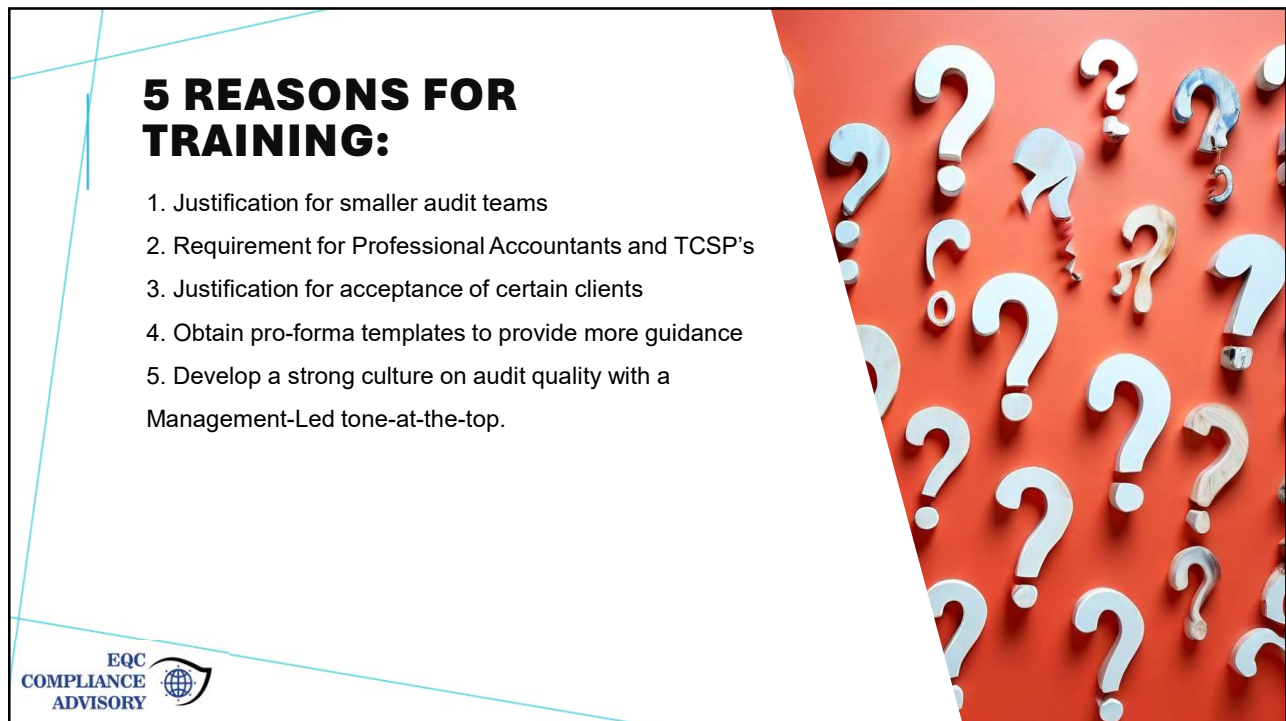





1



2

# AGENDA




## Training Topics

- 1. Inspection Process - Step-by-Step and Preparation Documents**
- 2. SQM – Common Findings**
- 3. AMCI – Common Findings**
- 4. Engagements – Common Findings**
- 5. Root Cause Analyses**
- 6. Remedial Action Plans**

3

# 1. INSPECTION STEP-BY-STEP & PREPARATION DOCUMENTS



**Objectives: Learn the new AFRC Inspection process**

- **Timeline from Start to Finish**
- **Obtain AFRC Forms required for submission**
- **What to Expect in:**
  - **Opening Meeting**
  - **During on-site inspection**
  - **Queries**
  - **Exit Meeting**
  - **Responses to Draft / Final Inspection Reports**

4

# 1. INSPECTION PROCESS (1/3)

```

graph TD
    A[1.1 Notification by Email on Day T (T)] --> B[1.2 Acknowledge Receipt on Day 7 (T+7)]
    B --> C[1.3 Complete Annex B and Submit on Day 21 (T+21)]
            
```

**What to Expect?**

On Day T Inform on-site inspection dates

- 3+ week on-site inspection period
- Inform powers of AFRC
- Inform obligations of the Practice

Annex B Provided on Day T

- 3+ week on-site inspection period
- Inform powers of AFRC
- Inform obligations of the Practice
- Understanding of the Practice's AML & SoQM policies, structure and client portfolio

From Days 21 to 42:

- Can ask for

5

## 1.3 COMPLETING ANNEX B

**What is Annex B?**

- Annex B is an Excel provided by AFRC with **EIGHT (8) worksheets for completion**

PPT Ref.	Name of Worksheet	Contents
1.3.1	1A. PU Profile	Background information of the Practice Unit
	1B. Partner Info	List of Practising Accountants with Admission Dates, EQR Eligibility, Admission & Promotion Dates and Specialty
1.3.2	2. SQM Info	A table with 42 items to gain understanding of the Practice's SQM policies
1.3.3	3A. AML	AML Policies, human resources handling AML Matters, firm-wide risk assessment, and training on AML
1.3.3	3B. AML (Specified Services)	List of clients with Specified Services under para. 600.2.1 and 600.2.2 of the AML Guidelines
1.3.4	4A. Non-PIE (non-MA & EA)	List of audit engagement other than MA / ME as defined under 1.1.7 within a specified 1-year period
1.3.4	4B. Non-PIE (MA & EA)	List of engagements involving MA / ME within a specified 1-year period (See 1.1.7 for definitions of MA / ME)
1.3.4	5A. Non-PIE (Ongoing)	List of ongoing audit engagements (i.e. accepted / re-engaged, but yet to issue audit reports)

