

IN THE MATTER OF

A Complaint made under section 34(1)(a) of the Professional Accountants Ordinance (Cap. 50) ("PAO")

BETWEEN

The Registrar of the Hong Kong Institute of
Certified Public Accountants

COMPLAINANT

AND

Choi Man Chau, Michael (F01453) 1st RESPONDENT
Chan Kin Wai (A24477) 2nd RESPONDENT
Pan China (HK) CPA Limited (M268) 3rd RESPONDENT

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

Members: Miss CHAN, Nancy (Chairman)
Mr. KAN Siu Lun
Mr. KWONG, Chi Ho, Cecil
Mr. CHOW, Tak Sing, Peter
Mr. WARDELL, James

ORDER

Upon reading the complaint against Mr. Choi Man Chau, Michael, a certified public accountant (practising) ("Choi") as the 1st Respondent, Mr. Chan Kin Wai, a certified public accountant (practising) ("Chan") as the 2nd Respondent, and Pan China (HK) CPA Limited, a corporate practice ("Pan China") as the 3rd Respondent, as set out in a letter from the Registrar of the Institute ("the Complainant") dated 25 June 2015, the written submission of the Respondents dated 15 October 2015 and 26 October 2015, the written submission of the Complainant dated 27 October 2015, and other relevant documents, the Disciplinary Committee is satisfied by the admission of the Respondents and the evidence adduced before it that the following complaints are proved:

1. Section 34(1)(a)(vi) of the PAO applies to Pan China and Choi in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraphs 8 and 9 of HKSA 500 in their impairment assessment of the Aleinuer Mine and Xinjiang Mine.

2. Section 34(1)(a)(vi) of the PAO applies to Pan China and Choi in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraph 8 of the HKSA 230 as a result of their failure to prepare any or any adequate audit documentation regarding their discussions with the management in the impairment assessment of the Aleinuer Mine and Xinjiang Mine.
3. Section 34(1)(a)(vi) of the PAO applies to Chan in that he failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraphs 20 and 21 of the HKSA 220 as a result of his failure to identify the audit deficiencies in the impairment assessment of the Aleinuer Mine and Xinjiang Mine when acting as the EQCR for the audit.
4. Section 34(1)(a)(vi) of the PAO applies to Choi and Chan in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraphs 100.5(c) and 130.1 of the COE as a result of their failure to maintain professional knowledge or skill and/or to act diligently when acting as the engagement director and EQCR respectively in the audit of the Company for the year ended 31 December 2010.

IT IS ORDERED that:-

1. the Respondents be reprimanded under section 35(1)(b) of the PAO;
2. each of the 1st and 2nd Respondents pay a penalty of HK\$12,000 under section 35(1)(c) of the PAO and the 3rd Respondent pay a penalty of HK\$50,000 under section 35(1)(c) of the PAO; and
6. 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\$83,215.60 under section 35(1)(iii) and section 35(1)(d)(ii) of the PAO. The costs and expenses shall be shared equally by the Respondents.

Dated the 21st day of December 2015

IN THE MATTER OF

A Complaint made under section 34(1)(a) of the Professional Accountants Ordinance (Cap. 50) ("PAO")

BETWEEN

The Registrar of the Hong Kong Institute of Certified Public Accountants COMPLAINANT

AND

Choi Man Chau, Michael (F01453) 1st RESPONDENT
Chan Kin Wai (A24477) 2nd RESPONDENT
Pan China (HK) CPA Limited (M268) 3rd RESPONDENT

Members: Miss CHAN, Nancy (Chairman)
 Mr. KAN Siu Lun
 Mr. KWONG, Chi Ho, Cecil
 Mr. CHOW, Tak Sing, Peter
 Mr. WARDELL, James

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 Mr. Choi Man Chau, Michael, a certified public accountant (practising) ("Choi") as the 1st Respondent, Mr. Chan Kin Wai, a certified public accountant (practising) ("Chan") as the 2nd Respondent, and Pan China (HK) CPA Limited, a corporate practice ("Pan China") as the 3rd Respondent. 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 25 June 2015 ("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) China Daye Non-Ferrous Metals Mining Limited ("**Company**") and its subsidiaries is a group listed on the Hong Kong Stock Exchange (Stock Code: 00661) ("**Group**"). The Group was principally engaged in corporate investment and trading in securities, minerals exploitation and

trading in non-ferrous metals. The audited financial statements of the Company for the year ended 31 December 2010 ("**2010 Financial Statements**") were prepared in accordance with Hong Kong Financial Reporting Standards.

