections as good practices.

Sanctions screening		
	Practices that do not use a commercial database	Practices that have subscribed to a commercial database
Initial screening	<ul style="list-style-type: none"> ✓ Perform screening before establishment of a client relationship ✓ Check the latest United Nations (“UN”) Security Council consolidated list 	<ul style="list-style-type: none"> ✓ Perform screening before establishment of a client relationship ✓ Check with the service provider whether the screening facility covers the UN sanctions lists before service subscription
Ongoing screening	<ul style="list-style-type: none"> ✓ Review for updates of sanctions lists monthly if there are no clients with high money laundering and terrorist financing (“ML / TF”) risk, or weekly if there are ✓ Refer to the UN Security Council press releases (can be assessed through the Institute’s AML designated page) to identify updates of sanctions lists 	<ul style="list-style-type: none"> ✓ Obtain an understanding from the service provider on the frequency of screening and whether the subscription includes ongoing screening ✓ Analyze alerts of potential hits notified by the service provider
Overall	<ul style="list-style-type: none"> ✓ Screening should be performed for all clients regardless of the services provided ✓ Screening should at a minimum cover name checking against targeted financial sanctions lists of the UN. However, depending on the practice’s own business circumstances, screening might also cover name checking against sanctions lists of other jurisdictions (e.g. the United States’ Office of Foreign Assets Control sanctions lists). ✓ Keep evidence of screening (e.g. a search report or a screen capture of the search result) 	

Applicable to practice units which provide services involving Specified Transactions and / or adopt good practices

AML / CTF policies, procedures and controls
<ul style="list-style-type: none"> ✓ Perform a firm-wide ML / TF risk assessment to understand the ML / TF risks of the practice. ✓ Design appropriate and specific policies, procedures and controls according to the practice’s own circumstances. ✓ Perform regular AML / CTF compliance reviews to assess the implementation and effectiveness of the practice’s AML / CTF policies, procedures and controls.

CDD procedures

A standard level of CDD measures on a client includes:

- ✓ Identification of the client, its beneficial owner(s) (“BO”) and the person(s) purporting to act on behalf of the client (“PPTA”)
- ✓ Verification of their identities and PPTA’s authority to act
- ✓ Obtaining information on the purpose and intended nature of the business relationship

Client ML / TF risk assessment	PPTA
<ul style="list-style-type: none"> ✓ Assess ML / TF risk of each client ✓ Take into account the client type, geographical location of the client, services offered by the practice, and mode of delivery of the services in the assessment ✓ Draw a conclusion on ML / TF risk of the client so as to determine the extent of CDD procedures (i.e. standard, enhanced or simplified) and frequency of ongoing monitoring 	<ul style="list-style-type: none"> ✓ At minimum, regard the person who is authorized to act on behalf of the client to establish a business relationship with the practice (i.e. the person who has signed or will sign an engagement letter on behalf of the client) as the PPTA ✓ Verify the PPTA’s identity, as well as his / her authority to act, in all types of CDD procedures, including simplified CDD procedures
Politically exposed person (“PEP”)	Client not physically present for identification purpose
<ul style="list-style-type: none"> ✓ Perform name checks to identify whether the client and / or its BO(s) are PEPs ✓ Assess ML / TF risk of a domestic PEP by giving consideration to the risk factors stated in paragraph 620.12.13 of the AML Guidelines ✓ For a foreign PEP and a high risk domestic PEP, perform enhanced CDD procedures which should include: <ul style="list-style-type: none"> o Obtaining senior management approval before commencing or continuing the client relationship; o Taking reasonable measures to establish the sources of wealth and funds of the PEP; o Assessing specific risk factors set out in paragraph 620.12.13; and o Reviewing CDD information at least annually 	<ul style="list-style-type: none"> ✓ Given the heightened risk ML / TF risk, apply equally effective client identification procedures and ongoing monitoring standards for a client not physically present for identification purposes as for those where the client is available for interview ✓ Perform at least one of the following measures: <ul style="list-style-type: none"> o Further verify the client’s identity by obtaining additional documents, data or information from a reliable and independent source, that are not previously used to verify the client’s identity; o Take supplementary measures to verify the information relating to the client that has been obtained by the practice (e.g. use of a suitable certifier)

Staff training and hiring

Staff training	Staff hiring
<ul style="list-style-type: none">✓ Provide regular AML / CTF training to all relevant staff members✓ Training materials should cover all essential topics (e.g. suspicious transaction reporting, restrictions relating to tipping off, CDD procedures and measures to mitigate high ML / TF risk situations like a PEP and a client not physical present for identification)✓ Implement measures to monitor training effectiveness (e.g. arranging a quiz)	<ul style="list-style-type: none">✓ Implement procedures (e.g. name screening) to ensure integrity of a new employee✓ Equip new employees with AML / CTF knowledge before they commence work (e.g. conducting new joiner AML / CTF training)

The above reminders are not exhaustive. Practitioners should familiarize themselves with the AML Guidelines, attend AML / CTF related continuing professional development courses, and visit the AML / CTF related pages in the Institute's website to fully understand the requirements and keep abreast of the latest regulatory development.

