

IN THE MATTER OF

A Complaint made under Section 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

Baker Tilly Hong Kong Limited
(Corporate Practice no.: M154)
Mr. Andrew David Ross
(Membership no.: A01858)
Ms. Kwok Lai Ha Helena
(Membership no.: A19044)

RESPONDENTS

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

Members: Mr. Kaung Wai Ming Alexander (Chairman)
Mr. David Fenn
Ms. Elizabeth Law
Mr. Chan Kee Sun Tom
Mr. Liu Ling Hong Stephen

ORDER & REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the “**Institute**” or the “**Complainant**”) against Baker Tilly Hong Kong Limited (“**Baker Tilly**”), Mr. Andrew David Ross (“**Ross**”) and Ms. Kwok Lai Ha Helena (“**Kwok**”).
2. Baker Tilly audited the financial statements of China North East Petroleum Holdings Limited (“**CNEP**”), a Nevada corporation engaged in the exploration and production of crude oil in the PRC, for the year ended 31 December 2009 (the “**2009 Audit**”), and issued an unqualified audit opinion in respect of CNEP’s 2009 financial statements.

3. Ross was the lead engagement director of the 2009 Audit, whereas Kwok was the director-in-charge of the 2009 Audit.
4. The complaint against the Respondents is as follows:-

“Section 34(1)(a)(vi) of the Professional Accounts Ordinance applies to BTHK, Ross, and Kwok in that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in §§100.4(c) and 130.1 of the Code of Ethics as a result of their failure to maintain professional knowledge or skill and/or to act diligently when acting as the auditor, lead engagement director, and director-in-charge respectively in the audit of CNEP for the year ended 31 December 2009.”
5. The Respondents have signed confirmations (the “**Confirmations**”) admitting the complaint against them.
6. In light of the admission by the Respondents and by consent between the parties, the Disciplinary Committee (the “**Committee**”) has directed that the steps set out in Rules 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with, and that the parties make written submissions as to sanctions and costs which should be imposed by the Committee.
7. In the Confirmations, the Respondents confirmed that they do not dispute the following facts:-
 - (i) In April 2010, questions were raised concerning a line item in the draft financial statements of CNEP indicating that US\$3.89 million (about RMB 26.57 million) was due to CNEP from a stockholder. This was said to reflect monies due to the company from a director, Gu Guizhi (“**Ju**”), the mother of the company’s CEO Wang Hongjun (“**Wang**”).
 - (ii) Thereafter, the audit committee of CNEP retained a forensic accounting firm to review the balance and evaluate CNEP’s internal controls.
 - (iii) The report produced by the forensic accounting firm identified 176 transactions involving transfers to the directors of CNEP (the “**Director Transfers**”) totalling around US\$59 million (about RMB 268 million) that had been made without specific board approval during 2009, including around US\$28 million paid to Wang and Ju. The report also noted that the approximately US\$20 million that would have remained due from Wang and Ju at the end of 2009 was reduced to almost zero through year-end consolidation and post-year-end closing adjustments that appear to have made with no valid reasons.
 - (iv) Baker Tilly issued an unqualified opinion on the 2009 audit.
 - (v) The Securities and Exchange Commission (“**SEC**”) found that CNEP’s 2009 financial statements did not disclose the Director Transfers as related party transactions (“**RPTs**”) in conformity with US GAAP.

8. The SEC initiated disciplinary proceedings against the Respondents and in December 2014 the Respondents agreed to have sanctions imposed upon them without admitting or denying the findings of audit deficiencies.
9. It should be noted that the decision of the Committee as to sanction and costs is based not on the findings of the SEC, which were not admitted by the Respondents when they settled with the SEC, but rather on the admissions made by the Respondents in these proceedings.
10. In these proceedings, the Respondents have admitted that they failed or neglected to observe, maintain or otherwise apply professional standards as provided in Sections 100.4(c) and 130.1 of the Code of Ethics as a result of their failure to maintain professional knowledge or skill and/or to act diligently when acting as the auditor, lead engagement director, and director-in-charge respectively of CNEP's 2009 audit.
11. Sections 100.4(c) and 130.1 of the Code of Ethics provide:-

