

IN THE MATTER OF

A Complaint made under section 34(1)(a) and section 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, who is 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 4 June 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 substantively as follows:-
 - 2.1 In May 2012, a Mr. L [xx] ("Mr. L"), who is a shareholder and director of a private company ("Company") lodged a complaint against the Respondent alleging that he did not properly conduct the audit on the financial statements of the Company for the period ended 31 March 2011 ("Financial Statements").
 - 2.2 Mr. L discovered that certain items had not properly been reported in the Financial Statements. It was also observed that the Financial Statements did not comply with the Small and Medium-sized Entity Financial Reporting Framework ("SME FRF"), and the Company did not satisfy

the criteria set out in section 141D of the Companies Ordinance for it to adopt the Small and Medium-sized Entity Financial Reporting Standard ("SME FRS").

First Complaint

- 2.3 It is required by paragraph 16 of SME-FRF that "A *company incorporated under the Companies Ordinance qualifies for reporting under the SME-FRF if it satisfies the criteria set out in section 141D of that Ordinance. Compliance with the SME-FRF and SME-FRS is necessary in order for financial statements to give a "true and correct" view when a Hong Kong incorporated company prepares its financial statements in accordance with section 141D of the Companies Ordinance*".
- 2.4 Section 141D(1) of the Companies Ordinance provides that "*Where all the shareholders of a private company agree in writing that this section shall apply with respect to a financial year of that company-...*". (underline added)
- 2.5 In the relevant audit report dated 11 November 2011, the Respondent expressed that "*In our opinion, the financial statements have been properly prepared ... in accordance with the SME-FRS...the balance sheet together with the notes thereon is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as at 31st March, 2011...*".
- 2.6 It was also stated in note 11 of the Financial Statements that "*All shareholders of the Company have agreed that Section 141D of the Companies Ordinance shall apply with respect to the financial year ended 31st March, 2011.*" (underline added)
- 2.7 Audit documentation in the working papers shows that written consent was only given by 5 out of 6 shareholders of the Company to apply section 141D in the preparation of the Financial Statements. Documentation shows that consent of Mr. L, who is also a shareholder, was not inspected.
- 2.8 The Respondent confirmed that written consent of only 5 out of 6 shareholders was obtained and that Mr. L had not signed a written consent form in this regard. He admitted that "*audit work did not satisfy the criteria set out in section 141D of the Companies Ordinance*".
- 2.9 The Respondent should have been aware that Mr. L's written consent was not obtained. The Respondent should have considered modifying the audit opinion in accordance with HKSA 705 "Modifications to the opinion in the independent auditor's report".
- 2.10 In light of an unmodified audit opinion expressed by the Respondent, he was in breach of HKSA 250 in that he failed to obtain sufficient audit evidence regarding the Company's compliance with SME-FRF and section 141D of the Companies Ordinance in order to adopt SME-FRS in

preparing the Financial Statements.

Second Complaint

Understatement of \$2,640,000 dividend payable that was treated as paid

- 2.11 It was disclosed in note 10 of the Financial Statements that final dividend declared (HK\$220.0 per share) totaling \$2,640,000 was paid during the period ended 31 March 2011.
- 2.12 The audit working papers show that:
- (a) There were unrepresented cheques as at 31 March 2011 (not yet cleared by the bank) in relation to the dividend declared and they were sent on 30 March 2011.
 - (b) \$2,640,000 was settled by six cheques (numbered 429708, 429709, 429710, 429711, 429712, and 429729) drawn by the Company, that were only cleared in February and March 2012.
 - (c) One of the cheques drawn (numbered 429729) was used to draw a bank cashier order of \$440,000 in favour of Mr. L.
- 2.13 The Respondent should have identified in the course of conducting relevant audit procedures in about October and November 2011 (i.e. six months after cheque issue date) that unrepresented cheques as at 31 March 2011 would become stale cheques and would generally not be processed by the drawing banks in Hong Kong. Hence, those six cheques cleared in February and March 2012 would have been drawn after the year end date of 31 March 2011.
- 2.14 Another documentation that "all 1st batch cheques were released on 30 March 2011" (underline added) also suggests that the six cheques numbered 429708, 429709, 429710, 429711, 429712, and 429729 mentioned above were the "2nd batch" of cheques drawn.
- 2.15 As it is clear that the shareholders only cashed in their dividends in February / March 2012, the dividend declared of \$2,640,000 would therefore remain unsettled when audit work was concluded on 11 November 2011 (i.e. date of audit report).
- 2.16 The working papers do not show that sufficient audit work was conducted to satisfy the Respondent that dividend declared was indeed paid before the conclusion of the audit on 11 November 2011. On the contrary, they show that the following audit evidence was not obtained:
- (a) inspection of the stale cheque copies or stubs (i.e. cheques released on 30 March 2011 but were still unrepresented on 11 November 2011);
 - (b) recording of the stale cheque numbers;
 - (c) inspection of documents showing shareholders' receipt of the stale cheques;