6

## 1.3.1 PU PROFILE (1/2)

#	Question	Guidelines
A	Individual Assigned Operational Responsibility	Identify those responsible for Relevant Ethical Requirements, Acceptance and Continuance, Engagement performance, Resources, Information and Communication, Monitoring and remediation process <ul style="list-style-type: none"> <li>Align with SoQM Manual and Appendix 1 Risk Assessment Database</li> <li>Align with Organization structure (SB management positions)</li> <li>Think about who you want to attend meetings with AFRC</li> </ul>
B	Number of Staff for each grade	As at two specified dates; by Qualified and Unqualified Staff
C	Number of Clients	As at two specified dates
D	Complexity and Operating Characteristics of the PU	Size, Geographical operations, Business Structure, Centralized functions
E	Management and Administrative duties of the PU	Financial and operational management decisions
F	Style of Leadership	Management structure – identify ultimate responsible and operational responsible persons
G	Laws and Standards	Code of Ethics and relevant financial reporting and auditing standards, cap. 50 PAO, cap. 622 CO, cap. 571 SFO, cap. 41 IO, cap. 112 IRO, cap. 615 MLRO, cap. 279 EO, cap. 29 TO

7

## 1.3.1 PU PROFILE (2/2)

#	Question	Guidelines
H	Network Requirements	<p>Definition of Network:</p> <ul style="list-style-type: none"> <li>Same / Similar business name</li> <li>Common members / directors / partners</li> <li>Shared employees</li> <li>Shared office / same registered office address</li> <li>Abide by the same SoQM / AML manuals</li> </ul> <p><b>Simple set up usually is good.</b> If CPA Practice only provides and issue billings for Audit, Assurance and Tax compliance services, and affiliated firm does not meet the definitions of a “Network” above.</p> <p>If same office, how to maintain independence?</p> <ol style="list-style-type: none"> <li>Affiliated firm should not provide accounting services to audit clients</li> <li>Rooms / Cabinets with locks that can segregate data</li> <li>Segregate data and add IT security measures e.g. user access rights, admin passwords</li> <li>If other non-audit services provided by affiliated firm, then reduce impact on financial reporting, and segregate duties on all levels.</li> </ol>

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## 1.3.2 SQM INFO (1/5)

Item # In Annex B	Information Requested	Guidelines
1 to 3	Key Leadership Roles, Business Structure	<ul style="list-style-type: none"> <li>- Specified in SoQM Manual, AML Manual</li> <li>- Aligned with 1A. PU Profile</li> <li>- Single Ultimate Responsible Person</li> </ul> Similar information as requested in 1A. PU Profile  Ultimate Responsible Person Operational Responsible Person(s) - for monitoring and remedial actions this is not asking who is the external monitor reviewer, it's the person within the practice responsible for oversight over the monitoring policies . Compliance Officer Money Laundering Responsible Officer
4	Performance Evaluations on Leadership Members	Deadline anniversary of 15 December from 2023 and onwards
5	SoQM Manual and Customizations	Need to keep a record of all changes made to the HKICPA Purchased Template
6	Code of Conduct and Staff Handbook	Staff handbook is not necessary, can just provide the Code of Ethics issued by the HKICPA

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## 1.3.2 SQM INFO (2/5)

Item # In Annex B	Information Requested	Guidelines
7	Audit Practice Manual	If use HKICPA APM then no need. Otherwise need to tailor the practice manual according to the practice's unique audit methodology.
8	Risk Assessment Documentation	Appendix 1 Risk Assessment Database
9	Practice Aids	Appendices to SoQM and AML Manuals can be templates; Can have no practice aids; Any practice aids would be an additional document for the practice to align with when there are changes made to the SoQM / AML manuals, and should be communicated to staff each time there is a revision
10 to 13	Firm's Polices	On risk assessment, monitoring and remedial process, actions in response to monitoring and regulatory inspections, allegations and complaints  i) When there are no such incidents, declare in the SoQM that such policies are drafted for preventative purpose, and the practice cannot guarantee that such circumstances, such as complaints would not occur. ii) SoQM should be revised to ensure there are procedures and policies to follow-up on monitoring and inspection findings iii) Need to provide the most recent monitoring review reports (CFM 3-year cycle & OPN 1-year cycle)

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## 1.3.2 SQM INFO (3/5)

Item # In Annex B	Information Requested	Guidelines
14 to 15	Communications	What minutes are needed? What if I am a sole proprietor?
16 to 18	Network	If there is a network of firms (Generally, network of firms complicates the inspection, as practically, the firms may not be as independent as ideal expectations)  What is needed when there are network firms?

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## 1.3.2 SQM INFO (4/5)

Item # In Annex B	Information Requested	Guidelines
19 to 21	Policies that promote an internal culture on audit quality	These normally are included in the SoQM Manual.  What do regulators want to see?
22 to 25	Records of Communications	Evidence of the actions taken by the practice to promote audit quality, such as those things regulators want to see.
26, 31, 38	Assignment of Audit Work to Audit Team members	Engagement budgets Budget vs Actual Which engagements need training?

