

IN THE MATTER OF

A Complaint made under section 34(1) of the Professional Accountants Ordinance, Cap 50

BETWEEN

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

AND

Chan Bing Chung  
(Membership No. A17643)

RESPONDENT

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

Members: Mr. Kwong Chi Ho Cecil (Chairman)  
Mr. Ko Ming Tung Edward  
Mr. Ngai Tak Sing Alfred  
Mr. Chow Tak Sing Peter  
Mr. Warren Peter Phillips

Date of Hearing: 18 November 2015

Date of Order & Reasons for Decision: 3 February 2016

#### **ORDER & 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. Chan Bing Chung (the “**Respondent**”).
2. The particulars of the complaint are set out in a letter dated 27 May 2015 (the “**Complaint**”) from the Registrar of the Institute to the Council of the Institute for referral to the Disciplinary Committee. A hearing was conducted by the Disciplinary Committee on 18 November 2015.

## BACKGROUND

3. Sing Lee Software (Group) Limited (the "**Company**") was incorporated in Bermuda and its shares are listed on the Growth Enterprise Market (stock code: 08076) of the Stock Exchange of Hong Kong Limited.
4. The financial statements of the Company and its subsidiaries (the "**Group**") for each of the years ended 31 December 2007, 2008 and 2009 ("**2007, 2008 and 2009 Financial Statements**") were stated to have been prepared in accordance with the International Financial Reporting Standards ("**IFRS**").
5. On 9 October 2007, the Company granted 47,550,000 share options to employees of the Group (the "**Share Options**"), at an exercisable price of HK\$0.368 per share. It was subject to vesting scale in tranches on 8 April 2008 (5%), 8 October 2008 (10%), 8 October 2009 (35%), and 8 October 2010 (50%), with a vesting period of 3 years. The exercise period is from 9 April 2008 to 8 October 2017.
6. The Group did not recognize any share-based payment expenses in the 2007, 2008 and 2009 Financial Statements, in accordance with IFRS 2 *Share-based Payment* ("**IFRS 2**").
7. K.M. Choi & Au Yeung Limited (the "**Corporate Practice**") was appointed as auditor of the Company and issued auditor's reports on the 2007, 2008 and 2009 Financial Statements. Mr. KM Choi ("**Choi**") was the engagement director. The auditor's report for each relevant year stated that the audit was conducted in accordance with International Standards on Auditing ("**ISA**").
8. Notwithstanding that the Group did not follow IFRS 2 to account for the Share Options, the Corporate Practice did not qualify the audit opinions on these financial statements to reflect the non-compliance.
9. The Corporate Practice subsequently resigned as the auditor of the Company. The financial statements for year ended 31 December 2010 ("**2010 Financial Statements**") of the Group stated that the Group failed to follow IFRS 2 and retrospective restatements were made to correct the prior period errors.
10. In July 2012, the Audit Investigation Board ("**AIB**") of the Financial Reporting Council ("**FRC**") investigated the conduct of the Corporate Practice and the engagement director, who admitted that they were not aware of the requirements of IFRS 2. The matter against the Corporate Practice and the engagement director was concluded by another Disciplinary Committee on 10 October 2013 (Case no. D12-0711F).

11. The Disciplinary Committee in that case accepted that the determination of the fair value of the Share Options in the 2007, 2008 and 2009 Financial Statements did not comply with IFRS 2. As a result, there was concern that the engagement quality control reviewer ("EQCR") might not have performed proper reviews on the relevant audits according to ISA 220 *Quality Control for Audits of Historical Financial Information* ("ISA 220").
12. The Respondent was a practising director of the Corporate Practice who acted as the EQCR for the 2009 audit.
13. On 7 October 2014, the FRC referred another report of the AIB dated 12 August 2014 to the Institute pursuant to section 9(f) of the FRC Ordinance (Cap.588).
14. The AIB found that the Respondent was aware of the judgment made by the engagement team in respect of the Share Options, but failed to identify that such measurement was not in accordance with IFRS 2. They concluded that the Respondent did not properly perform the engagement quality control review in accordance with paragraphs 38 and 39 of ISA 220, and therefore, he did not comply with paragraphs 100.4(c) and 130.1 of the Code of Ethics for Professional Accountants ("COE").
15. Responding to the Institute's enquiries in a letter dated 11 November 2014, the Respondent reiterated his reply to the FRC which expressed his disagreement that he had failed to perform appropriate quality control review because the Share Options were not identified as a significant matter in the audit.

