

January 1997 to 1999, failed or neglected to apply certain applicable professional standards within the meaning of section 34(1)(a)(vi) of the PAO, the Financial Reporting Council referred the matter to the Council of the HKICPA.

4. The particulars of the complaint are set out in a letter from the Complainant dated 28 November 2013 ("**the Complaint**") to the Council to the HKICPA.
5. On 27 October 2014, the Disciplinary Committee (the "**Committee**") approved the parties' joint application by letter dated 9 October 2014 to consolidate the complaints set out in the Complaint into the First to Fourth Amended Complaints set out in the Representative of the Complainant's letter dated 30 September 2014 to the Clerk of this Committee ("**the Amended Complaint**").
6. The Amended Complaint relates to the audits of the accounts of A Group and are summarised as follows:

First Amended Complaint

- (a) In respect of the audit of the accounts of the A Group for the years ended 31 January 1997, 31 January 1998 and 31 January 1999, section 34(1)(a)(vi) of the PAO applies to each of the Respondents in that:
 - i) as regards for the year ended 31 January 1997, each of the Respondents failed or neglected to observe, maintain or otherwise apply Paragraph 7 of Statement 3.101 by failing to obtain relevant and reliable audit evidence sufficient to enable it/he to draw reasonable conclusions; and
 - ii) as regards the years ended 31 January 1998 and/or 31 January 1999, each of the Respondents failed or neglected to observe, maintain or otherwise apply Paragraph 2 of SAS 400 by failing to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base it/his audit opinion.

Second Amended Complaint

- (b) In respect of the audit of the accounts of the A Group for the years ended 31 January 1997, 31 January 1998 and 31 January 1999, section 34(1)(a)(vi) of the PAO applies to each of the Respondents in that:
- i) as regards the year ended 31 January 1997, it/he failed or neglected to observe, maintain or otherwise apply Paragraph 4 of Statement 3.101 by failing to adequately record its/his work; and
 - ii) as regards the years ended 31 January 1998 and 31 January 1999, it/he failed or neglected to observe, maintain or otherwise apply paragraphs 2, 5, and/or 6 of SAS 230 by failing to document matters which were important in providing evidence to support the audit opinion, to prepare working papers which were sufficiently complete and detailed to provide an overall understanding of the audit to another experienced auditor, and to record in working papers the planning, nature, timing and extent of the audit procedures performed, the results thereof, and the conclusions drawn from the audit evidence.

Third Amended Complaint

- (c) In respect of the audit of the accounts of the A Group for the years ended 31 January 1997, 31 January 1998 and 31 January 1999, section 34(1)(a)(vi) of the PAO applies to each of the Respondents in that:
- i) as regards the year ended 31 January 1997, it/he failed or neglected to observe, maintain or otherwise apply Paragraph 4 of Statement 3.101 by failing to adequately plan its/his work; and
 - ii) as regards the years ended 31 January 1998 and/or 31 January 1999, it/he failed or neglected to observe, maintain or otherwise apply Paragraph 2 of SAS 200 by failing to plan the audit work

so that the audit would be performed in an effective manner.

Fourth Amended Complaint

- (d) In respect of the audit of the accounts of the A Group for the years ended 31 January 1997, 31 January 1998 and/or 31 January 1999, section 34(1)(a)(vi) of the PAO applies to each of the Respondents in that each of the Respondents failed or neglected to observe, maintain or otherwise apply Paragraph 2 of Statement 1.200 by failing to carry out it/his professional work with a proper regard for the technical and professional standards expected of it/him as a member of the Hong Kong Society of Accountants (as the Institute then was).
7. Each of the Respondents' has admitted (a) the Amended Complaint and (b) the facts set out in the Respondents' Admitted Facts dated 30 September 2014 ("**the Admitted Facts**"). The relevant Admitted Facts are as follows:
- (a) Company A was incorporated in Bermuda and listed on the main board of The Stock Exchange of Hong Kong Limited. Company A was placed into provisional liquidation in Hong Kong on 23 August 2000 and in Bermuda on 29 September 2000. Subsequently Company A was placed in liquidation.
- (b) The accounts of the A Group for the years ended 31 January 1997, 1998 and 1999 were stated to be prepared in accordance with accounting principles generally accepted in Hong Kong. The 1st Respondent was the auditor of the accounts. The 1st Respondent's auditors reports stated that the audits were conducted in accordance with the Statements of Auditing Standards issued by the HKICPA (formerly the Hong Kong Society of Accountants). The audit opinions expressed by the 1st Respondent on the accounts for those years were unqualified.
- (c) The 2nd Respondent was the Engagement Partner for the 1997, 1998 and 1999 audits.

