

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

The Respondent

RESPONDENT

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 29 August 2014 (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:-

BACKGROUND

- a. The Respondent is the sole proprietor of a Firm
- b. On 30 March 2011, the Firm issued an auditor’s report on the financial statements of W Limited (the “Company”) for the year ended 31 March 2010 (the “Financial Statements”). The Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards (the “HKFRS”) for Private Entities and requirements of the Hong Kong Companies Ordinance (the “CO”)¹.
- c. The auditor’s report stated that the Financial Statements give a true and fair view of the state of the Company’s affairs as at 31 March 2010 and of its loss and cash

¹ Predecessor Hong Kong Companies Ordinance (Cap. 32)

flows for the year then ended in accordance with HKFRS for Private Entities and have been properly prepared in accordance with the CO.

RELEVANT PROFESSIONAL STANDARDS

3. The HKFRS for Private Entities provides the following:
- “2.20 An essential characteristic to a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a constructive obligation...”
 - “2.39 An entity shall recognize a liability in the statement of financial position when (a) the entity has an obligation at the end of the reporting period as a result of a past event, (b) it is probable that the entity will be required to transfer resources embodying economic benefits in settlement, and (c) the settlement amount can be measured reliably.”
 - “33.2 A related party is a person or entity that is related to the entity that is preparing its financial statements (the reporting entity). (a) A person or a close member of that person’s family is related to a reporting entity if that person: (i) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity...”
 - “33.9 If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions...”
4. The Hong Kong Standards on Auditing (the “HKSA”) 700 - *Forming An Opinion And Reporting On Financial Statements* further states:
- “10 The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.”
 - “11 In order to form that Opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account (b) the auditor's conclusion, in accordance with HKSA 450, whether uncorrected misstatements are material, individually or in aggregate”
 - “12 The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.”
 - “17 If the auditor (b) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report in accordance with HKSA 705.”

THE COMPLAINT

5. 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 10, 11, 12 and/or 17 of HKSA 700 for failure to form an appropriate audit opinion in respect of the Company's material misstatement on bank borrowings and related party transactions in the Financial Statements.

FACTS AND CIRCUMSTANCES IN SUPPORT OF THE COMPLAINT

6. The Firm's working papers included an audit confirmation issued by Nanyang Commercial Bank (the "NCB") indicating that the Company had six outstanding loans drawn from the bank as of 31 March 2010. However, the Financial Statements only reported two out of six of the NCB bank loans.
7. According to the Firm's working papers, the year end balances of the four bank loans from NCB (the "Four Bank Loans") which were not reported in the Financial Statements are listed below.

<u>Outstanding balance at year end (HK\$)</u>	
Loan 1	1,403,680.17
Loan 2	1,510,740.51
Loan 3	1,546,427.27
Loan 4	731,557.23
<hr style="border-top: 1px solid black;"/> Total	<hr style="border-top: 1px solid black;"/> 5,192,405.18

8. The balances had been verified by relevant bank audit confirmations. The Four Bank Loans were secured by mortgaged properties.
9. The working papers documented the names of the individual beneficiary owners of the mortgaged properties which were verified to the Land Registry records. These individual owners included the Company's director and his family members.
10. The working papers clearly indicated that the Firm is aware of the Four Bank Loans not being reported in the Financial Statements.
11. The Four Bank Loans are material to the Financial Statements as the aggregate loan balance of HK\$5,192,405 exceeds the Company's total assets and net assets of HK\$3,961,567 and HK\$479,999, respectively.
12. The Four Bank Loans were drawn under the Company's name and accordingly, the Company had obligations to repay these loans. As such, the Four Bank Loans should be reported in the Financial Statements as liabilities in accordance with section 2 of the HKFRS for Private Entities.
13. The Four Bank Loans are then lent to the director and his family members for financing of their properties. A director is key management personnel and his family members are "related parties" as defined in section 33 of the HKFRS for Private Entities.

14. Under section 161B of the CO², loans to directors of a company and persons who are connected to a director of a company should be disclosed in the Financial Statements. Therefore, the Four Bank Loans should be disclosed in the Financial Statements in accordance with section 33 of the HKFRS for Private Entities and section 161B of the CO.

DECISION OF THIS COMMITTEE

15. Based on the above, the Financial Statements contained incorrect amounts and material non-compliance with HKFRS for Private Entities and the CO. The auditors did not obtain reasonable assurance that the Financial Statements as a whole are free of material misstatement.
16. Had the Firm appropriately evaluated the conclusions drawn from the audit evidence obtained relating to the Four Bank Loans, it should come to the conclusion that the Financial Statements had not been prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework and were not free of material misstatements. Accordingly, the Firm should have modified its opinion in respect of the Company's failure to report the Four Bank Loans, in accordance with paragraphs 10, 11, 12 and/or 17 of HKSA 700.
17. In the circumstances, section 34(1)(a)(vi) of the PAO applies to the Respondent.
18. By a signed confirmation dated 24 September 2014, the Respondent admitted the Complaint against him. He did not dispute the facts as set out in the Complaint. The parties had also 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.
19. On 4 June 2015, 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.
20. Undoubtedly, the breach committed by the Respondent is very serious. In his letter to the Institute dated 11 August 2014, the Respondent submitted, inter alia, that due to his focus "*on the real intention and usage of the concerned mortgage loans, and also the agreement made between the shareholders for the accounting of these loans while neglecting the formal contractual relationship between the bank and the Company. In this regards, I might make a misjudgment on these accounting treatment and in consequence, leading to the non-compliance with the relevant Professional Standards and failure for modifying the audit opinion*". The Disciplinary Committee is of the view that none of the above constitutes an acceptable mitigating factor.
21. However, the Disciplinary Committee accepted a 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.

SANCTIONS AND ORDER

² Section 161B of the predecessor Hong Kong Companies Ordinance (Cap. 32)

22. 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, the parties' submissions on sanctions and costs and their conduct throughout the proceedings.
23. In relation to costs, the Disciplinary Committee considers that the costs and expenses totalling HK\$19,437 as assessed in the Complainant's Statement of Costs dated 23 June 2015 are reasonable and therefore should be allowed.
24. 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\$50,000 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\$19,437 under section 35(1)(iii) of the PAO.

Dated the 21st day of September 2015

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 COMPLAINANT
Institute of Certified Public
Accountants

AND

The Respondent RESPONDENT

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 29 August 2014, the written submissions of the Complainant dated 23 June 2015 and the Respondent dated 15 June 2015, 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 Respondent in that he failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 10, 11, 12 and/or 17 of Hong Kong Standard of Auditing 700 for failure to form an appropriate audit opinion in respect of World Hope Development Limited in the financial statements for the year ended 31 March 2010.

1. 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\$50,000 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\$ HK\$19,437 under section 35(1)(iii) of the PAO.

Dated the 21st day of September 2015