

## **AUDITORS' OBLIGATION IN REPORTING FRAUD**

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Since the outbreak of corporate scandals such as Enron and Worldcom, a lot of investors lost their confidence in the stock market and Dow Jones Industrials Average Index dropped by over 20% since then. To restore the confidence of investors, it is the primary responsibility of the directors to install an efficient and effective internal control systems in their corporations to mitigate frauds. How about us as auditors? Can we play a role in detecting fraud? According to a survey, significant portion of fraud was detected by external audit!

Then, what is the auditors' obligation in reporting fraud at listed companies? Under S.157 of the Securities and Futures Ordinance ("SFO"), the persons in the course of performing their functions as auditors of licenced corporations or associated entities of intermediaries, they shall as soon as reasonably practicable lodge a written report on significant matters to the Securities and Future Commission ("SFC").

Will it cause a breach of implied term of confidentiality with the client if they divulge the information about the client's affairs to the regulatory authorities? The answer is "NO". The duty of confidentiality is not absolute! S.381 of the SFO provides the immunity to auditors of listed corporations to report to the SFC. The auditors shall not incur any civil liability, whether arising in contract, tort, defamation, equity or otherwise, by reason of their communicating in good faith with the SFC any information or opinion on a matter of which they become or became aware in their capacity as such auditors which in their opinion suggests the persons involved in the management of the affairs of the corporation have engaged in fraud.

Upon investigation, the SFC is empowered under S.179 of the SFO to require production of records and documents concerning listed corporations from third parties, including the auditors and bankers and explanations thereof, where there are circumstances suggesting that persons involved in the management of the corporation have engaged in fraud.

Auditors effectively have no option but to comply with the direction of the SFC, otherwise, penalties in the form of fines and/ or imprisonment will be imposed by the SFC.

Also, they are obliged to maintain confidentiality in respect of all matters relating to the SFC' s investigation and prohibited from informing the client, otherwise, they commit an offence under S.378 of the SFO.

Auditors should consider establishing their own policies and procedures to assist in the SFC' s investigation as a risk management practice. The proposed guidance is being developed by the Hong Kong Society of Accountants and will be issued for consultation in due course.