- (d) confirmation by Mr. L of receipt of his dividend entitlement of \$440,000; and
- (e) confirmation by the other five shareholders of receipt of their dividend entitlement of \$440,000 each (confirmations returned from them showing there was no amount due to them were only requested in June 2012, after the conclusion of the audit on 11 November 2011);
- (f) the subsequent settlement of \$2,640,000 (settlement of \$2,640,000 in February and March 2012 could not have been checked at the time of the audit conducted in October and November 2011); and
- (g) the auditor's consideration of the appropriateness of reclassifying dividend paid to dividend payable regarding the stale cheques upon an understanding documented in the working papers that "*The 5 brothers / sisters must listen to elder brother L [xx] permission to present the cheques though resolution was passed in the board minutes and quarterly meeting*".

2.17 Although incorrect classification of dividend paid and payable does not affect the amount of net assets of the Financial Statements, the understatement of dividend payable and cash and bank balance of \$2,640,000 is material to the Financial Statements which show that profit for the period was \$3,259,964, net assets were \$631,964, cash and bank balance was \$1,443,829 and total liabilities were \$1,171,462.

2.18 In the circumstances, the Respondent was in breach of HKSA 500 in that he failed to obtain sufficient audit evidence to agree that dividend declared of \$2,640,000 was paid (when in fact it was only settled almost one year subsequent to 31 March 2011).

Understatement of \$643,120 rental expense payable that was treated as paid

2.19 It was disclosed in note 4 of the Financial Statements that rent and rates expense of \$1,706,601 was incurred during the period ended 31 March 2011.

2.20 The working papers show that:

- (a) \$1,706,601 comprised rental expenses of \$1,656,000 (\$36,000 + \$1,200,000 + \$420,000) and rates of \$50,601 (\$47,640 + \$2,961) for three properties, two of which were co-owned by Mr. L and some of the Company's other shareholders.
- (b) Only \$1,012,880 (comprising 5 cheques presented in September 2011 of cheque numbers 429158, 429159, 429160, 429161, 429162) out of \$1,656,000 (comprising a total of 12 cheques issued as of 31 March 2011) was settled prior to the conclusion of the audit on 11 November 2011. The remaining amount of \$643,120 included rent payable due to Mr. L of \$457,000 and was only settled in February and March 2012.

- 2.21 In respect of audit work on rental payment, it was documented that:
- (a) "27/3/2012" was the subsequent clearing date for the rent of \$444,400 marked as "L [xx]" i.e. Mr. L; and
 - (b) "*rent paid checked to BIR 57 for the year ended 31/3/3011 portion*".
- 2.22 Furthermore, the audit work on rental payment above regarding the subsequent clearing of the cheques could not have been performed at the time when the audit was concluded in November 2011 because:
- (a) a cheque cleared on 27 March 2012 was unlikely to have been issued on or before the year end date of 31 March 2011 (which would have become a stale cheque 6 months after issuance);
 - (b) clearance of the cheque on 27 March 2012 could not have been checked at the time of the audit in November 2011; and
 - (c) the returns contained in the working papers were received by the Inland Revenue Department on 19 December 2011, after the audit report date of 11 November 2011.
- 2.23 The working papers do not show sufficient audit work conducted to satisfy the Respondent that rental expenses were indeed paid before the conclusion of the audit on 11 November 2011. On the contrary, it shows that the following audit evidence was not obtained:
- (a) inspection of the stale cheque copies or stubs amounting to \$643,120 (i.e. cheques released on 30 March 2011 but were still not presented on 11 November 2011);
 - (b) recording of the stale cheque numbers;
 - (c) inspection of documents showing shareholders' receipt of the stale cheques;
 - (d) confirmation by Mr. L of receipt of his share of rental payment of \$457,000; and
 - (e) confirmation by the other shareholders of receipt of the other rental payments (confirmations returned from them showing that there was no amount due to them were only requested in June 2012, after the conclusion of the audit on 11 November 2011);
 - (f) checking subsequent settlement of \$643,120 (settlement of \$643,120 in February and March 2012 could not have been made at the time of the audit conducted in October and November 2011); and
 - (g) enquiry of the status of the rental payment in respect of the stale cheques.
- 2.24 Although incorrect classification of rental expense paid and payable does

not affect the amount of net assets of the Financial Statements, the understatement of accrued expense payable and cash and bank balance of \$643,120 is material to the Financial Statements which show that profit for the period was \$3,259,964, net assets were \$631,964, cash and bank balance was \$1,443,829 and total liabilities were \$1,171,462.