We summarize below useful resources which can facilitate practices to comply with AML / CTF requirements.

Useful resources relating to AML / CTF compliance

The Institute's AML designated page



<https://www.hkicpa.org.hk/en/Standards-and-regulation/Anti-money-laundering>

The Institute's FAQs on AML monitoring



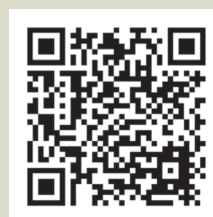
<https://www.hkicpa.org.hk/en/Tools/FAQ/Quality-assurance/Practice-review---AML-Monitoring>

Example AML / CTF policy manual for practices which do not apply good practices



<https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Standards-and-regulation/QA/2019/Example-AML-CTF-policies-and-procedures.pdf>

UN Security Council Consolidated List



<https://www.un.org/securitycouncil/content/un-sc-consolidated-list>

Communication with members

The results of the programme 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 issued a number of publications including (1) the 2020 annual report; (2) an Article in A Plus July 2021 on accounting for share options granted by holding companies to employees of subsidiaries; and (3) an alert covering referral fees for introduction of clients and maintenance of a registered office.
- On 15 October 2021, the QAD launched an e-seminar on “Quality Assurance Reviews”. This e-seminar is open for subscription for a year and covers key issues identified from the quality assurance programmes.
- The QAD team participated in the practice review session of the 2021 SMP Symposium (Webinar) in November 2021 which attracted approximately 350 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 2021

Name	Position	Company
Mr. LEUNG, Kai Cheong, Kenneth (Appointed 8 January 2021)	Chairman	Lewis Silkin
Dr. AU, King Lun	Member	Financial Services Development Council, Government of HKSAR
Mr. CHAN, Kam Wing, Clement	Member	BDO Limited
Miss CHAN, Mei Bo, Mabel	Member	Grant Thornton (Hong Kong) Limited
Mr. CHENG, Chung Ching, Raymond (Appointed 8 January 2021)	Member	HLB Hodgson Impey Cheng Limited
Ms. CHOI, Heung Kwan, Agnes (Appointed 8 January 2021)	Member	
Ms. HUI, Grace	Member	Hong Kong Exchanges and Clearing Limited
Mr. POGSON, Timothy Keith	Member	Ernst & Young
Dr. SO, Shiu Tsung Thomas (Appointed 5 February 2021)	Member	Mayer Brown
Ms. TSUI, Lai Ching, Kitty (Appointed 8 January 2021)	Member	Companies Registry, Government of HKSAR

Members of the Practice Review Committee in 2021

Name	Position	Company
Mr. HEBDITCH, Paul Donald	Chairman	Ernst & Young
Mr. LI, Kin Hang (Appointed 8 January 2021)	Deputy Chairman	Ken and Associates Company Limited
Mr. CHAN, Tze Kit	Member	Grant Thornton Hong Kong Limited
Mr. CHENG, Ho Long (Appointed 8 January 2021)	Member	WISE DILIGENT CPA COMPANY LIMITED
Mr. CHIU, Wing Cheung, Ringo	Member	BDO Limited
Mr. CHUI, Cheuk Yin, Bruce	Member	Bruce C.Y. Chui & Co.
Mr. KWOK, Kin Leung	Member	HLB Hodgson Impey Cheng Limited
Mr. LAU, Ho Kit, Ivan	Member	H.K. Lau & Co.
Mr. LO, Charbon	Member	Crowe (HK) CPA Limited
Ms. NG, Shun Yin	Member	KPMG
Mr. PANG, Wai Hang	Member	SHINEWING (HK) CPA Limited
Mr. TANG, Ying Cheung, Eric (Appointed 8 January 2021)	Member	Deloitte Touche Tohmatsu
Ms. TSUI, Maria Yuk Hung	Member	PricewaterhouseCoopers
Mr. WONG, Chun Bong	Member	BONWAY CONSULTANCY LIMITED
Mr. YAM, Tak Fai, Ronald (Appointed 8 January 2021)	Member	RSM Hong Kong

This Annual Report is intended for general guidance only. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this Annual Report can be accepted by the Hong Kong Institute of Certified Public Accountants.

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