## **THE COMPLAINT**

16. Section 34(1)(a)(vi) of the Professional Accountants Ordinance (Cap. 50) ("PAO") applies to the Respondent in that he has failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 100.4(c) as elaborated in paragraph 130.1 of the Code, as a result of his failure to maintain professional knowledge or skill and/or failure to act diligently, as the EQCR of the audit of the Company and the Group for the year ended 31 December 2009.

## RELEVANT PROFESSIONAL STANDARDS

### 17. Relevant paragraphs of ISA 220:

*"38. An engagement quality control review should include an objective evaluation of:*

- (a) The significant judgments made by the engagement team; and*
- (b) The conclusions reached in formulating the auditor's report.*

*39. An engagement quality control review ordinarily involves discussion with the engagement partner, a review of the financial information and the auditor's report, and, in particular, consideration of whether the auditor's report is appropriate. It also involves a review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions they reached. The extent of the review depends on the complexity of the audit engagement and the risk that the auditor's report might not be appropriate in the circumstances...."*

### 18. Relevant paragraphs of the then applicable COE:

*"100.4 A professional accountant is required to comply with the following fundamental principles:*

- (c) Professional Competence and Due Care*  
*... A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services."*

*"130.1 The principle of professional competence and due care imposes the following obligations on 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 providing professional services."*

*"130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis."*

## FACTS AND CIRCUMSTANCES IN SUPPORT OF THE COMPLAINT

19. Apparently, the Group did not follow IFRS 2 in accounting for the Share Options in the 2009 Financial Statements:
- (a) Note 3 of the 2010 Financial Statements of the Company, stated that *"the Group did not follow IFRS 2 Share-based Payment to account for share options granted to employees after 7 November 2002 and vested on or after 1 January 2005. The prior period errors are corrected by retrospective restatement to increase share options reserve and accumulated losses as at 1 January 2009 by RMB5,392,000 and to restate the result for the year ended 31 December 2009 from profit for the year of RMB1,302,000 to loss for the year of RMB1,547,000 with the recognition of share-based payment expenses amounting to RMB2,849,000...."*
  - (b) The Corporate Practice and the engagement director who audited the 2009 Financial Statements did not dispute that the determination of the fair value of the Share Options did not follow IFRS 2. In fact, they admitted ignorance of IFRS 2.
  - (c) The Disciplinary Committee of the previous case accepted that the determination of the fair value of the Share Options of the Company in its financial statements for the years 2007 to 2009 did not follow IFRS 2.
20. The same Disciplinary Committee also found that the Corporate Practice failed to evaluate the fair value measurement of the Share Option and did not obtain sufficient appropriate audit evidence to enable them to conclude that the fair value measurement of the Share Options complied with IFRS 2 in the audit of the 2009 Financial Statements.
21. The non-recognition of share-based payments expenses by RMB2,849,000 in the 2009 Financial Statements, which represented more than two-folds of the consolidated profit for that year, had a material effect on the consolidated profit or loss of the Group for 2009. The Corporate Practice should have expressed a qualified audit opinion in this respect.
22. In 2011, the AIB investigated the Corporate Practice and Choi in relation to the above audit deficiencies. Choi admitted in letters to the AIB that he was not aware of the existence and requirements of IFRS 2. The investigation resulted in a disciplinary proceeding - D-12-0711 F - being instituted against Choi and the Corporate Practice. The disciplinary committee found that there was a breach of IFRS 2 for the years 2007-09, and ordered (inter alia) that Choi be removed as a member for 18 months. Paragraph 13 of the decision of the Disciplinary Committee stated as follows:-