In the circumstances, the Respondent was in breach of HKSA 500 in that he failed to obtain sufficient audit evidence to agree that rental expenses of \$643,120 were paid (when in fact they were only settled almost one year subsequent to 31 March 2011).

3. The Respondent admitted the Complaint against him. He did not dispute the facts as set out in the Complaint. He agreed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.
4. Based on the evidence submitted by the parties and the Respondent's full admission of the facts substantiating the Complaint, the DC is satisfied that the Complaint is proved. The only remaining issue is the appropriate discretionary order to make in relation to the Respondent pursuant to the DC's disciplinary powers under section 35 of the PAO.
5. By a letter dated 17 September 2013 addressed to the Complainant and the Respondent, the Clerk to the Disciplinary Committee ("DC"), under the direction of the DC, informed the parties that they should make written submissions to the DC as to the sanctions and costs and that the DC would not hold a hearing on sanctions and costs unless otherwise requested by the parties.
6. In the Complainant's written submission dated 8 October 2013, the Complainant submitted that the Respondent should be reprimanded and invited the DC to consider whether imposing a "small sum of financial penalty" was warranted. The Complainant also sought an order for costs and expenses incurred in this case in the amount of HK\$25,887 and provided an annexure detailing the precise breakdown of this amount.
7. In the Respondent's written submission dated 31 October 2013, the Respondent expressed "regret for the misconduct". It was stated that while an attempt had been made to obtain the consent of all six shareholders, the error resulted because the audit was "not well supervised and documented". The Respondent noted that "no damage was done to the company and to any party" as a result of the misstatements in the financial records. He asked the DC to consider "imposing a mild sanction". The submission concluded by acknowledging the DC's discretion in imposing sanctions and contained no specific response to the Complainant's request for an order to pay costs and expenses.
8. In considering the proper orders to be made in this case, the DC has had regard to all the aforesaid matters, including the particulars in support of the Complaint, the gravity of the breaches including the fact that no one was put

at risk of economic loss, the remorse of the Respondent as evidenced by his timely admission of responsibility, the absence of any previous proven disciplinary complaints against the Respondent, and the respective positions of the parties on the issue of sanctions.

9. The DC orders that:-
 - 1) the Respondent be reprimanded under section 35(1)(b) of the PAO; and
 - 2) the Respondent do pay the costs and expenses of and incidental to the proceedings, those being the costs and expenses of the Complainant in the sum of HK\$25,887, under section 35(1)(iii) of the PAO.

Dated the 27th day of January 2014

IN THE MATTER OF

A Complaint made under section 34(1)(a) and section 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

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

Members:

ORDER

Upon reading the complaint against the Respondent, being a certified public accountant (practising), as set out in a letter from the Registrar of the Institute ("the Complainant") dated 4 June 2013, the written submission of the Complainant dated 8 October 2013, the written submission of the Respondent dated 31 October 2013, the Disciplinary Committee is satisfied by the admission of the Respondent and the evidence adduced before it that the following complaints are proved:

- 1st Complaint: Section 34(1)(a)(vi) of the PAO applies to the Respondent in that the Respondent failed or neglected to observe, maintain or otherwise apply professional standards, namely, HKSA 250 as a result of his failure to obtain, in respect of the relevant financial statements, sufficient audit evidence regarding the Company's compliance with SME-FRF and s141D of the Companies Ordinance in order to adopt SME-FRS in its preparation of the financial statements.
- 2nd Complaint: Section 34(1)(a)(vi) of the PAO applies to the Respondent in that the Respondent, failed or neglected to observe, maintain or otherwise apply professional standards, namely, HKSA 500 as a result of his failure to obtain sufficient audit evidence in respect of

the understatement of liabilities and dividend payable and/or rental expense payable that were incorrectly treated as payments already made in the relevant financial statements.

IT IS ORDERED that:-

1. the Respondent be reprimanded under section 35(1)(b) of the PAO; and
2. the Respondent do pay the costs and expenses of and incidental to the proceedings, those being the costs and expenses of the Complainant in the sum of HK\$25,887, under section 35(1)(iii) of the PAO.

Dated the 27th day of January 2014