“100.4. A professional accountant is required to 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. 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 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 providing professional services.”
12. The complaint against the Respondents is essentially that they failed to audit the material Director Transfers and to conclude that they were RPTs in accordance with applicable Public Company Accounting Oversight Board (PCAOB) standards, and failed to adequately revise the firm's audit planning regarding fraud risks.
13. On the basis of the Respondents' admission, the Committee finds that they have failed or neglected to observe, maintain or otherwise apply a professional standard in breach of section 34(1)(a)(vi) of the Professional Accountants Ordinance (the “PAO”).
14. The Committee has received and considered written submissions on sanctions and costs from the Complainant and from the Respondents.
15. In the Complainant's written submissions on sanctions and costs, whilst it was accepted that this is the first case in which the Respondents had also been the subject of a

disciplinary order from the SEC, based upon misconduct in another jurisdiction and based upon a non-Hong Kong standard, the Committee was nevertheless invited to draw some guidance from past cases where there had been a failure to maintain professional knowledge or skill and/or to act diligently with the relevant rules of another regulatory body, as well as past cases concerning the failure to disclose RPTs.

16. In arriving at its decision on sanctions and costs, the Committee has taken into account the fact that the Respondents have already been sanctioned by the SEC in respect of the same conduct, in particular the financial penalties levied against the Respondents.
17. The Complainant made reference to D-15-1100H in which multiple breaches of auditing standards had occurred. The Complainant argued that there were similarities to the present case, due to inadequate review of the company's internal controls, consideration of the fraud risk factors, and assessment of audit risk. Also, the audit procedures for RPTs were inadequate, as were the disclosures for RPTs in the financial statements. In that case, the sanction was a cancellation of the respondents' practising certificate for 12 months.
18. The Complainant also made reference to D-05-0144C. In that case, in contrast, in respect of a failure to make a RPT disclosure in the financial statements of a private company, the sanction was a monetary fine of HK\$20,000.
19. The Committee has considered both of these past cases. In D-15-1100H, there were a total of 5 complaints covering 4 audit periods, involving amongst other things apparent breaches of trust by the trust company being audited, failure to segregate trust funds from company assets, and potential misappropriation of client monies, in circumstances where there were already civil and criminal proceedings on foot against the company's principal. The facts and circumstances of that case were clearly far more serious than the present one.
20. On the other hand, in D-05-0144C, the company concerned was a private company, and it appears that the extent of the RPTs was not as extensive as in the present case. In the present case, the RPTs in question ie. the Director Transfers comprised 176 transactions totalling around US\$59 million (about RMB 268 million).
21. It appears to the Committee that the nature of the conduct in the present case falls somewhere between the two past cases referred to by the Complainant.
22. The Complainant has quite fairly indicated that as the present case involves the application of US rather than Hong Kong accounting standards, a cancellation of practising certificate, which allows a CPA to practice as a Hong Kong auditor, would not be an appropriate sanction, and has submitted that the appropriate penalty would be a reprimand and a monetary penalty commensurate with the seriousness of the offence.
23. In considering the proper order to be made in this case, the Committee has had regard to the written submissions of the Respondents, and in particular the following matters in mitigation:-

