

2. By a letter dated 1 June 2017 to the Council of the Institute (“**the Complaint**”), the Practice Review Committee (“**the Complainant**”) complained that the Respondent failed or neglected to observe, maintain or otherwise apply professional standards under section 34(1)(a)(vi) of the Professional Accountants Ordinance (“**PAO**”).
3. On 19 July 2017, the Respondent confirmed his admission of the complaints against him and he did not dispute the facts as set out in the Complaint. The parties jointly proposed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with and that the admitted complaints could be disposed of on the basis of the admission made.
4. In view of the Respondent’s admission, the Committee acceded to the parties’ joint application to dispense with the steps set out in paragraphs 17 to 30 of the Rules and directed the parties to make written submissions on sanctions and costs.
5. On 4 January 2018 and 5 January 2018, the Complainant and the Respondent made their respective submissions on sanctions and costs.

Background

6. The Respondent is a sole proprietor of Dynamic Dragons & Co., CPA (“**Dynamic**”) and TCY CPA Limited (“**TCY**”) (collectively the “**Practices**”). He is responsible for the quality control system of the Practices.

7. The Practices did not employ any staff. The audit work of Dynamic and TCY was carried out by "Service Co D" and "Service Co C" respectively. These services companies received remuneration for the services they provided to the Practices. The Respondent confirmed that he did not have any interest or directorship in these companies.
8. The Respondent confirmed that the Practices apply the same quality control system and audit methodology. Accordingly, the practice review covered both Practices.
9. The practice review was conducted by a reviewer from the Institute's Quality Assurance Department (“**Reviewer**”). The results of the practice review had been reported to the Complainant which is responsible for exercising the powers under Part IVA of the PAO.
10. The Reviewer selected the following two completed audit engagements for review:
 - (a) Client Y, a private entity, for the year ended 31 March 2015. The relevant auditor's report was issued by TCY on 9 November 2015.
 - (b) Client O, a private entity, for the year ended 31 March 2015. The relevant auditor's report was issued by Dynamic on 19 June 2015.
11. The Reviewer found that a number of deficiencies in the Practices' quality control system and audit engagements. In addition, it was found that the

Respondent had not been straightforward in his representations to the Reviewer.

12. A Reviewer's Report dated 12 October 2016 outlining the practice review findings was produced. In the Respondent's responses to the draft report dated 12 June 2016, he did not dispute the facts and observations made by the Reviewer.
13. Copies of the working papers in relation to Client Y and Client O were produced. The Respondent confirmed that they represented the complete documentation for the audit engagements.
14. Based on the Reviewer's Report and the Respondent's responses, the Complainant considered the Respondent had breached professional standards and decided to raise a complaint against the Respondent. The Complainant issued its decision letter to the Respondent on 11 November 2016.
15. The relevant facts and observations based on which a complaint was raised were provided to the Respondent on 26 April 2017. In his response dated 6 May 2017, the Respondent did not dispute those facts and observations.

Relevant Professional Standards

16. The following relevant professional standards are relevant and applicable:
 - (a) Code of Ethics for Professional Accountants ("COE");

- (b) Hong Kong Standard on Quality Control 1 "*Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*" ("HKSQC 1"); and
- (c) Hong Kong Standard on Auditing 500 "*Audit Evidence*" ("HKSA 500").

The Complaints

First Complaint

- 17. Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he had failed or neglected to observe, maintain or otherwise apply a professional standard namely, paragraphs 100.5(a), 110.1 and 110.2 of the COE in respect of the false and/or misleading answers he provided in the practice review and in the 2014 practice review self-assessment questionnaire ("EQS") regarding Dynamic.

Second Complaint

- 18. Section 34(1)(a)(vi) of the PAO applies to the Respondent for having failed or neglected to observe, maintain or otherwise apply a professional standard namely, HKSQC 1, in that being the sole proprietor responsible for the Practices' quality control system, his Practices had not implemented adequate quality control policies and procedures in respect of independence requirements and engagement performance.

Third Complaint

19. Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he had failed or neglected to observe, maintain or otherwise apply a professional standard namely, paragraph 6 of HKSA 500 in that he had failed to design and/or perform audit procedures that are appropriate for the purpose of obtaining sufficient appropriate audit evidence in relation to the audit of the financial statements of Client Y for the year ended 31 March 2015 by TCY.

Facts and circumstances in support of the First Complaint

20. According to the fundamental principle of integrity under paragraphs 100.5(a), 110.1 and 110.2 of the COE, a professional accountant is required to be straightforward and not knowingly be associated with information which contains false or misleading statements; or information furnished recklessly.
21. At the start of the practice review visit, the Respondent told the Reviewer that the Practices used some planning and completion programmes and checklists based on the Institute's Audit Practice Manual for their audit engagements.
22. The Reviewer later discovered that the Respondent had completed certain programmes and checklists only for the engagements selected in advance for review. During the practice review visit, the Reviewer spot checked other audit engagement files and noted that no programmes and checklists were used by the Practices.