*“The Respondents, [ie Choi and the Corporate Practice] admitted ignorance of IFRS 2 shows that they failed to attain or maintain the requisite professional knowledge to conduct an audit of the Company’s Financial Statements and in particular with regard to the Share Options.”*

23. A further investigation was carried out by AIB into the Respondent’s role as EQCR in the 2009 audit, and a report dated 12 August 2014 was issued (the “**AIB Report**”). The Executive Summary stated (inter alia) the following (at p iii):

*“... Notwithstanding that there were various clues indicating that the engagement team’s assessment on financial statement risks and its conclusion reached in relation to the share options might not be appropriate, [the Respondent] failed to identify the accounting of the share options in the 2009 Financial Statements as a risky area susceptible to misstatements and that the measurement and recognition of the share options in the 2007 Financial Statements, the 2008 Financial Statements and the 2009 Financial Statements did not comply with IFRS 2. [The Respondent], as the EQCR for the 2009 Audit, indicated that he was satisfied with the audit evidence obtained and procedures performed by the audit team and that the 2009 Financial Statements complied with IFRSs. Therefore the evidence strongly suggests that [the Respondent] did not properly perform his engagement quality control review in this respect according to the requirements under paragraphs 38 and 39 of ISA 220.*

*The above audit failure demonstrates that [the Respondent] did not comply with section 130.1 of the COE as he did not act diligently according to the applicable technical and professional standards when providing professional services in the 2009 Audit relating to the performance of the engagement quality control review.”*

24. In the Engagement Quality Control Review Risk Tolerance Worksheet (the “**Risk Worksheet**”) [annex 2H, AIB Report], the Respondent ticked a box indicating “low risk” and the absence of any “very complex specialized transactions”. The same worksheet states that stock-based compensation should be considered as “high risk”
25. In another audit document “Appendix K Engagement Quality Control Review Worksheet” [annex 2G, AIB Report], which was signed by the Respondent using his initial “JC”, the last page included the following statement:-

*“Based on my review of the engagement file, discussions with engagement personnel and the responses to my review comments, I am satisfied that the engagement report can be released.”*

26. The Respondent, under the name of his own practice JP Union & Co., addressed to the Corporate Practice a memo with subject "EQCR - Sing Lee Software (Group) Limited for the year ended 31/12/09" ("EQCR Memo") [annex 2I, AIB Report]. It contains "Audit Highlights", including one section entitled "Share option". That section included the following statements:

*"Certain share options are expired and forfeited. Echo with your audit team's opinion, there is no any financial effect because no share option reserve was recognized in the prior years and hence no subsequent elimination of share option reserve."*

27. The Respondent failed to identify that the measurement and recognition of the Share Options in the 2009 Financial Statements did not comply with IFRS 2. In the EQCR Memo, it was recorded that the fair value of the Share Options on the grant date was nil because the exercise price is higher than the market price on that date.

28. Further, the Respondent stated in his letter dated 27 April 2015 to the Institute:-

*"The Audit Highlight [ie the EQCR Memo] prepared by the audit team together with the Practice Review Report made me believed that the value of share options at the grant date in 2007 is Nil in accordance with IFRS 2."*

#### **THE ISSUES AND THE FINDINGS OF THE COMMITTEE**

29. According to IFRS 2, for share options granted to employees, an entity should measure the fair value of share options granted at the measurement date based on market prices of those share options. If the market prices of the share options granted are not available, the entity should estimate their fair value using a valuation technique to estimate what the price of those share options would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties.

30. As the Company is a listed company in Hong Kong, it is apparent that the market price of the shares underlying the Share Options were available at the measurement date.

31. The Respondent should have identified that the engagement team's acceptance of the exercise price of the Share Options as the only consideration in determining fair value did not follow the provisions as set out in IFRS 2.