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## 1.3.2 SQM INFO (5/5)

Item # In Annex B	Information Requested	Guidelines
27 to 30	Ethics & Client Acceptance, and Engagement Performance	Refer to SoQM Manual (Ensure consistency with working papers to be submitted) Nothing else needs to be submitted at this stage Insert existing templates into SoQM Manual
32 to 37	Recruitment, Competency framework, Training, CPD monitoring and plans	Recruitment Appraisal Forms Standardize competence expectations Training needs evidence such as materials Good to submit a training plan that is updated annually
38 to 42	EQR, Service Provider policies, complaints, allegations and whistleblowing	Refer to the SoQM Manual Explain in Appendix 1 – Risk Assessment Database & in the SoQM Manual reason for including these policies in the absence of relevant incidents, reviewers or service providers

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## 1.3.3 AML INFO (1/2)

Item # In Annex B	Information Requested	Guidelines
2	AML Manual	What must be included in the AML Manual?
1, 4, 5	Specified Services	If the Practice provides specified services then applicable, otherwise can just N/A <u>Para. 600.2.1 of AML Guidelines:</u> (a) the buying and selling real estate; (b) the managing of client money, securities or other assets; (c) the management of bank, savings or securities accounts; (d) the organization of contributions for the creation, operation or management of corporations; (e) the creation, operation or management of legal persons or legal arrangements; (f) the buying or selling of business entities

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## 1.3.3 AML INFO (2/2)

Item # In Annex B	Information Requested	Guidelines
1, 4, 5 – continued	Specified Services	If the Practice provides specified services then applicable, otherwise can just N/A <u>Para. 600.2.2 of AML Guidelines:</u> (a) forming corporations or other legal persons; (b) acting as, or arranging for another person to act as: (i) a director or secretary of a company; (ii) a partner of a partnership; or (iii) in a similar position in relation to other legal persons; (c) providing a registered office, business address, correspondence or administrative address for a corporation, a partnership or any other legal person or legal arrangement; (d) acting as, or arranging for another person to act: (i) as a trustee of an express trust or similar legal arrangement, or (ii) as a nominee shareholder for a person other than a corporation whose securities are listed on a recognized stock market.
3, 7, 8, 9	Annual Compliance Review, Annual Declarations, Training, CVs	1) CV's of CO & MLRO 2) All audit team members annual declarations (T03) 3) Annual Compliance review (T02) 4) Training Records, Materials, and new hires (any training provided?)

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## 1.3.4 ENGAGEMENT INFO

Name of Worksheet in Annex B	Guidelines
4A. Non-PIE (non-MA&EA)	Engagement List for audit and assurance reports issued within 12-month period Key information include: - Audit fee - Year-end date - Report date - EQR / Partner Names - Regulated / Listed / Subsidiary of Listed - Group Audit - If Top 10 Audit fee OR regulated: GAAP / Opinion / Principal activity / Revenue / Assets / Gov't Grants /
4B. Non-PIE (MA&EA)	Major Acquisition = Major Transaction under HK Listing Rules Extreme Acquisition = Acquisition / Series of Acquisitions under HK Listing Rules
5A. Non-PIE (ongoing)	Accepted / Re-Accepted Engagements where audit and assurance reports are not yet issued up to the date of submission

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# 1. INSPECTION PROCESS (2/3)

1.4 Selection of Engagements  
on Days 38-40 (T+38-40)

1.5 On-Site Visit on Day 42 &  
Submission of Annex D (T+42)

1.6 On-Site Opening Meeting  
on Day 43 (T+43)

## What to Expect?

On Days 38 to 40 :Selection of Two Engagements:

- Detailed Review
- Regulated / High Fees

On Day 42: Submit Engagement Files:

- Hard copy vs Soft Copy
- From Acceptance to Archive
- Submit Annex D on each selected engagement

On Day 43: Present on Engagements & Opening Meeting

- Attendees
- PowerPoint Presentations on Engagements

# 1.4 SELECTION OF ENGAGEMENTS (D38-40)(1/3)

## Example 1:

On-Site Inspection begins at 09:30 on Monday, 16 September, 2024

Selection of Two to Four Engagements: at 17:30 on Thursday, 12 September, 2024

## Example 2:

On-Site Inspection begins at 09:30 on Thursday, 26 September, 2024

Selection of Two to Four Engagements: at 17:30 on Tuesday, 24 September, 2024

Two Audit Engagements are selected for detailed review

## Benchmarks for selection of engagements:

- Any engagements that are filtered by Forms 4A / 4B in Annex B
- Only engagements with top 10 audit fees can be selected?
- How would the inspectors know what our remaining engagements are?
- Should we submit Hard copy or Soft Copies?
- If we submit hard copies and they were printed from excel & word files, how do we explain that there are no soft copies for inspection?
- What about permanent files? Tax files? Co sec Files?
- What to include in audit working paper files?

## 1.4 SELECTION OF ENGAGEMENTS (D38-40) (2/3)

### What Most Likely Will Be Reviewed?

- 1) Everything related to Revenue Recognition
  - a) Internal Controls
  - b) Agent vs Principal
  - c) Understanding of the client's business operations
  - d) Point of Revenue Recognition
  - e) Measurement of Revenues
  - f) Extent of Audit Tests of Details on Revenue Recognition
  - g) Sampling Method on Revenues
  - h) Analytical Reviews on revenues (esp. if there is significant fluctuations)
  - i) Stage of Completion calculation
  - j) Reliability of information produced by the entity (System-generated Sales Reports)
- 2) Compliance of Ordinances (PAO, SFO, EO, IO, TO, CO, IRO)
- 3) Application of Practice Notes
- 4) Valuation of Most Significant Assets
- 5) Management Override of Controls

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## 1.4 SELECTION OF ENGAGEMENTS (D38-40) (3/3)

### Two Engagements are selected for review on Client Acceptance / Engagement Continuance Procedures:

- What will be reviewed?
- What to include?
- If my AML procedures are in Permanent File, then do I need to update the P-Files?
- What if we did not do sanction screening procedures when the client was initially accepted?
- What if we did not receive a professional clearance letter from the previous auditor?
- What if the engagement letter was signed a long time ago?

