

IN THE MATTER OF

Complaints made under section 34(1)(a) of the  
Professional Accountants Ordinance (Cap. 50)

BETWEEN

Registrar of the Hong Kong Institute of                      COMPLAINANT  
Certified Public Accountants

AND

The Respondent    RESPONDENT

Before a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants ("the Institute")

Members:

### **REASONS FOR DECISION**

#### **Introduction**

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the "**Complainant**") against [the Respondent], a certified public accountant (the "**Respondent**").
2. A complaint was lodged with the Institute on 20 October 2011 against [the Firm] ("**[the Firm]**"), of which the Respondent is and was the sole proprietor at all material times, in respect of its audit of the financial statements of the Incorporated Owners of [a] Building ("IOs") for the years ended 31 August 2003 to 31 August 2009.

3. In relation to the complaint, on 30 January 2012, the Institute wrote to the Respondent, requesting a full set of the audit working papers for the years ended 31 August 2003 to 31 August 2009 to be retained pending investigation.
4. On 13 February and 7 March 2012, the Respondent replied that the papers for the IOs had not been kept and the audit working papers of the IOs for the years ended 30 August 2004 to 30 August 2009 were destroyed on 20 January 2012 with none of these documents being scanned or retained in electronic format.
5. The Respondent's failure to keep the audit papers hampered the Institute's investigation. The original complainant had not provided sufficient information. Thus, the Institute decided not to proceed with the original complaint.
6. In January 2013, the Complainant lodged complaints of the present case against the Respondent in relation to his destruction of the IOs' audit working papers in breach of the relevant professional standards.

### **The Complaints**

7. The complaints raised by the Complainant against the Respondent are set out in the Complainant's letter dated 8 January 2013.

#### *The First Complaint*

8. Section 34(1)(a)(vi) of the Professional Accountants Ordinance (Cap. 50) (the "**PAO**") applies to the Respondent in that he had failed or neglected to observe, maintain or otherwise apply a professional standard namely Hong Kong Standard on Auditing 230 (the "**HKSA 230**") "Audit Documentation" in that audit documentation (hard or soft copies) for the IOs audits for the years ended 31 August 2007, 31 August 2008 and 31 August 2009 (the "**Relevant Working Papers**") were not retained.
9. HKSA 230 stipulated that:-

Paragraph 28

*"After the assembly of the final audit file has been completed, the auditor should not delete or discard audit documentation before the end of its retention period."*

Paragraph 29

*“HKSQC1 requires firms to establish policies and procedures for the retention of engagement documentation. As HKSQC1 indicates, the retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor’s report ... “*

*The Second Complaint*

10. Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he had failed or neglected to observe, maintain or otherwise apply a professional standard in that his firm’s retention policy of audit documentation, for audit reports issued on or after 15 June 2006, did not comply with Hong Kong Standard on Quality Control 1 (“**HKSQC1**”).
11. HKSQC1 stipulated that:-

Paragraph 73i

*“The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm or as required by law or regulation.”*

Paragraph 73j

*“The needs of the firm for retention of engagement documentation and the period of such retention, will vary with the nature of the engagement and the firm’s circumstances ... or whether there are generally accepted retention periods in the jurisdiction in the absence of specific legal or regulatory requirements. In the specific case of audit engagements, the retention period ordinarily is no shorter than five years from the date of the auditor’s report, or, if later, the date of the group auditor’s report.”*

12. By destroying the Relevant Working Papers on 20 January 2012, the Respondent has not retained such audit working papers for “*no shorter than five years*” as required by HKSA 230 and HKSQC1.

## The course of the proceedings

13. On 22 February 2013, the Respondent admitted to the abovementioned complaints. Accordingly, the Complainant and the Respondent filed their submissions on sanctions and costs on 30 July and 3 August 2013 respectively for the hearing scheduled on 10 September 2013.
14. In the submissions on sanctions and costs, the Complainant suggested that the Respondent should at least be reprimanded and pay the costs incurred in the proceedings against him. The Complainant has not been able to find precedent case with similar breaches, the sanction would be very much left to this Committee's discretion.
15. On the other hand, the Respondent would like this Committee to consider the small scale of [the Firm] with informal or incorrect methods for the retention of audit working papers, taking into account the special situation of the present case that audit working papers for other clients had been scanned.
16. In the hearing, the Respondent reiterated his explanations of the special situation of the present case that: -
  - a) the Relevant Working Papers had been disposed of in accordance with [the Firm]'s own prevailing Retention Policy (i.e. for the period 31/7/07 – 31/12/10, audit working papers for general audit engagement be kept for 2 years and for special audit engagement be kept for 5 years); as the IOs was considered to be a general client, as opposed to being member of a group of companies, the Relevant Working Papers were kept for 2 years only;
  - b) as another prosecution against [the Firm] was made on 29 January 2010 in relation to the same audit client i.e. the IOs (the "**Previous Prosecution**"), [the Firm] had assumed that the working papers for the IOs were no longer required; and
  - c) as [the Firm] had been replaced as the IOs' auditor in late 2010, it was reasonable to assume that the Relevant Working Papers are of no continuing significance to future engagements.