23. After further discussion, the Respondent admitted that the relevant programmes and checklists were prepared just before the practice review and that the audit engagement teams did not prepare audit planning and completion documents during the audits. This shows that the Respondent had knowingly made untrue statements to the Reviewer, in breach of the fundamental principle of integrity.
24. Certain answers provided by the Respondent in the 2014 EQS regarding Dynamic were false and/or misleading. For example, the EQS reported the following:
- (a) Dynamic did not get business referrals of audit clients from independent service providers. However, it later transpired that all Dynamic's audit clients were referred by Service Co D;
 - (b) Dynamic or other parties with close business relationships with Dynamic did not provide non-assurance services to its audit clients. However, Dynamic did provide tax computation services to all its audit clients. Further, Service Co D (which, as a service company which performed audit work for and referred business to Dynamic, had a close business relationship with Dynamic) provided secretarial and accounting services to Dynamic's audit clients.
 - (c) Dynamic had completed a monitoring review in March 2014. However, this was incorrect as it was admitted that it only carried out the first monitoring reviews of the quality control system and a

completed engagement in June 2014 and December 2014, respectively.

25. Such false and/or misleading answers in the EQS indicate that the Respondent had knowingly submitted false or misleading answers in the EQS and/or furnished information recklessly in the EQS, in breach of the fundamental principle of integrity under paragraphs 100.5(a), 110.1 and 110.2 of the COE.

Facts and circumstances in support of the Second Complaint

26. HKSQC 1 requires all firms of professional accountants to establish and maintain an adequate system of quality control which meets the requirements under the standard. Paragraph 16 of HKSQC 1 requires a practice to establish and maintain a system of quality control that includes policies and procedures that address, amongst other things, the elements of ethical requirements and engagement performance.
27. In addition, paragraphs 17 and 57 of HKSQC 1 require a practice to establish policies and procedures to ensure appropriate documentation is prepared to provide evidence of the operation of each element of its system of quality control.

Ethical Requirement - Independence

28. Paragraph 21 of HKSQC 1 requires a practice to establish policies and procedures designed to provide the practice with reasonable assurance that the firm and its personnel maintain independence where required by relevant ethical requirements.

29. As the Practices did not employ any staff, the audit work of Dynamic and TCY were carried out by Service Co D and Service Co C respectively.
30. The Respondent stated that the service companies provide accounting and/or secretarial services for his Practices' audit clients. He asserted that the staff assigned by Service Co D and Service Co C to handle the Respondent's audits were not involved in the provision of accounting and/or secretarial services but no information could be provided to support his representation.
31. Given the Respondent had not performed any independent assessment procedures to ensure that the service companies had proper safeguards in place to address the potential independence threats, the Respondent is considered to have failed to ensure that the Practices comply with paragraph 21 of HKSQC 1.

Engagement performance

32. According to paragraph 32 of HKSQC 1, a practice shall establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards.
33. During the practice review, the Reviewer selected certain engagement files on the spot for review and found that there was no evidence or documentation to show that the Respondent had carried out the following audit procedures as required under the relevant Hong Kong Standard on Auditing ("**HKSA**"):

- (a) Obtain an understanding of the entities' internal controls relevant to the audits; and evaluate the design of those controls to determine whether they have been properly implemented in the period under audit, in accordance with HKSA 315 *"Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment"*.
- (b) Perform audit procedures, including journal entry testing to address the risks of management override of controls, in accordance with HKSA 240 *"The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"*.
- (c) Determine performance materiality and a clearly trivial amount as required by HKSA 320 *"Materiality in Planning and Performing an Audit"* and HKSA 450 *"Evaluation of Misstatements Identified during the Audit"*.
- (d) Obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified, in accordance with HKSA 560 *"Subsequent Events"*.
- (e) Obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and

evaluate the management's assessment of the entity's ability to continue as a going concern, in accordance with HKSA 570 *"Going Concern"*.

34. The above findings demonstrate that the Respondent did not ensure that the Practices had established policies and procedures that are effective to ensure that audit engagements performed are in accordance with relevant auditing standards.