### Other Considerations

- Audit fee > 15% of the Practice's fees
- Risk tolerance assessment
- Prior Year's audit report was modified
- Long-time association with audit client

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# 1. INSPECTION PROCESS (2/3)

↓

1.4 Selection of Engagements  
on Days 38-40 (T+38-40)

↓

1.5 On-Site Visit on Day 42 &  
Submission of Annex D (T+42)

↓

1.6 On-Site Opening Meeting  
on Day 43 (T+43)

↓

## What to Expect?

On Days 38 to 40 :Selection of Two Engagements:

- Detailed Review
- Regulated / High Fees

On Day 42: Submit Engagement Files:

- Hard copy vs Soft Copy
- From Acceptance to Archive
- Submit Annex D on each selected engagement

On Day 43: Present on Engagements & Opening Meeting

- Attendees
- PowerPoint Presentations on Engagements

# 1.5 ON-SITE VISIT (1/2) (D42)

## What is Annex D?

Annex D is an Excel File provided by the AFRC with 5 worksheets for completion for each selected engagement.

It is usually provided on the day when engagements are selected, and has 5 worksheets for completion and is due on the first day of the on-site visit.

## What type of information is required?

- Engagement information: Engagement dates for various stages of audit, involvement of EQR, Audit fee, etc.
- Client information: Descriptions of business, structures, major customers, key financial information
- Audit Considerations: Everything included in audit planning, such as Materiality, PM, Threshold, Risks, Accounting Estimates, Working paper references, Group audit methodology, internal controls, reliance on internal audits, going concern, limitation of scope, IT audits, uncorrected misstatements, etc.
- List of documents: Eng Letter, Audit & Assurance reports, non-audit services provided, Rep letter, timesheet record, etc.
- Long-time association with the client – years of service, any rotation, etc.

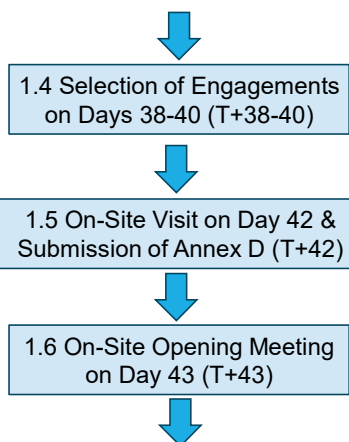
## 1.5 ON-SITE VISIT (2/2) (D42)

### Other Considerations:

- 1) Who should be present on Day 1?
- 2) What should we submit to inspectors on Day 1?
- 3) What to expect on Day 1?
- 4) Can we leave the office while the inspectors are here?
- 5) Should we leave anything in the room?
- 6) What if inspectors ask me a question, and we do not immediately have the answers?
- 7) Giving a good impression
- 8) PowerPoint Presentation?
- 9) How to prepare for the on-site visit?

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## 1. INSPECTION PROCESS (2/3)



### **What to Expect?**

On Days 38 to 40 :Selection of Two Engagements:

- Detailed Review
- Regulated / High Fees

On Day 42: Submit Engagement Files:

- Hard copy vs Soft Copy
- From Acceptance to Archive
- Submit Annex D on each selected engagement

On Day 43: Present on Engagements & Opening Meeting

- Attendees
- PowerPoint Presentations on Engagements

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## 1.6 OPENING MEETING (D43)

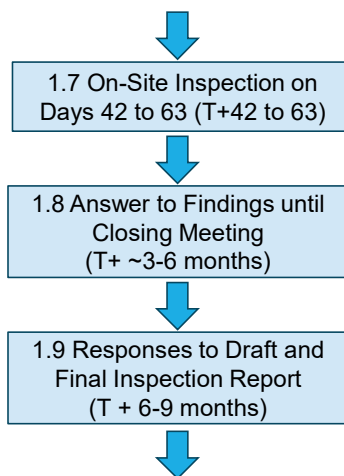
### What to Expect?

- 1) Introduction of the organization structure, client portfolio, key challenges, use of external service providers, resource management, network firms
- 2) How the SoQM was customized to the Practice:
  - How was Appendix 1 Risk Assessment Database prepared?
  - What are the Practice's key risks?
  - What customizations were made from the template purchased?
  - Why are many of appendices included in the SoQM but not used?
- 3) Introduction of every section of the SoQM
- 4) Go through the most recent self-evaluation of the SoQM and external monitor reviewer's ongoing policy monitoring review, remedial actions taken by the practice
- 5) Introduction of the Firm's AML procedures and policies
- 6) Declarations of any complaints, allegations and previous disciplinary sanctions imposed on the Practice

**NOTE:** These may be asked during the 21-day period between Submission of Annex B and Commencement of On-site inspection

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## 1. INSPECTION PROCESS (3/3)



### What to Expect?

1. 2-3 Rounds of Written Queries
2. Live queries
3. Selection of 2 engagement files for review of client acceptance / engagement continuance procedures

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## 1.7 ONSITE INSPECTION (D42-63)(1/2)

### What to Expect?

#### Review by section:

- SoQM
- AML
- 2 Audit Engagements (For Detailed Review)
- 2 Engagements on Client Acceptance / Engagement Continuance
- 2-3 Rounds of written queries per section
- 1-2 business days given to reply to written queries (at this stage no remedial actions needed)

