Proceedings No.: D-13-0800F

IN THE MATTER OF

A Complaint made under Section 34(1)(a) and 34(1A) of the Professional Accountants Ordinance (Cap.50) (the "**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

The 1st Respondent	FIRST RESPONDENT
The 2nd Respondent	SECOND RESPONDENT

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

Members:

ORDER & REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the "**Institute**") against The 1st Respondent , a certified public accountant as the First Respondent; and The 2nd Respondent , a corporate practice. Section 34(1)(a)(vi) of the PAO applied to the Respondents.

2. The particulars of the Complaint as set out in a letter dated 27 June 2014 (the "**Complaint**") from the Registrar to the Council of the Institute for consideration of referring the Complaint to the Disciplinary Panels, are as follows:-

BACKGROUND

(1) China Water Industry Group Limited (the "**Company**") is incorporated in the Cayman Islands and its shares are listed on the Main Board (Stock Code: 01129) of The Stock Exchange of Hong Kong Limited.

(2) The financial statements for the Company and its subsidiaries (the "**Group**") for the years ended 31 December 2008 (the "2008 Financial Statements") and 2009 (the "**2009 Financial Statements**") were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants .

(3) The 2nd Respondent audited the 2008 and the 2009 Financial Statements. The 2nd Respondent 's audit reports for the 2008 and 2009 Financial Statements (signed and dated 27 April 2009 and 28 April 2010, respectively), stated that the audits were conducted in accordance with the Hong Kong Standards on Auditing. The 1st Respondent was stated to be the director responsible for the performance of the audit engagements.

(4) The consolidated profit / (loss) of the Group stated in the 2008 and 2009 Financial Statements was HK$58.8 million and HK$(342.5) million, respectively. The consolidated net assets of the Group stated in the 2008 and 2009 Financial Statements were HK$710.9 million and HK$1,343.5 million respectively.

(5) The 2nd Respondent expressed an unmodified opinion on the 2008 Financial Statements. In respect of the 2009 Financial Statements, the 2nd Respondent disclaimed its opinion on the basis that the fundamental uncertainty relating to the adoption of the going concern basis in preparing the 2009 Financial Statements was significant.

(6) The Institute's Professional Standards Monitoring Panel had identified possible auditing irregularities in the 2008 Financial Statements in relation to the non-recognition of impairment losses on certain available-for-sale investments that had been carried at fair values based on their quoted market prices, which were significantly below their costs.

(7) In February 2012, the Council of the Institute, in accordance with the Memorandum of Understanding between the Financial Reporting Council ("**FRC**") and the Institute remitted the matter to the FRC for its further investigation.

(8) Having considered all the information before it, the FRC, on 23 March 2012, directed the Audit Investigation Board ("**AIB**") in accordance with section 23(3)(b) of the FRC Ordinance, to investigate the possible auditing irregularity and the question of whether or not there is such an irregularity in relation to The 2nd Respondent 's audit of the 2008 Financial Statements and the 2009 Financial Statements in respect of the recognition of impairment losses on available-for-sale investments in the 2008 Financial Statements and the

recognition of gains and losses on disposal of available-for-sale investments in the 2009 Financial Statements, respectively.

(9) On 18 September 2012, the AIB sent its draft investigation report to The 2nd Respondent for its comments. The 2nd Respondent 's response contained in a letter dated 11 December 2012 from King & Wood Mallesons ("**KWM**"), lawyers engaged to represent The 2nd Respondent in the AIB's investigations, was included in the AIB's investigation report (the "Investigation Report") that was adopted by the FRC on 7 March 2013.

(10) On 11 March 2013, the FRC referred the Investigation Report together with annexures to the Institute pursuant to section 9(f) of the FRC Ordinance.

(11) In making the referral, the FRC considered that The 2nd Respondent had failed or neglected to observe, maintain or otherwise apply professional standards under section 34(1)(a)(vi) of the Professional Accountants Ordinance, Cap 50 (the "PAO").

SUMMARY OF PRINCIPAL ISSUES

(12) The principal issues relate to The 2nd Respondent 's concurrence of the Group's decision not to treat a significant decline in the fair values below their costs of the Group's investments in two quoted equity instruments, measured by reference to their published prices in an active market as objective evidence of impairment, in the 2008 Financial Statements. The cumulative decline in fair values of the subject investments, totalling HK$71.7 million, had been recognised in equity and was not removed to be recognised in profit or loss in the 2008 Financial Statements.

(13) Paragraph 67 of the then Hong Kong Accounting Standard 39 Financial Instruments: Recognition and Measurement (December 2008) ("**HKAS 39**") requires that when there exists objective evidence of impairment, any cumulative loss that had been recognised directly in equity should be removed from equity and recognised in profit or loss even though the financial asset had not been derecognised.

(14) Had the impairment losses been recognised in accordance with HKAS 39.67 in the 2008 Financial Statements, the stated profit of HK$58.8 million would have had to change to a loss of HK$12.9 million.

(15) The principal issues are explained in the AIB Report, which should be referred to for full details. The issues and evidence will be further addressed in the Complainant's Case to be filed pursuant to the Disciplinary Committee Proceedings Rules.

(16) The Respondents' audit documentation was not sufficient to enable an experienced auditor to understand the results of the audit procedures and the audit evidence obtained. The deficiencies in the working papers of the Respondents included:

(a) Draft valuation report on which the Respondents relied to conclude that the intrinsic values of the available-for-sale financial assets were close to the purchase cost per share had been neither signed nor dated ;

(b) Working papers indicated Respondents' acceptance that the intrinsic value of an investee dropped "while there was no major change in the management and operation of the subject company"; however, they failed to document how they came to this conclusion given the disposal of a business segment and resignation of the chairman.

(c) Respondents failed to document how they considered potentially unfavorable operation information about one of the investees in determining that the decline in fair value was a result of the global financial crisis.

THE COMPLAINT

(17) Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they have failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 2 and/or 9 and/or 18 of Hong Kong Standard on Auditing 230 Audit Documentation (Issued February 2006) in that they failed to prepare audit documentation that provides a sufficient and appropriate record of the objective analysis undertaken to support the basis of their concurrence with the Group's accounting treatment of the impairment losses of HK$71.7 million recorded in the Group's investment revaluation reserves.

3. The Respondents admitted the Complaint against them. They did not dispute the facts as set out in the Complaint. On 22 July 2014, the parties agreed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.

4. On 7 November 2014, the Disciplinary Committee informed the parties that they should make written submissions to the Disciplinary Committee on sanctions and costs.

5. 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 Respondent's personal circumstances, and the conduct of the parties throughout the proceedings.

6. The Disciplinary Committee orders that:-

(1) Both the First and Second Respondent be reprimanded under Section 35(1)(b) of the PAO;

(2) the Respondents do pay a penalty of HK$35,000 under Section 35(1)(c) of the PAO. The penalty shall be shared by the Respondents equally; and

(3) the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant and the Financial Reporting Council in the total sum of HK$45,628 and HK$84,066.80 under section 35(1)(iii) and section 35(1)(d)(ii) of the PAO respectively. The costs and expenses shall be shared equally by the Respondents.

Dated the 6th day of January 2015