Proceedings No.: D-12-0738F (A)

IN THE MATTER OF

A Complaint made under section 34(1)(a) and 34(1A) of the Professional Accountants Ordinance (Cap. 50) (“PAO”) and referred to the Disciplinary Committee under section 33(3) of the PAO

BETWEEN

The Registrar of the Hong Kong Institute of Certified Public Accountants	COMPLAINANT
AND	
Respondent	RESPONDENT

Members:

REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (**the** “**Institute**”) as Complainant against the Respondent, a certified public accountant (practising). Section 34(1)(a)(vi) of the PAO applied to the Respondent.

2. The particulars of the Complaint as set out in a letter dated 8 October 2013 (**the** “**Complaint**”) from the Registrar of the Institute to the Council of the Institute for consideration of the Complaint for referral to the Disciplinary Panels were as follows:-

    (1) Company A (**the "Company"**) was incorporated in the Cayman Islands and its shares are listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong (Stock Code xxxx).

    (2) The financial statements for the Company and its subsidiaries (**the "Group"**) for the years ended 31 December 2006 and 31 December 2007 (**collectively the "2006 and 2007 Financial Statements"**) were stated to have been prepared in accordance with the Hong Kong

Financial Reporting Standards ("**HKFRS**") issued by the Hong Kong Institute of Certified Public Accountants.

(3) A CPA firm ("**the Firm**") (Firm no.: xxxx) audited the 2006 and 2007 Financial Statements. The Respondent is the sole-proprietor of the Firm.

(4) The Firm's audit reports for the 2006 and 2007 Financial Statements (signed and dated 23 October 2007 and 19 March 2008 respectively) stated that the audits were conducted in accordance with the Hong Kong Standards on Auditing.

(5) The consolidated profit of the Group stated in the 2006 and 2007 Financial Statements was HK$5.5 million and HK$0.2 million, respectively. The consolidated net assets of the Group stated in the 2006 and 2007 Financial Statements were HK$74 million and HK$75 million respectively. The Firm expressed an unmodified opinion on the 2006 and 2007 Financial Statements.

(6) The Financial Reporting Council (the "**FRC**") received a complaint of possible non-compliance and auditing irregularity in respect of inter alia the 2006 and 2007 Financial Statements. The complaint related to, among others, non-compliances with accounting standards when measuring revalued plant and machinery in the 2006 and 2007 Financial Statements which were subsequently corrected by retrospective restatements in the Group's financial statements for the year ended 31 December 2010.

(7) In carrying out its investigation of the complaint, the FRC noted that no depreciation had been charged on the revalued plant and machinery in the 2006 and 2007 Financial Statements. This led to understatements of depreciation charges of approximately HK$ 8.1 million and HK$10.6 million in 2006 and 2007 respectively.

(8) The FRC further noted that there had been no disclosure of a reconciliation of the carrying amount at the beginning and end of the period showing depreciation, and the carrying amount of the revalued plant and machinery under the cost model in the 2006 and 2007 Financial Statements. Therefore, the FRC concluded that there was non-compliance with paragraphs 31, 35, 52, 73 and 77 of Hong Kong Accounting Standard 16 Property, Plant and Equipment ("**HKAS 16**").

(9) On 21 May 2012, the FRC sought the Firm's explanation on how it had been satisfied that the measurement and disclosure of the revalued plant and machinery in the 2006 and 2007 Financial Statements complied with HKAS 16.

(10) On 18 June 2012, the Firm replied as follows:

"*We reviewed the accounting treatment of depreciation expenses taken by the Group with respect to property, plant and equipment for the years ended 31 December 2006 and 2007 and noted that management of the Group were of the view that as long as the property, plant and equipment were stated at their fair value based on the valued amounts as at each respective year end dates, no depreciation charge would then be necessary as any change in the revalued amount of the property, plant and equipment would then be recognized in the accounts of the Group for that particular year. When we performed our audit of the Group for the years ended 31 December 2006 and 2007, we accepted the treatment as fair and reasonable.*

We agree that depreciation charges should be recognized on the Group's property, plant and equipment and that the revalued amounts of these assets as at their respective year end should be compared to the carrying amounts of these assets, after netting off the accumulated depreciation charges, and the difference be recognized as a change in the revalued amounts of these assets in the accounts of the Group. We deeply regret for our misunderstanding and misinterpretation of HKAS 16."

(11) On 18 September 2012, the FRC referred an extract of its complaint assessment report (**the "Report"**) and annexures to the Institute, pursuant to s.9(f) of the FRC Ordinance. In making the referral, the FRC considered that the Firm had failed or neglected to observe, maintain or otherwise apply a professional standard pursuant to section 34(1)(a)(vi) of the Professional Accountants Ordinance, Cap 50 ("**PAO**").

SUMMARY OF PRINCIPAL ISSUES

(12) The principal issues relate to the failures by the Group to comply with paragraphs 31, 35, 52, 73 and 77 of HKAS 16 in that

a. no depreciation had been charged on the revalued plant and machinery in the 2006 and 2007 Financial Statements; and

b. there was no disclosure of a reconciliation of the carrying amount at the beginning and end of the period showing depreciation, and the carrying amount of the revalued plant and machinery under the cost model in the 2006 and 2007 Financial Statements.