- (2) Pan China was the auditor of the Company for the financial year in question, and they expressed an unmodified audit opinion on the 2010 Financial Statements. The auditor's report stated that the audit was conducted in accordance with Hong Kong Standards on Auditing.
- (3) Choi, a former practising director of Pan China, was the engagement director and signed the auditor's report in the name of Pan China on 29 March 2011 on the 2010 Financial Statements.
- (4) Chan, a practising director of Pan China, was the engagement quality control reviewer ("**EQCR**") for the audit.
- (5) The 2010 Financial Statements show that the Company's major assets included mining rights of HK\$2,156 million (2009: HK\$2,142 million), representing 107% (2009: 109%) of the Company's net assets.
- (6) Note 17 *Mining Rights* in the 2010 Financial Statements and prior periods' financial statements of the Company states,

17. MINING RIGHTS	As at 31 Dec 2010 HK\$'000	As at 31 Dec 2009 HK\$'000	As at 30 Apr 2009 HK\$'000	As at 30 Apr 2008 HK\$'000
Cost/ Carrying amount:				
At the beginning of the year	2,142,547	2,055,140	2,488,859	-
Additions	-	-	-	2,488,859
Impairment loss (provided) / written back	<u>14,038</u>	<u>87,407</u>	<u>(433,719)</u>	<u>-</u>
Balance at the end of the year	<u>2,156,585</u>	<u>2,142,547</u>	<u>2,055,140</u>	<u>2,488,859</u>

No amortisation was provided during the year/period as the Group has not yet commenced the exploitation of the ores.

- (7) Note 5(b) to the 2010 Financial Statements states,

"The Group determines whether an asset is impaired at least on an annual basis or where an indication of impairment exists. This requires an estimation of the value in use of the asset. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the assets and also to choose a suitable discount rate in order to calculate the present value of those cash flows."

- (8) The Company acquired two mining rights during the financial year ended 30 April 2008 at a fair value of \$2,488 million:

- (a) Aleinuer Mine (a molybdenum mine in Mongolia) ("**Aleinuer Mine**"); and
- (b) Xinjiang Mine (a copper mine in Xinjiang) ("**Xinjiang Mine**")
- (9) In the circulars issued by the Company to shareholders during the acquisition of the two mining rights in June 2007 and January 2008, the Company announced that:
- (a) *"It is expected that the commercial operation of the [Aleinuer Mine] will commence in mid 2009 following the completion of the construction of the mining facilities....."; and*
- (b) *"It is expected that first phase of the mining and processing facilities of the [Xinjiang Mine]..... will commence commercial operation by 2009."*
- (10) In the 2010 Financial Statements, the carrying amounts of the Aleinuer Mine and Xinjiang Mine were \$723.8 million and \$1,432.7 million respectively, representing 36% and 71% of the Group's net assets as at 31 December 2010 (note 17, 2010 Financial Statements).
- (11) For the year ended 31 December 2011, note 17 to the financial statements disclosed that due to the legal proceedings concerning the Aleinuer Mine and the actual circumstances concerning the mine, the Company made a full impairment provision of HK\$723.8 million against the Aleinuer Mine. The loss for the year 2011 amounted to HK\$669 million.

17. MINING RIGHTS	As at 31 Dec 2011 HK\$'000	As at 31 Dec 2010 HK\$'000
Cost/ Carrying amount:		
At the beginning of the year	2,156,585	2,142,547
Impairment loss (provided) / written back	<u>(723,838)</u>	<u>14,038</u>
Balance at the end of the year	<u>1,432,747</u>	<u>2,156,585</u>
No amortisation was provided during the year/period as the Group has not yet commenced the exploitation of the ores		

- (12) On 12 November 2014, the Financial Reporting Council referred the matter to the Institute enclosing a Report of the Audit Investigation Board dated 1 September 2014 pursuant to section 9(f) of the Financial Reporting Council Ordinance, Cap 588 (the "**AIB Report**").