#### Guidelines:

- If there is an auditor's rationale for certain judgement or audit procedures performed – Explain the judgement to inspectors – show competence
- Do not just agree with inspectors
- It is common for inspectors to act friendly so you would spill.
- If you are unsure on how to answer, ask for more time!
- Possibility of extension of onsite review period (Not necessarily an extension of review scope)
- Do not panic – not every question is a potential deficiency

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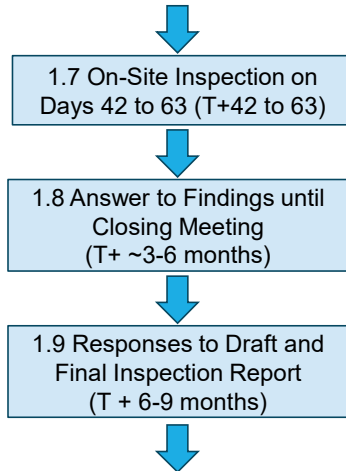
## 1.7 ONSITE INSPECTION (D42-63)(2/2)

### Frequently Asked Questions:

- 1) Can inspectors abruptly select more audit files for review?
- 2) I already answered the inspector's questions, why “死唔断气”
- 3) How many inspectors will stay at our office?
- 4) Why did the inspection team take away our submitted files?
- 5) When will the inspectors leave our office?
- 6) Should I travel during the onsite inspection period?
- 7) Will the inspectors request any additional information?

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# 1. INSPECTION PROCESS (3/3)



## What to Expect?

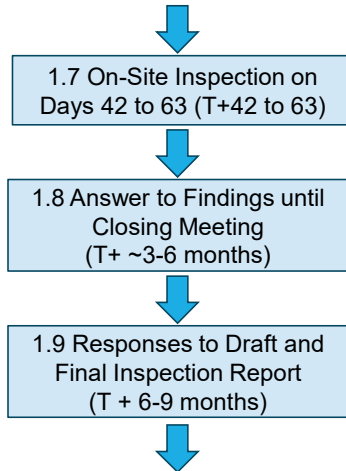
1. 2-3 Rounds of Written Queries
2. Live queries
3. Selection of 2 engagement files for review of client acceptance / engagement continuance procedures

# 1.8 ANSWER TO FINDINGS UNTIL CLOSING MEETING

## Frequently Asked Questions:

- 1) How long does it take to the closing meeting?
- 2) We have not heard back from the inspectors for a long time, what should we do?
- 3) Why are the inspectors scanning all our working papers, and asking us to confirm completeness?
- 4) What should we do when the inspectors send us a log of all scanned working papers?
- 5) We have been informed of a pre-scheduled closing meeting, who should attend? How should we prepare for it?

# 1. INSPECTION PROCESS (3/3)



## What to Expect?

1. There will be no additional findings other than those mentioned in the closing meeting
2. The draft inspection report is only for you to comment, but it is not necessary to provide remedial action plan at this stage.
3. The final inspection report is likely to be exactly the same as the draft, and you will be given 21 calendar days to submit a remedial action plan with supporting evidence, and root cause analyses

# 1.9 RESPONSES TO DRAFT / FINAL INSPECTION REPORTS (1/2)

## Draft Inspection Report:

- You may be notified by the inspectors once they have posted the draft inspection report
- 21 days given to comment on the draft inspection report from the date on the letter (i.e. not receipt date)
- Explain your rationale without disagreeing (unless if the deficiencies are factually incorrect)
- Only respond to the deficiencies included in Section 4 of the draft inspection report
- The deficiencies are laid out by section:
  1. SoQM
  2. AML
  3. Company A Deficiencies
  4. Company B Deficiencies
- Do not reply selectively.
- You may provide some preliminary remedial actions if you have already taken them
- Ensure there is a clear tabular presentation in replying to each finding



## 1.9 RESPONSES TO DRAFT / FINAL INSPECTION REPORTS (2/2)

### Final Inspection Report:

- 21 days given to submit a detailed remedial plan, root cause analysis
- You will be given a remedial plan template (Excel File) to complete the following on an Apple-to-Apple Basis:
  - Brief description of the main driver/significant finding
  - Root Cause of the finding
  - Whether the finding indicate a systemic issue?
  - Basis of the conclusion on whether it is a systemic issue
  - Description of remedial actions
  - Supporting documents of remedial actions
  - Completion status / Expected completion date of remedial actions
- EQC Average Length of Reply Letter is 15 to 25 pages with 10-20 supporting documents

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### What to Expect?


 FAIL

#### Possible Outcomes of Follow-up Actions

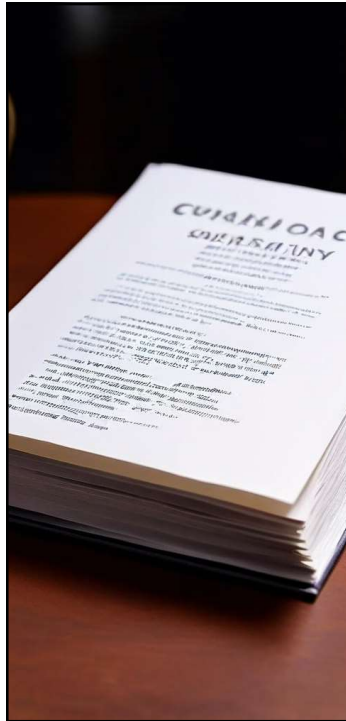
- 1) Ongoing Monitoring
- 2) Specific Follow-up Actions
- 3) Follow-up Inspection
- 4) Referral to Investigation / Compliance Department