- (d) The 3rd Respondent joined the Company A audit team as a senior manager in or around 1992. He then became the Engagement Principal for the 1994 -1997 audits and the Second Partner for the 1998 and 1999 audits. The number of hours recorded by the 3rd Respondent to the Company A audits in 1997, 1998 and 1999 were, respectively, 412 hours, 343 hours and 273 hours.

Audit Area 1 ("Japanese Land")

- (e) Included in the accounts of 1997, 1998 and 1999 as "land and buildings" was an item said to be parcels of land located in Japan valued at US\$121 million ("**Japanese Land**"), which comprised two consolidation journal entries made in a prior year by (i) reclassifying a long-standing entry from "investment in land interests" to "land" and (ii) making a debit to fixed assets and a credit to reserves. However, there was no sufficient documentation in relation to Company A's basis of the prior year consolidation entry of debiting land and crediting reserves. There was not sufficient audit evidence or documentation to ascertain that A Group was the legal owner of those pieces of land, or had beneficial interest in the Japanese Land. The Respondents concurred with Company A that the Japanese Land to be treated as "land and buildings" in those accounts despite not having sufficient evidence or documentation to substantiate such categorization. There was also not sufficient audit evidence for the Respondents' concurrence with Company A's non-disclosure of additional information in the notes to the accounts for 1997, 1998 and 1999 to explain the nature of the beneficial interest in the Japanese Land.
- (f) Further, despite having an independent professional valuation valuing the carrying amount of the Japanese Land having been reduced as at 31 January 1998, the Respondents concurred with Company A for not making any adjustments to its accounts for the year ended 31 January 1998.

Audit Area 2 ("The German Land")

- (g) Another item included in the accounts for 1997, 1998 and 1999 as

"land and buildings" was an item said to be parcels of land located in Germany with an aggregate value of US\$80 million that the A Group purportedly acquired when they acquired one of its subsidiary companies ("**The German Land**"). In fact some of parcels of land that formed The German Land had already been sold by a company not belonged to A Group prior to 1997. The Respondents concurred with Company A such treatment to be included into the accounts despite:

- i) not having sufficient audit evidence and documentation to ascertain the legal title or beneficial interest of The German Land; and
- ii) not having sufficient audit evidence to recognize The German Land as "lands and buildings".

There was also not sufficient audit evidence for the Respondents' concurrence with Company A's 's non-disclosure of additional information in the notes to the accounts for 1997, 1998 and 1999 to explain the nature of the beneficial interest in The German Land.

- (h) The Respondents also failed to plan the audit adequately and thereafter failed to document adequately the procedures performed in relation to the tracing of the ownership of The German Land.

Audit Area 3 (General ledger review / Bank balance confirmation procedures / 26 Late Adjustments)

- (i) In the years 1997, 1998 and 1999, Company A had a number of accounts that had a nil balance as at 31 January 1997, 1998 and 1999. However, if scrutinized, the Respondents should have discovered that those accounts had significant movements during the year and those movements ought to have been investigated. The Respondents did not investigate those movements, nor did the Respondents devise a proper audit plan to detect those movements.
- (j) In the years 1997, 1998 and 1999, Company A had a number of

bank accounts that had a nil balance as at 31 January 1997, 1998 and 1999. There was no documentation on the commercial reasons behind not closing down those bank accounts with zero year-end balances, especially those with a zero year-end balance for two consecutive years, nor was there any documentation on the reasons for no further testing of those bank accounts, such as sending bank balance confirmation.

- (k) For the year ended 31 January 1997, the auditor of a sub-group of A Group expressed qualified opinion on Company A reporting package which had incorporated 26 Late Adjustments. The 26 Late Adjustments mainly related to two advances from the sub-group to A Group of approximately HK\$84 million and HK\$122 million which the remittance had been done without instructions. The Respondent failed to obtain sufficient audit evidence to verify the nature and validity of the 26 Late Adjustments, and was there insufficient documentation of the evidence obtained and procedure performed in relation to the 26 Late Adjustments.

Audit Planning

- (l) The planning of the audits for 1997, 1998 and 1999 was inadequate as the Respondents did not sufficiently address the risks associated with the nature of the interests in the German and Japanese Lands and with the special treasury function of Company A .

Audits in general

- (m) The Respondents have also failed to, or did not sufficiently carry out its/his professional work with a proper regards for the technical and professional standards expected of it/him as a member of the HKICPA in respect of those accounts.
8. On 27 October 2014, the Committee agreed to dispense with further written submissions and the hearing on the substantive allegations in light of the admissions made by the Respondents and the Admitted Facts.