Relevant Professional Standards

- (13) Paragraphs 8, 9 and A48 of Hong Kong Standard on Auditing 500 *Audit Evidence* ("**HKSA 500**") states,

8. If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (Ref: Para. A34 A36)

(a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37 A43)

(b) Obtain an understanding of the work of that expert; and (Ref Para. A44-A47)

(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. 448)

9. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary in the circumstances:

(a) Obtaining audit evidence about the accuracy and completeness of the information; and (Ref Para. A49-A50)

(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)

A48. Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

- The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;*
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and*
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.*

- (14) Paragraph 20 and 21 of Hong Kong Standard on Auditing 220 *Quality Control for an Audit of Financial Statements* ("**HKSA 220**") states,

20. The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:

(a) Discussion of significant matters with the engagement partner;

(b) Review of the financial statements and the proposed auditor's report;

(c) Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and

(d) Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: Para. A26-A27, A29-A31)

21. For audits of financial statements of listed entities, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

- (a) The engagement team's evaluation of the firm's independence in relation to the audit engagement;*
- (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and*
- (c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached. (Ref: Para. A28-A31)*

- (15) Sections 100.5(c) and 130.1 of the *Code of Ethics for Professional Accountants ("COE ")* states,

100.5 A professional accountant shall comply with the following fundamental principles:

.....

(c) Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

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

- (a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and*
- (b) To act diligently in accordance with applicable technical and professional standards when performing professional activities or providing professional services.*

- (16) Paragraph 8 of Hong Kong Standard on Auditing 230 *Audit Documentation ("HKSA 230")* states,

8. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2-A5, A16-A17)

- (a) The nature, timing, and extent of the audit procedures performed to comply with the HKSAs and applicable legal and regulatory requirements; (Ref: Para. A6-A7)*
- (b) The results of the audit procedures performed, and the audit evidence obtained; and*

(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8-A11)

Complaint 1

- (17) Section 34(1)(a)(vi) applies to Pan China and Choi in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraphs 8 and 9 of HKSA 500 in their impairment assessment of the Aleinuer Mine and Xinjiang Mine.

Facts and Circumstances in support of Complaint 1

- (18) The Company engaged a valuer ("**Valuer**") to provide an opinion on the fair value of the Aleinuer Mine and Xinjiang Mine as at 31 December 2010 ("**Valuation Reports**"). The Valuation Reports were prepared with reference to feasibility study reports prepared in 2006 and 2008 respectively ("**Feasibility Study Reports**").
- (19) Pan China considered that the valuation approach was "reasonable" and the values of the Aleinuer Mine and Xinjiang Mine as at 31 December 2010 were "fairly stated". However they failed to consider or consider adequately the following factors or apparent deficiencies in the valuation.
- (20) As the Feasibility Study Reports were prepared back in 2006 and 2008, the Respondents failed to ascertain whether the facts and assumptions in these feasibility reports were still applicable or whether appropriate adjustments should be made in the valuations. Further details are set out in AIB Report §§3.2.3-3.2.4.
- (21) The Respondents did not test the sufficiency, relevance and accuracy of the source data used by the Valuer. Further details are set out in AIB Report §§3.2.6, 3.2.8, and 3.2.9, which included (inter alia) the following failures:
- (a) Price adjustments were limited to discussions with management of the Company and the Respondents simply accepted the management's view that no price and costs adjustment was needed throughout the forecast periods. In fact, there were significant changes in the prices of minerals in those past few years.
 - (b) There was no consideration of the impact of general inflation as required by paragraph 40 of HKAS 36 *Impairment of Assets*¹.

¹ HKAS36, §40 provides that "Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or

(c) Discounted cash flow projections wrongly included estimated future income tax payments and cash outflow from financing activities, contrary to para 50 of HKAS36². Pan China admitted to this mistake in their letter of 26 March 2013 to the AIB.