(13) The associated reduction of profits arising from the undercharged depreciation on the overall consolidated profit for the year, of 11 % and 14% in 2006 and 2007 respectively, was considered material to the respective financial statements.

(14) In the circumstances, the Firm failed to express a modified auditor's opinion on the 2006 and 2007 Financial Statements regarding the non-compliance with HKAS 16 and/or the Firm failed to comply with the requirements of professional standards.

(15) The principal issues are explained in the Report, which should be referred to for details.

RELEVANT PROFESSIONAL STANDARDS

(16) Hong Kong Standard on Auditing 700 "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" ("**HKSA 700**")

"11. The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements."

"13. Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework involves evaluating whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework for particular classes of transactions, account balances and disclosures...."

(17) Section 130 "Professional Competence and Due Care" of the Code of Ethics for Professional Accountants ("**Code**")

"130.1 The principle of professional competence and due care imposes the following obligations on professional accountants:

(b) To act diligently in accordance with applicable technical and professional standards when providing professional services.

130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis."

(18) HKAS 16:

"31. After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less

any subsequent accumulated depreciation and subsequent accumulated impairment losses.... "

"35. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:

... (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings."

"52. Depreciation is recognized even if the fair value of the asset exceeds its carrying amount...."

"73. The financial statements shall disclose, for each class of property, plant and equipment

... (e) a reconciliation of the carrying amount at the beginning and end of the period showing:... (vii) depreciation ...."

"77. If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed:

... (e) for each revalued class of property, plant and equipment, the carrying amount that would have been recognized had the assets been carried under the cost model ...."

THE COMPLAINTS

The First Complaint

(19) Section 34 (1)(a)(vi) of the PAO applies to the Respondent in that he failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 11 and 13 of HKSA 700 for failure to express a modified auditor's opinion in respect of the Group's non-compliance with HKAS 16 in the 2006 and 2007 Financial Statements.

The Second Complaint (in the alternative to the First Complaint)

(20) Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he failed or neglected to observe, maintain or otherwise apply a professional standard namely section 130 of the Code for failure to act

diligently in accordance with HKAS 16 in the audits of the 2006 and 2007 Financial Statements.

3. The Respondent admitted the First Complaint against him. He did not dispute the facts as set out in the Complaint. On 7 November 2013, the parties made a joint application to the Disciplinary Committee and they agreed that the steps set out in rules 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.

4. On 29 April 2014, the Disciplinary Committee issued a Notice of Commencement of Proceedings, enclosing a procedural timetable and a full set of the complaint documents to the parties. The parties were requested to make written submissions to the Disciplinary Committee on sanctions and costs and that the Disciplinary Committee would not hold a hearing on sanctions and costs unless otherwise requested by the parties.

5. Undoubtedly, the breach committed by the Respondent is very serious. In his letter to the Disciplinary Committee dated 19 May 2014, the Respondent submitted, inter alia, that due to his limited experience in conducting audits of listed companies and his poor medical condition at the relevant time, the Firm placed heavy reliance on a consultant whom the Respondent understood was experienced in the audit of listed companies. The Respondent further submitted that the error was purely caused by a misinterpretation of HKAS 16. The Disciplinary Committee is of the view that none of the above constitutes an acceptable mitigating factor. The one and only mitigating factor in the present case is the Respondent's admission to the Complaint, thereby saving further costs and expenses of the Institute and the Disciplinary Committee.

6. In considering the proper order to be made in this case, the Disciplinary Committee has had regard to all the aforesaid matters, including the particulars in support of the Complaint, the breach concerned two auditors' reports, the parties' submissions on sanctions and costs and their conduct throughout the proceedings.

7. In relation to costs, the Disciplinary Committee considers that the costs and expenses totalling HK$23,157.40 as assessed in the Complainant's Statement of Costs dated 20 May 2014 are reasonable and therefore should be allowed.

8. The Disciplinary Committee ORDERS that:-

(a) the Respondent be reprimanded under section 35(1)(b) of the PAO;

(b) the Respondent do pay a penalty of HK$70,000 under section 35(1)(c) of the PAO;

(c) the Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK$23,157.40 under section 35(1)(iii) of the PAO.

Dated the 11th day of September 2014

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BETWEEN

The Registrar of the Hong Kong Institute of Certified Public Accountants	COMPLAINANT
AND	
Respondent	RESPONDENT

Members:

ORDER

Upon reading the complaint against the Respondent, a certified public accountant (practising) as set out in a letter from the Registrar of the Institute ("the Complainant") dated 8 October 2013, the written submissions of the Complainant dated 20 May 2014 and the Respondent dated 19 May 2014, and other relevant documents, the Disciplinary Committee is satisfied by the admission of the Respondent and the evidence adduced before it that the following complaint is proved:

Section 34(1)(a)(vi) of the PAO applies to the Respondents in that he failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 11 and 13 of Hong Kong Standard of Auditing 700 for failure to express a modified auditors' opinion in respect of Company A and its subsidiaries' non-compliance with Hong Kong Accounting Standard 16 in the 2006 and 2007 Financial Statements.

The Disciplinary Committee ORDERS that:-

1) the Respondent be reprimanded under section 35(1)(b) of the PAO;

2) the Respondent do pay a penalty of HK$70,000 under section 35(1)(c) of the PAO; and

3) the Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK$23,157.40 under section 35(1)(iii) of the PAO.

Dated the 11th day of September 2014