32. The Respondent contested that there was no violation of IFRS 2 throughout the proceedings, the hearing and even after the hearing. His major line of argument was it was fair for the Company to treat the valuation of the Share Options as zero. In support of his argument, he made various submissions citing different examples, valuation models, research papers, journals, authorities citing scenarios where valuation of options can be treated as zero.
33. The Committee fully considered all arguments and submissions (even those submissions that were not properly admitted in the proceedings) put forward by the Respondent. The Committee is of the view that all these arguments are either irrelevant, speculative or unauthoritative. Needless to say, the Respondent's arguments shows his lack of understanding of IFRS 2.
34. In light of the above, the Respondent, as the EQCR for the 2009 audit, failed to perform an objective evaluation of the identification of audit risks, the audit procedures conducted and the conclusions reached relating to the Share Options by the engagement team, in accordance with paragraph 38 of ISA 220.
35. Even if the Respondent genuinely believes, whether rightly or wrongly, that the Share Options should be treated as zero under IFRS 2, the Committee have serious doubt whether the Respondent had such belief during the material time when the 2009 audit was reviewed by him.
36. In addition, the Committee is of the view that the Respondent did not have an effective discussion with the engagement director in accordance with paragraph 39 of ISA 220 because had he done so, he would realize that the engagement director was not aware of the requirements under IFRS 2. In fact, the Respondent admitted in the hearing that he did not discuss with the audit team in relation to the 2009 audit.
37. The above failures show that the Respondent did not properly perform the engagement quality control review according to the requirements under paragraphs 38 and 39 of ISA 220. These failures demonstrate that the Respondent did not comply with paragraphs 100.4(c) and 130.1 of COE as he did not act diligently according to the applicable technical and professional standards when carrying out the engagement quality control review as EQCR in the 2009 audit.
38. Based on the above, the Committee is satisfied that the Complaint against the Respondent is proven.



39. The Committee observed that the Respondent had repeatedly claimed that the subsequent 2010 Financial Statements were "Deloitte's valuation" and that such valuation was "wrong" and should be evaluated by the Committee. It clearly shows the Respondent's lack of understanding of (i) the role of auditors to the Company; and (ii) the irrelevance of subsequent financial statements of the Company to the necessary duties and work done needed by an EQCR in the base year.

## DECISION

40. In arriving at the proper sanctions to be imposed on the Respondent, the Committee considered the following facts and matters specific to this case:

- (a) The Complaint relates to the audit and the review of the audit of a company listed in Hong Kong. Whilst the Committee is unaware of any civil claims from the public, market manipulation allegations or collaboration with the Company allegations resulting from the Respondent's transgressions, the Committee is aware of the need to safeguard public interests which is often unmeasurable in monetary terms.
- (b) Expectations by the public that practising accountants should discharge their duties and conduct their work to the highest standards, and if the public expectations are shaken then the price to be paid by the profession as a whole can be high.
- (c) The conduct of the Respondent throughout the proceedings, and his understanding of the relevant accounting standards and principles (or the lack of).

41. Having considered the above facts and matters and all other factors the Committee deem appropriate, including a Statement of Costs dated 25 November 2015 submitted by the Institute totalling HK\$125,966.70 which include HK\$20,075.70 costs incurred by the Financial Reporting Council and which the Committee is satisfied were reasonably and necessarily incurred, we make the following orders:

- (a) The Respondent pay a penalty of HK\$50,000 under section 35(1)(c) of the PAO;
- (b) The Respondent pay the costs of and expenses incidental to the proceedings of the Institute and the Financial Reporting Council in the total sum of HK\$125,966.70 under section 35(1)(iii) and section 35(1)(d)(ii) of the PAO;

- (c) The practising certificate issued to the Respondent in 2016 be cancelled on the 40<sup>th</sup> day from the date of this order under section 35(1)(da) of the PAO; and
- (d) A practising certificate shall not be issued to the Respondent for a period of 9 months on the 40<sup>th</sup> day from the date of this order under section 35(1)(db) of the PAO.