(22) There was no evidence of audit work done to ascertain the relevance and reasonableness of 12 out of 15 items in the estimated future cash outflows. Audit evidence was obtained for only 2 items for Xinjiang Mine and one item for Aleinuer Mine. Further details are set out in §§3.2.11 and 3.2.12 of the AIB Report.

Complaint 2

(23) Section 34(1)(a)(vi) applies to Pan China and Choi in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraph 8 of the HKSA 230 as a result of their failure to prepare any or any adequate audit documentation regarding their discussions with the management in the impairment assessment of the Aleinuer Mine and Xinjiang Mine.

Facts and circumstances in support of Complaint 2

(24) When asked by AIB to respond to the audit deficiencies as set out above, Pan China alleged in their letters of 26 March 2013 and 13 January 2014 that they had certain discussions with Company's management concerning the impairment assessment of the 2 mines – see AIB Report §§3.1.3.2, 3.1.3.5, and 3.1.3.6. However the documentation of these alleged discussions was limited to a one-page handwritten note in the audit working paper (annex 2T to the AIB Report), which did not cover many of the matters set out in the letters of 26 March 2013 and 13 January 2014.

(25) In the premises, Pan China and Choi failed to document or document sufficiently the details of their discussion with management concerning the impairment assessment as set out in the letters of 26 March 2013 and 13 January 2014.

Complaint 3

(26) Section 34(1)(a)(vi) applies to Chan in that he failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraphs 20 and 21 of the HKSA 220 as a result of his failure to

decreases)."

² HKAS36, §50 provides that "Estimates of future cash flows shall not include:

- (a) Cash inflows or outflows from financing activities; or
- (b) Income tax receipts or payments."

identify the audit deficiencies in the impairment assessment of the Aleinuer Mine and Xinjiang Mine when acting as the EQCR.

Facts and Circumstances in support of Complaint 3

- (27) The mining rights in the Aleinuer Mine and Xinjiang Mine were the principal assets of the Group and yet their valuations appeared inherently imprecise and were based on various estimates and assumptions made by the Company's management and the Valuer. It is reasonable to expect that Chan as the EQCR would select the audit working papers concerning the impairment assessment when performing the EQCR. Had he done so, he should have identified the audit deficiencies as set out above.
- (28) Accordingly, Chan as the EQCR failed to comply with para 20 and 21 of HKSA 220.

Complaint 4

- (29) Section 34(1)(a)(vi) of the PAO applies to Choi and Chan in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in paragraphs 100.5(c) and 130.1 of the COE as a result of their failure to maintain professional knowledge or skill and/or to act diligently when acting as the engagement director and EQCR respectively in the audit of the Company for the year ended 31 December 2010.

Facts and Circumstances in support of Complaint 4

- (30) Based on the above audit deficiencies, Choi and Chan have failed to maintain their professional knowledge or skill and/or to act diligently when acting as the engagement director and EQCR respectively in the audit of the Company for the year ended 31 December 2010.
3. The Respondents admitted the Complaint against them. They did not dispute the facts as set out in the Complaint. They agreed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.
 4. By a letter dated 6 October 2015 addressed to the Complainant and the Respondents, 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.
 5. In considering the proper order 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 written submission of the Respondents dated 15 and 26

October 2015, the written submission of the Complainant dated 27 October 2015, and the conduct of the Complainant and the Respondents throughout the proceedings. The DC found that the Complaint (1 to 4 above) has been proved.

6. The DC orders that:-

- 1) the Respondents be reprimanded under section 35(1)(b) of the PAO;
- 2) each of the 1st and 2nd Respondents pay a penalty of HK\$12,000 under section 35(1)(c) of the PAO and the 3rd Respondent pay a penalty of HK\$50,000 under section 35(1)(c) of the PAO; 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\$83,215.60 under section 35(1)(iii) and section 35(1)(d)(ii) of the PAO. The costs and expenses shall be shared equally by the Respondents.

Dated the 21st day of December 2015