9. On 18 December 2014, the Committee was invited by the parties to direct the Respondents to pay a sum of HK\$1,351,071 to the Complainant pursuant to s.35 PAO on the basis that it reflects the costs of the Complainant, the costs of the AIB's investigation, the costs of the Clerk and disbursements. The Committee agrees to the parties' assessment and orders accordingly.
10. The only issue remains to be dealt with by the Committee is the question of Sanction. On sanction, the parties have filed written submissions and have indicated that they are content to deal with the issue of sanction on paper without a hearing. We have considered the facts as set out in the Admitted Facts, all the submissions and authorities submitted by the parties, in particular the following:

1st, 2nd & 3rd Respondents

- (a) The present case does not involve dishonesty or deliberate misconduct on the part of the Respondents. In fact, the Respondents argue that the auditing of Company A was considerably more challenging at the time because internal control were overridden to perpetrate a fraud that was participated by the most senior members of Company A's s management. However, in our view, it is precisely because of the potential for such dishonest activities by management that compliance with proper auditing procedures in auditing the accounts of companies is so important, particularly in the context of public companies: see *D-03-IC17H ("Global Trend Case")*.
- (b) Moreover, this case involves breaches of auditing standards in the course of performing critical, core auditing procedures, and many of these fundamental errors continued for **an extended period** of time.
- (c) Non-compliance with professional standards on listed company's financial statements concerns broader public interest and the sanction should provide a more effective deterrent against such deficiencies for the purpose of enhancing and preserving Hong Kong's position as an international financial centre: see *Case No.*

D-99-IC-08-X and Global Trend Case.

- (d) We accept that the Respondents were cooperative with the investigation of the FRC and have treated the present complaint and disciplinary procedures seriously. Moreover, the Respondents admitted to the Amended Complaints. Although the admissions were not made at the earliest opportunity, we take the view that time and expenses have been saved by their admissions.
- (e) Although we have jurisdiction to penalise the Respondents separately for each charge, we take the view that the charges are not separate and distinct to warrant such treatment.

1st Respondent

- (f) The 1st Respondent does not have a clean record. In the most recent case, the 1st Respondent was reprimanded, fined HK\$150,000 and ordered to pay costs of HK\$2 million.

2nd Respondent

- (g) The 2nd Respondent was first registered with the HKICPA in 1976; he became a fellow member in 1984 and was first issued a practising certificate on 20 May 1986. He is currently a retired member of the HKICPA.
- (h) The 2nd Respondent was the Engagement Partner for the audits of A Group accounts from 1992 to 1999. The Engagement Partner is the senior member of the audit team and is ultimately responsible for ensuring the audits had been performed adequately. He is involved in planning the audit, considering important audit issues and approving the final Senior Review Memorandum. He is the person who signs the audit opinion on behalf of the 1st Respondent.
- (i) That the Second Respondent has an unblemished disciplinary record for the years he was registered as a certified public accountant.

3rd Respondent

- (j) The 3rd Respondent is currently a practising member of the HKICPA and a partner of the 1st Respondent. He was first registered as a HKICPA member in 1988 and issued with a practising certificate on 17 February 1998.
- (k) The 3rd Respondent joined the Company A audit team as a Senior Manager in 1992; was the Engagement Principal for the 1994 - 1997 audits and the Second Partner during the 1998 and 1999 Audits.
- (l) It is evident from the 1st Respondent's billing on the 3rd Respondent's hours spent in the Company A audits for the years in question that the 3rd Respondent was heavily involved in those audits. We take the view that being a member of the HKICPA and involved in the Company A audits as a member of the HKICPA, the 3rd Respondent's duty towards adhering to the professional standards and auditing standards as laid down by the HKICPA are separate and distinct from that of other members (albeit senior or otherwise) in the audit team. Hence, we do not accept that the 3rd Respondent should not be sanctioned simply because he was not the Engagement Partner for the audits in question, or that he was merely the engagement principal in the 1997 Audit and the Second Partner in the 1998 and 1999 Audits.
- (m) Moreover, the 3rd Respondent does not have a clean disciplinary record. In the *Global Trend Case*, the 3rd Respondent was reprimanded, fined HK\$35,000 and ordered to pay costs of HK\$550,000.

11. Accordingly, in relation to all the charges, we hereby order that:

- (a) The Respondents be reprimanded;
- (b) The 1st Respondent be fined HK\$200,000
- (c) The 2nd Respondent be fined HK\$100,000;
- (d) The 3rd Respondent be fined HK\$100,000; and
- (e) The Respondents do pay a sum of HK\$1,351,071 to the Complainant pursuant to s.35 PAO as costs for the present

proceedings.

Dated the 10th day of April 2015