17. The Complainant was of the view that the Respondent's explanations were not justified as HKSA 230 makes clear references to HKSQC1 which indicates the required retention period of five years. Hence the professional standards do not give room for misinterpretation by the Respondent.
18. The Respondent further explained that he misunderstood that the required standard of retention of work papers of five years only applied to special audit engagements, and that [the Firm]'s Retention Policy abided by the previous professional standards. However, this Committee was of the view that the HKSA 230 was of simple language, requiring the audit working papers to be retained for no shorter than five years, and that this standard was issued in 2006 and thus for a long period of time already. Therefore, such an explanation was not acceptable.
19. This Committee queried that from [the Firm]'s "*Register of Scanned/ Destroyed/ Deleted Working Papers Dead clients for auditor report dated after 15/6/2006*" , it appears that only the audit working papers of the IOs, but not other clients, were not scanned upon destruction. The Respondent explained that the IOs was no longer current client of [the Firm]'s and as the Previous Prosecution ended, he decided not to keep any record for the IOs.
20. This Committee further questioned why the Respondent did not destroy the IOs' audit working papers immediately after the Previous Prosecution i.e. January 2010, but waited until January 2012. The Respondent replied that it was due to [the Firm]'s policy of keeping client's working papers for 2 years.
21. The Complainant did not go so far as to allege that the Respondent deliberately destroyed the papers to frustrate the Institute's investigation. Yet this Committee feels that destruction of the Relevant Working Papers in the circumstances of this case is entirely unjustifiable and will take into account such circumstances in considering the appropriate sanctions.

## Sanctions

22. In its letter dated 8 January 2013 and in the hearing, the Complainant emphasized that public interest is best served when audit work papers can be reviewed and evaluated to ensure compliance with standards and lack of appropriate documentation is a serious deficiency and limits the protection of the public.
23. In addition, it is drawn to this Committee's attention that in the Previous Prosecution, [the Firm] was prosecuted because of deficient audit work done. The Respondent was ordered to be reprimanded, pay a penalty of HK\$35,000 and pay the allowed costs and expenses incidental to the proceedings.
24. Taking all the above matters into account, the Committee is of the view that the appropriate sanctions for both the first and the second complaints are that:-
  - 1) The Respondent be reprimanded;
  - 2) The Respondent do pay a penalty in the amount of HK\$40,000; and
  - 3) The Respondent do pay costs to the Complainant as assessed below.
25. This Committee so orders accordingly, such orders to take effect on the 50<sup>th</sup> day of this order under section 35(1) of the PAO.

## Costs

26. Pursuant to section 35(1)(iii) of the PAO, this Committee has a very wide discretion and "*may make such orders as [it] thinks fit with regards to the payment of costs and expenses of and incidental to the proceedings, whether of the Institute (including the costs and expenses of the Disciplinary Committee) or of any complainant or of the certified public accountant...*"
27. In the Complainant's Statement of Costs, the estimated further costs to completion of proceedings, i.e. costs assigned for time spent on the hearing scheduled on 11 September 2013, were calculated on a 2-hour basis. In order to reflect the actual length of the hearing, the Committee decided that such estimated further costs should be calculated on a 1-hour basis.

28. The Respondent disputed that the photocopying charges of \$1,300 as stated in the Complainant's Statement of Costs was excessive. This Committee agreed that that sum of charges was unnecessarily high and thus should be cut by half i.e. \$650.
29. Accordingly, the Committee orders that the Respondent do pay costs at the amount of HK\$39,750 to the Complainant.

Such costs are to be paid on or before the day the order in paragraph 25 takes effect.

Dated the 29<sup>th</sup> day of October 2013