OR


 PASS

- Letter of Acknowledgement
- Self-Monitoring


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## 2. SOQM – COMMON FINDINGS

PPT Ref.	Common Finding
2.1	How to deal with Long-Association Audit Clients
2.2	Definition of Network firms and safeguards for Affiliated Company Secretarial firms and consulting companies
2.3	Quality Risks and Responses specific to the Practice
2.4	Learn to demonstrate a Practitioner-led culture of quality audits and justify for adequacy of audit employees

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EQC  
COMPLIANCE  
ADVISORY 

## 2.1 LONG ASSOCIATION AUDIT CLIENTS

Familiarity and Self-Interest threats may affect independence and objectivity (section 540.3 of HKCoE)  
Para. 34(a)(i) of HKSQM 1:

- The firm establishes policies or procedures for:
  - (i) Identifying, evaluating and addressing threats to compliance with the relevant ethical requirements

**Limitations of SMP's**

- Limited Practising Accountants / Audit team members to enforce rotation
- Risk of knowledge discontinuity where historical client knowledge needs to be taken into consideration in evaluating reasonableness of accounting estimates
- Rotation may lead to operational inefficiencies leading to risk of errors

**Solutions:**

- 1) Independent monitoring (Internal Cold File Reviews / External Monitoring Reviews)
- 2) Customize audit training to topics needed in the audit of long-associated clients
- 3) Adjustments to performance appraisals to include performance in addressing deficiencies identified in monitoring activities and regulatory inspections (if yet to have inspections, then use common findings extracted in this training).
- 4) Revise and customize the SoQM Manual and Appendix 1 Risk Assessment Database to include these policies and procedures mentioned above.

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## 2.2 NETWORK FIRMS

### Definition of Network Firms:

- Shared office
- Common owners / directors / key management personnel
- Same / Similar brand name

Need to assess the threats arising from network firms providing non-audit services for audit clients of the practice.

### Common non-audit services:

Company secretarial services  
Human resources services  
Tax planning and compliance services  
Accounting services

- 1) Commitment to audit quality – Implement safeguards to maintain objectivity and prevent conflict of interests
- 2) SoQM Manual and Appendix 1 Risk Assessment take into consideration of this risk
- 3) Independent partner responsible for all non-audit services
- 4) Monitoring & remedial policies and regular compliance training for staff
- 5) Independence declarations for network firms

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## 2.3 QUALITY RISKS AND RESPONSES

- Appendix 1 - Risk Assessment Database
  - Only the relevant quality objectives and risks should be retained
  - Responses to address risks, description of the firm's practice, responsible person
  - Look for keywords:
    - Employees, Staff, Appraisals, Handbook, Personnel, Coaching, Training, Recruitment
    - Sub-contractors
    - Network
    - PIE / Public Interest Entities / Regulated Entities
    - Group Audits / Consolidation
    - EQR / Engagement Quality Review / EQ Review
    - Sole proprietor / director / partner
    - Complaints / Allegations / Whistle-blowing
    - Dates for annual cut-off
    - Service Providers
    - Communication for Sole Proprietors

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## 2.4 INTERNAL CULTURE ON AUDIT QUALITY

- How to promote a management-led internal culture on audit quality?
  - 1) Revise the SoQM Manual & Appendix 1 to include policies and procedures that reflect the following:
    - LOTS of communication supported by emails, internal circulars, minutes, training, etc.
    - Training plan and regular training sessions (can be internal / external)
    - Staff performances with KPI metrics based on the Practice's competence framework
    - Cold File Reviews, and remedial actions
    - External Monitoring Reviews, and remedial actions
    - Regulatory Inspection Findings, and remedial actions
    - Oversight of fulfillment of CPD requirements
    - Metrics to measure the adequacy of human resources
    - Setting criteria when external consultants / EQR should be appointed
    - Setting criteria for type of audit engagements that the Practice may not accept
    - Policies for ensuring the implementation of remedial actions

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## 3. AMCI – COMMON FINDINGS

PPT Ref.	Common Finding
3.1	What KYC Procedures are Must-Do
3.2	When to perform Sanction Screening procedures
3.3	Definition of key management personnel

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## 3.1 MUST-DO KYC PROCEDURES

- Simplified Approach
- Obtain identification documents / document the inspection of identification documents
- No KYC Procedures required when no specified services are provided by the Practice
- No KYC procedures required when the assessed risk is low
  - Specify in the AML Procedures Manual that risk is by default “Low” if none the following circumstances exist:
    - High Risk Jurisdictions (E.g. Sudan, North Korea, Iraq, Afghanistan, Somalia, etc.)
    - Potential Suspicious Transactions
    - Unknown sources of funds

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## 3.2 SANCTION SCREENING PROCEDURES

- Sanction Screening Coverage: Immediate, Intermediate and Ultimate shareholders > 25%
- Directors / key management personnel
- The potential client entity
- Ultimate beneficial owner
- Must perform sanction screening prior to the acceptance of new clients (i.e. signing of engagement letter)
- If ongoing monitoring is performed (i.e. periodically e.g. monthly, weekly, daily), then no need to perform before engagement continuance procedures (if there are no changes to above stakeholders)
- EVIDENCE NEEDED of initial and ongoing sanction screening
- Procedures to test the reliability of service providers

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### 3.3 DEFINITION OF KEY MANAGEMENT PERSONNEL

- Inspect the Memorandum of Articles and Association to identify individuals / entities with power / control / significant influence
- For sizeable clients, good to include C-level executives, if they are neither the directors / major shareholders (i.e. > 25% interest)

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### 4. ENGAGEMENT – COMMON FINDINGS

PPT Ref.	Common Finding
4.1	Auditing Revenues – Cut-off, Extent of Sample Size, Coverage, Point of Recognition
4.2	Scope of work on Journal entries
4.3	What is IPE? What audit procedures are required?
4.4	How to evaluate key assumptions used in valuation reports?