Facts and circumstances in support of the Third Complaint

35. According to paragraph 6 of HKSA 500, an auditor is required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.
36. TCY issued an unqualified audit opinion on the financial statements of Client Y for the year ended 31 March 2015.
37. The auditor's report stated that the auditor had conducted the audit in accordance with Hong Kong Standards on Auditing and with reference to Practice Note 900 *Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard* ("PN900"). PN900 provides that HKSAs apply to audits of financial statements.
38. The audit working papers of Client Y did not show any evidence that TCY had properly carried out audit procedures for the purpose of obtaining sufficient appropriate audit evidence in respect of the following

accounts which are material to the financial statements. The aggregate value of inventories and trade receivables represented 57% of Client Y's net assets as at 31 March 2015 and the sales returns represented 4.4% of the gross revenue of Client Y for the year ended 31 March 2015.

38.1 Inventories

(a) The working papers show that the balance of inventories as at the year end date was HK\$940,478. According to the working papers, the balance comprised raw materials, work-in-progress and finished goods.

(b) According to TCY's audit program for inventories, the auditor performed the following:

“Check pricing of inventories against supplier's invoices (to verify cost) and to subsequent sales invoices (to verify the application of the lower of cost and net realizable value rule).”

(c) The Respondent did not carry out any audit work to:

- test the costing of finished goods and work-in-progress to verify their costs;
- assess the appropriateness of the inventory costing method used;
- check the subsequent sales invoices to verify the application of lower of cost and net realizable value;

and

- assess the need for any provision for slow moving or obsolete items.

38.2 Trade receivables

- (a) The working papers show that the balance of trade receivables as at the year end date was HK\$7,854,239.
- (b) It was documented that the auditor had checked to receipts of 17% of the trade receivables which were subsequently settled by customers.
- (c) No audit procedures were carried out to address the recoverability of the remaining trade receivable balance.

38.3 Sales returns

- (a) The working papers show that the profit and loss accounts included an amount of sales return of HK\$1,957,039 as at year end date.
- (b) According to TCY's audit program for profit and loss accounts, the auditor performed the following:

"1. Compare current year profit and loss account with prior year, enquire into the reasons for any significant variations and consider audit

implications.

2. *Verify major items by references to supporting invoices, agreements (if applicable)"*

(c) No audit procedures were carried out to ascertain the appropriateness of the recognition of the sales returns.

39. On the basis of the above findings, TCY is considered to have failed to comply with paragraph 6 of HKSA 500 in that he did not obtain sufficient and appropriate audit evidence such that a reasonable conclusion could be drawn on the relevant accounts.

The Parties' Submissions on Sanctions and Costs

40. Both the Complainant and the Respondent have made their respective submissions on sanctions and costs.
41. In the Complainant's submissions dated 4 January 2018, the Complainant has referred to three cases, namely Proceedings No. D-15-1117P, Proceedings No. D-15-1102P and Proceedings No. D-14-0979P, wherein in these cases the respondents were found to have failed to comply with professional standards with similar features to the current complaint.
42. The Complainant further submits that the Institute regarded the offence of providing false or misleading information in the EQS as a serious professional misconduct and the profession takes a very serious view on breach of fundamental principle of integrity.

43. In view of the severe nature of the case, the Complainant suggested to this Committee to consider a cancellation of the Respondent's practising certificate as the sanction.
44. The Complainant also submits that the Respondent should pay the costs and expenses of and incidental to the proceedings of the Institute (including the costs and expenses of this Committee). The Complainant has provided a Statement of Costs dated 4 January 2018 which states a total of HK\$34,175.
45. The Respondent, on the other hand, invites this Committee to consider three cases, namely Proceedings No. D-14-0979P, Proceedings No. D-14-0946P and Proceedings No. D-16-1138P.

Decision and Order

46. The Committee notes that it has a wide discretion on the sanctions it might impose. Each case is fact sensitive and the Committee is not bound by the decision of a previous committee.
47. Having considered all the relevant facts of the Complaint, the parties, submissions, the Respondent's conduct throughout the proceedings and his personal circumstance, the Committee considers that a financial penalty of HK\$60,000 is appropriate.
48. It is also considered that a reprimand will be a proper sanction to signify the Committee's disapproval of his conduct.

49. As for costs, the Committee considers that the sum of HK\$34,175 was incurred reasonably and should be borne by the Respondent.

50. The Committee makes the following order:

- i) The Respondent be reprimanded under section 35(1)(b) of the PAO;
- ii) The Respondent do pay a penalty of HK\$60,000 pursuant to section 35 (1)(c) of the PAO;
- iii) The Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant (including the costs of this Committee) in total sum of HK\$34,175 under section 35(1)(iii) of the PAO.

Dated the 20th day of April 2018

Mr. Chan Raymond
Chairman

Mr. HO Kam Wing, Richard
Member

Miss CHAN Chui Bik, Cindy
Member

Mr. SHEN Ka Yip, Timothy
Member

Mr. DOO William Junior Guilherme
Member