Responsibility of CPAs who prepare corporate financial statements

Guidance for CPAs who serve as directors or senior financial executives

Sections 379 and 380 of the Companies Ordinance (Cap. 622) require a Hong Kong-incorporated company to prepare financial statements that give a true and fair view of its financial affairs. Financial statements are a key channel for a company to communicate its performance, financial position and prospects. Users of them draw on the information to make important decisions. For instance, investors and creditors rely on information in the financial statements to evaluate the profitability of their investments and the repayment ability of the company. Similarly, financial statements provide a basis for a company's management to develop business plans and make strategic choices.

Preparers of a company's financial statements and their responsibilities

Financial statements prepared under the Companies Ordinance must comply with applicable financial reporting standards. The practical work falls on the company's accounting team headed by the chief financial officer (CFO), financial controller (FC) or other similarly titled senior management positions.

Ultimately, the board of directors is collectively responsible for the integrity of the company's financial statements. The directors are charged with approving the financial statements prepared by the accounting team, presenting them for audit, and laying them before the annual general meeting of the company. They are expected to understand and assess the company's accounting process and internal controls, review the financial statements, and enquire into and resolve issues that may arise.

In the case of listed companies, there is commonly a segregation of roles within the board. Executive directors make most of the key management decisions and are seen as running the company's business day to day. Non-executive directors serve in a more advisory capacity and are less involved in the daily operations of the company. Independent non-executive directors (INEDs) oversee company management at a high level and often chair or serve as members of the audit committee, which independently reviews the effectiveness of the financial reporting process and integrity of the financial statements.

The listing rules of the Hong Kong stock exchange contain detailed provisions on the duties of directors in their different roles and the work of the audit committee. The rules require the board of directors and the audit committee of a listed company to have at least one INED with professional accounting qualifications or relevant accounting expertise in order to assist the board on accounting matters.

The following provide additional sources of reference on the duties of directors and audit committee:

- *A Guide on Directors' Duties* published by the Companies Registry.
- *Guidelines for Directors* and *Guide for Independent Non-executive Directors* published by the Hong Kong Institute of Directors.
- *A Guide for Effective Audit Committees* published by the Institute.

The fundamental principles set out in the *Code of Ethics for Professional Accountants* describe how CPAs must act competently and with due care when discharging their responsibilities. For CPAs who are directors of a company or in senior management positions such as CFOs or FCs, these responsibilities include the company's financial reporting matters.

In cases of financial reporting irregularities, the Institute will enquire of CPAs who are directors or in senior management positions and take regulatory actions against the responsible individuals as appropriate.

Regulatory actions taken by the Institute for irregularities in financial reporting

The responsibility of company management to prevent financial statement irregularities is separate from the responsibility of the auditor, whose duty is to express an opinion on the financial statements. Irregularities in financial reporting indicate a possible failure on the part of the directors and senior management to act diligently when preparing and approving the financial statements.

In recent years, the Institute has taken regulatory actions against CPAs who were directors or senior management personnel as a result of irregularities found in companies' audited financial statements.

In one case, a CPA served as executive director and the CFO supervising a listed company's accounting team. The group's audited financial statements contained material errors in accounting for certain business acquisitions and financial instruments. The Institute found the CPA had failed to act with professional competence and due care in preparing the financial statements, and was therefore in breach of the relevant fundamental principle in the code. The CPA was publicly reprimanded.

In another case, a CPA was the audit committee chair of a listed company. He failed to independently assess whether the accounting treatment of a material receipt from a construction contract complied with relevant accounting standards, relying instead on the representations of the company's management and auditor. The Institute found the CPA had breached the fundamental principle of professional competence and due care in the code. He was privately reprimanded by way of a disapproval letter.

In conclusion, CPAs serving as directors, audit committee members, or heads of financial functions are bound by the fundamental principles of the code and the specific provisions that apply to professional accountants in business. They should discharge their responsibilities with due regard to those requirements and act in the utmost professional manner to ensure the integrity of the company's financial reporting process and the financial statements prepared from it.

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