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## 4.1 AUDITING REVENUES

- 1) Sample Size for Occurrence and Completeness of Revenues
  - When coverage is in single digit %, consider to extend sample size
- 2) Test of Accuracy and Completeness of System Generated Sales Reports
- 3) Identify the point of revenue recognition and check to the right source documents in test of details
- 4) For Services rendered over a period of time, re-calculate the stage of completion and test check the accuracy of data inputs
  - Proper allocation of costs
  - Labour costs (timesheets, bank statements, employment agreements)
  - Total cost of sales and Total sales match with T/B
- 5) Walkthrough and system notes on sales business cycle
- 6) Consider extent (i.e. sample size) on cut-off
- 7) Consider audit work on cash sales
- 8) Consider the appropriate procedures on sales to related parties (confirmations & arm's length)
- 9) Consider if documentation on Agent vs Principal is adequate (Inventory risk, Credit Risk)

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## 4.2 JOURNAL ENTRIES TESTING

### Completeness of Journal Entries

1. Obtain each account's ledger
2. Obtain T/B for the reporting period
3. Obtain prior year's audited accounts
4. Cross-match prior year's audited T/B against opening balances
5. For each account, re-compute closing balances = total debits – total credits + opening balances

Sequential test on Journal Entries no longer required as the extent of testing is limited!

### Journal Entries Test for Management Override of Controls

1. Identify journal entries that exhibit fraudulent characteristics
2. The fraudulent characteristics should be clearly stated in the testing working paper
3. Explain the basis of these characteristic may be indicator of fraud
4. The characteristics cannot limit the selection of journal entries to be tested to ONLY those close to end of the reporting period.
5. Must check and document what source documents are inspected (3<sup>rd</sup> Party Source Documents only!)
6. The procedures should be able to rationalize the commercial substance of transactions (so suggest not to select bank transfers)

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## 4.3 PROCEDURES ON IPE (1/2)

### HKSA 500 (Revised Audit Evidence Para. 9):

“When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor’s purpose, including, as necessary in the circumstances:

- (a) Obtaining audit evidence about the accuracy and completeness of the information, and
- (b) Evaluating whether the information is sufficiently precise and detailed for the auditor’s purposes.”

### Examples of information produced by the entity:

- System-generated sales reports
- Receivables aging reports
- Stock Lists
- Fixed Asset Registers
- Payroll Reports
- Depreciation schedules
- Capex Reports

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## 4.3 PROCEDURES ON IPE (2/2)

How to satisfy the requirements of Para. 9 of HKSA 500 (Revised):

Forward testing:

- Select samples from the IPE, and vouch to source documents to test the accuracy
- E.g. for a trading company – aging receivables reports
  - Select a debtor and vouch to dates of bills of lading / delivery notes to ensure that the debtor balance is classified in the proper aging band
  - Need to document the dates and amounts in order to ascertain that the classification in aging bands of 0-30 day, 31-60 days, 61 to 90 days are correct.

Backward testing:

- Select samples from the source documents, and vouch to the IPE to test the completeness
- Using the above example, select bills of lading / delivery notes to ensure that they have been accounted for in the IPE.
- These are similar to tests of control, so the sample size is not calculated by population / materiality / risk level, but rather the frequency of the control activities entailed within the business cycle, which the IPE is relied upon by the management.

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## 4.4 EVALUATION OF KEY ASSUMPTIONS (1/2)

Relevant Auditing Standards:

**Para 8(c) of HKSA 500 (Revised) Audit Evidence:**

- If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall to the extent necessary, having regard to the significance of the expert's work for the auditor's purpose:
- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion

**Para. 22 to 24 of HKSA 540 (Revised) Auditing Accounting Estimates and Related Disclosures:**

Para. 22: Testing How Management Made the Accounting Estimates

Para. 23: Methods in Testing mentioned in para. 22

**In particular para 23(d):**

When management's application of the method involves complex modelling, whether judgements have been applied consistently and whether, where applicable:

- (i) The design of the model meets the measurement objective of the applicable financial reporting framework, is appropriate in the circumstances, and, if applicable, changes from the prior period's model are appropriate in the circumstances, and
- (ii) Adjustments to the output of the model are consistent with the measurement objective of the applicable financial reporting framework and are appropriate in the circumstances



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## 4.4 EVALUATION OF KEY ASSUMPTIONS (2/2)

Examples of Key Assumptions used by a Valuer of an Investment Property:

- Capitalization rates, expected yield, discount rates, growth rates, vacancy rates, market rents, etc.

**Suggested Procedures:**


- Evaluate the Expert's qualification and independence
- Examine the valuer's scope of work
- Review the assumptions and methodologies used by the expert
- Perform sensitivity analyses
- Corroborate with other audit evidence
- Variance analysis (compare last year's assumptions with actual data in the current year)
- Review of subsequent events
- Test if the key assumptions are objectively adjusted (consider qualitative adjustments)
  - E.g. Direction, Location, Age of Building, Convenience, etc.




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## 5. ROOT CAUSE ANALYSIS

PPT Ref.	Key Topics
5.1	What root causes are “safe”
5.2	Systemic / Isolated issues
5.3	How to arrive at a safe root cause?