- (i) The Director Transfers were first identified by the Respondents and reported by the Respondents to the Audit Committee of CNEP, which led to the instruction of the forensic accounting firm to investigate the matter.
 - (ii) The forensic accounting firm concluded that there was no evidence that any of the funds had been diverted by Ju and Wang for their own use, but rather, that each of the payments had been used by Ju and Wang to settle accounts payable on behalf of CNEP and its subsidiary companies.
 - (iii) No regulatory or criminal proceedings were pursued by the SEC in respect of the Director Transfers for fraud, inappropriate use of funds, misstatement or misleading reporting or any other regulatory or criminal offence.
 - (iv) Heavy sanctions have already been imposed by the SEC against the Respondents. The Respondents were not permitted to perform US listed-audits for 3 years, and the financial penalties included disgorgement of Baker Tilly's audit fee of US\$75,000, and US\$20,000 for Ross and US\$10,000 for Kwok respectively. The Respondents have also already suffered significant reputational damage as a result of the incident.
 - (v) The Respondents have admitted the complaint against them, thereby resulting in the saving of time and costs in these proceedings.
24. At the same time, the Committee notes in the context of the sanctions imposed by the SEC that Baker Tilly states that it decided to close its US/SEC Registrants business unit, which dealt with PCAOB-governed audits, for its own commercial reasons. Hence, the impact of the denial by the SEC for Baker Tilly to perform US listed-audits for 3 years must be viewed in this context.
25. In their written submissions, the Respondents also sought to draw parallels between what occurred in the present case and what they say is the practice of Hong Kong auditors which has been used for Hong Kong listing applicants and is accepted by The Stock Exchange of Hong Kong. However, given that the Respondents have admitted the complaint against them, which is that they failed or neglected to observe, maintain or otherwise apply professional standards, which were PCAOB standards applicable in the US, the Committee does not consider this to be a matter which carries any real weight.
26. The Respondents concluded their written submissions by submitting that in view of the already substantial financial sanctions already imposed by the SEC, it would be unreasonable and inappropriate to impose further fines, and that the appropriate sanction would be reprimands against the Respondents only.
27. In deciding on the appropriate sanction, the Committee has a wide discretion under Section 35 of the PAO. What would be an appropriate sanction in any particular case must be considered in the light of all of the circumstances of that particular case.
28. As to costs, the Committee has a discretion to determine the extent to which costs should be recoverable. Absent any good reason to do otherwise, costs should follow the event ie. be awarded to the successful party in the proceedings.

29. The Committee considers that the appropriate sanctions in this case would be:-
- (i) Reprimands for each of the Respondents;
 - (ii) Orders that Baker Tilly pay a penalty of HK\$100,000, Ross pay a penalty of HK\$70,000 and Kwok pay a penalty of HK\$30,000;
 - (iii) An order that the Respondents pay the Complainant's costs and the costs of the Clerk to the Committee.
30. The Complainant has produced a Statement of Costs and seeks costs in the total amount of HK\$648,042.60. This includes the costs and expenses of the Complainant itself for conducting its investigation, preparing the complaint in these proceedings and obtaining expert evidence, as well as the costs and expenses of the Clerk to the Committee, in the total amount of HK\$648,042.60. A significant component of the costs and expenses claimed were the professional fees of Joseph W Richardson CPA LLC for preparing an expert report (HK\$435,723.60).
31. The Respondents submit that the costs and expenses claimed by the Complainant are excessive and unreasonable, in particular that the fees of the expert were incurred prematurely, and that the fees of the expert were excessive as the instructions given to the expert were too broad and went beyond the essential issues which the Committee would have required assistance on.
32. There is some force to the Respondents' submission concerning the fees of the expert. Under the Disciplinary Committee Proceedings Rules, it is for the Chairman and/or the Committee to consider whether expert evidence is appropriate and to give directions to the parties to permit them to adduce expert evidence, such matters usually being addressed at the directions hearing in the proceedings (which in the present case was rendered unnecessary due to the Respondents' admission of the complaint against them). In the present case, the Complainant obtained and proceeded to obtain its expert report in the absence of any direction from the Chairman and/or the Committee.
33. A review of the contents of the expert's report also tends to support the Respondents' contention that the ambit of the expert report was too wide and went beyond the essential issues which the Committee would have required assistance on. There were three sections to the expert report, only one of which contained an opinion on the application of the relevant US accounting principles and auditing requirements to the facts of the case. The second section contained an opinion corroborating the findings made by the SEC, and the third section contained a "rebuttal report" rebutting the arguments raised by the Respondents.
34. Given that these proceedings did not require any final determination from the Committee on the merits, the Committee does not consider it appropriate to now conduct what would effectively be a mini-trial as to the utility of the expert evidence. However, the Committee does consider that it would be appropriate to make a sizeable reduction, on a broad brush basis, to the costs and expenses claimed by the Complainant.