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## 5.1 SAFE ROOT CAUSES

Upon the issuance of the Final Inspection Report, the practice is required to prepare a “Root Cause Analysis” which is submitted together with the letter containing the remedial actions (i.e. within 21 days from date of Final Report).

From the 2023 Inspection Report:  
*“Firms must thoroughly assess their remediation plans to ensure they robustly address the root causes of the identified deficiencies.”*

Result-Oriented – Think of root causes that you can think of remedial actions that can adequately address, and that you can implement those actions without any regulatory supervision.

Example of a bad root cause – **Talent Shortage!** How would you resolve it? Does it mean your practice accepted too many audit engagements even when you were aware there were inadequate human resources?



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## 5.2 SYSTEMIC / ISOLATED ISSUES

When the Final Inspection Report is issued, the regulator will provide you with a Remedial Plan template, in which, you would have to explain your conclusion for each finding, whether it is a **Systemic** / **Isolated** issue.

**Systemic Issue:** a deficiency that is not confined to a single instance, and it is indicative of widespread weaknesses within the Practice's processes, controls, or methodologies. In other words, the deficiency may affect multiple engagements.

- When there are systemic issues, revise the SoQM Manual as one of the remedial actions.
- It is unlikely that all issues are not systemic.

Need help with addressing systemic issues / explaining why a finding is not systemic? We can help.

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## 5.3 ARRIVING AT SAFE ROOT CAUSES

- Regulators need to be able to see your **chain of thought** in the Root Cause Analysis
- **Cannot immediately come up** with the "intended root cause"
- So the analysis is a good chance to eliminate other unsolvable root causes, and **"show-off"** the Practice's strengths, and eliminate root causes that may potentially lead to significant disciplinary penalties / sanctions

Examples of Questions Asked in Root Cause Analysis:

1. What is the structure of the existing training program within the firm concerning Anti-Money Laundering/Counter-Terrorist Financing and audit methodologies?
2. How do the current audit templates and tools influence the methods and practices of the engagement teams during audits?
3. What processes are in place to ensure the audit team's qualifications and experience comply with both the firm's standards and regulatory requirements?
4. What are the underlying reasons for the deficiencies highlighted in the AFRC inspection, and what measures are suggested to rectify these issues?

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## 6. REMEDIAL ACTION PLANS

PPT Ref.	Key Topics
6.1	What are possible remedial actions?
6.2	Types of remedial actions that require minimal ongoing monitoring by the AFRC
6.3	Ideal timeline of remedial action plans
6.4	Supporting documentation to demonstrate effective implementation of action plans

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### 6.1 POSSIBLE REMEDIAL ACTIONS

1. Revisions to the Firm's policies (SoQM Manual / AML Manual)
2. Adoption of tougher independent monitoring activities (cold file reviews / external monitor reviews)
3. Pro-active communications with the audit team member of the findings, and remedial actions implemented by the Practice
4. Customized training with a plan for practitioner, managers, and audit team (topics should differ for management & juniors) and should specifically address the findings
5. Engagement and Issuance of a Completed File Monitoring Review report
6. Design and Create Pro-Forma Working Paper templates and include them in the customized training
7. On-going monitoring mechanisms to ensure that the above remedial actions are sufficient

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## 6.2 ACTIONS REQUIRING MINIMAL AFRC SUPERVISION

- If possible, always complete the remedial actions and provide evidence that they have already been carried out by the submission date of the reply to the final inspection report.

### Common mistakes:

- Future tense (e.g. we will improve...)
- Same answer for every finding (e.g. Thanks for the finding, we have taken note for future consideration)
- If you have a strong internal culture on audit quality, why would you wait and hope the regulators would somehow just trust your word?!

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## 6.3 IDEAL TIMELINE OF ACTION PLAN

- Some remedial actions cannot be taken within the 3-week period
- So always start preparing when the finding have been informed during the Closing Meeting, or at the latest, upon the issuance of the draft inspection report.
- For ongoing remedial actions, such as ongoing monitoring, or training plan, do not do nothing. Provide initial steps, e.g. engagement letter with external monitor review, training plans by topics with objectives, training content, frequency and expected attendees, revision of the SoQM Manual to align the remedial plans with the Firm's policies.
- The decision on "Pass" or "Fail" is likely to be made within 3-4 months of the submission of your remedial action plan and supporting evidence, so complete the actions within this period to demonstrate pro-activeness.

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## 6.4 SUPPORTING DOCUMENTATION

Possible Supporting Documentation:

1. Revised SoQM Manual / AML Manual highlighting the changes
2. Internal Minutes of Meetings held subsequent to the closing meeting
3. Newly designed pro-forma working paper templates that can sufficiently address the deficiencies
4. Engagement letters with external consultants, monitor reviewers or training providers
  - To be absolutely safe, you may engage a law firm through EQC to ensure all communications are privileged and confidential.
5. Monitoring review reports issued by external monitor reviewer
6. Training Plans by topics
7. Adoption of new pro-forma working paper templates in recently completed engagements of similar nature of the inspected engagements.

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## EQC CONSULTANCY SERVICES

- Experience in handling over 200 Practice reviews / Inspections
- Consulted in all stages of practice reviews / inspections
- Work with RPC – law firm in handling complaints / mitigating negotiations
- Use innovative technologies to generate working papers
- External monitoring reviews, drafting of SoQM policies, AML Policies
- Prep Work for inspections and responses to inspection findings
- Consultancy for root cause analyses and remedial actions
- Customized training programs specific to findings

We have been providing services on everything covered in this training.

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