35. The Committee accordingly allows the costs and expenses of the Complainant, including the costs and expenses of the Clerk to the Committee, in the amount of HK\$300,000.
36. Finally, in their written submissions, the Respondents have also requested that, on the basis that there has already been adverse publicity as a result of the SEC's orders, which received significant coverage in the Hong Kong media and caused substantial reputational damage to the Respondents, that the names of the Respondents be withheld in the publication of the decision of the Committee. The Complainant opposes this request.
37. The Committee notes that the issue of whether there is any power to withhold publication of a decision of the Committee has recently been considered by the Court of Appeal in The Registrar of the Hong Kong Institute of Certified Public Accountants v X & Anor [2017] 3 HKLRD 541. That case was concerned with an application to stay or restrain the publication of two decisions of the disciplinary committee until the final determination of an appeal from the decisions. Amongst other things, the Court of Appeal considered the question of whether the disciplinary committee has jurisdiction to publish its decisions, and was of the view that the disciplinary committee does have jurisdiction to publish its own decisions and to prohibit or stay such publication on terms.
38. But even proceeding on the basis that the Committee has the power to decide to withhold publication of its decision or any part of its decision, such as withholding the names of the Respondents, the Committee is mindful of the fact that the statutory regime under the PAO intends that disciplinary proceedings be conducted in public unless there are good reasons as to why the hearing should be conducted privately. This is consistent with the principle of open administration of justice. Section 36(1A) of the PAO provides:-
- “Every hearing of the Disciplinary Committee shall be held in public unless the Disciplinary Committee—*
- (a) on its own motion; or*
- (b) on the application of (i) the complainant; or (ii) the certified public accountant against whom the complaint is made,*
- determines that in the interests of justice a hearing or any part thereof shall not be held in public in which case it may hold the hearing or the part thereof (as the case may be) in private.”*
39. If hearings are to be held in public, then it would follow that the decisions made following such hearings should also be a matter of public record.
40. The Committee accepts that, in general, public obloquy attaches to the publication of a disciplinary sanction. However, the reputational damage is part of the sting of the sanction itself. The reprimands for the Respondents would not have the same effect if they were kept private.

41. The fact that there has already been adverse publicity and reputational damage as a result of the SEC's orders, as submitted by the Respondents, does not mean that the publication of the Committee's decision identifying the Respondents would unfairly compound the adverse reputational effect on the Respondents. Furthermore, the Committee's decision arises out of the same incident which resulted in the SEC's orders, which are already matters of public record.
42. Taking into account the foregoing, the Committee does not consider that there is any good reason to withhold the names of the Respondents in the publication of the decision of the Committee.
43. The Committee accordingly declines to make an order that the names of the Respondents be withheld in the publication of the decision of the Committee.
44. The Committee orders that:-
 - (1) Each of the Respondents be reprimanded under Section 35(1)(b) of the PAO;
 - (2) Baker Tilly pay a penalty of HK\$100,000 to the Institute under Section 35(1)(c) of the PAO;
 - (3) Ross pay a penalty of HK\$70,000 to the Institute under Section 35(1)(c) of the PAO;
 - (4) Kwok pay a penalty of HK\$30,000 to the Institute under Section 35(1)(c) of the PAO;
 - (5) The Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant including the costs of the Clerk to the Disciplinary Committee in the sum of HK\$300,000 under Section 35(1)(iii) of the PAO.

Dated the 12th day of December 2017

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A Complaint made under Section 34(1A) of the Professional Accountants Ordinance (Cap.50) (“the PAO”) and referred to the Disciplinary Committee under Section 33(3) of the PAO

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ORDER & REASONS FOR DECISION

Dated the 12th day of December 2017