

PROCEEDINGS NO.: D-17-1249F

IN THE MATTER OF

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

Between

THE REGISTRAR OF THE HONG KONG
INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS *Complainant*

and

MR. WONG WANG HEI
(Membership No. A07115) *1st Respondent*

MR. TSANG YIU CHUNG
(Membership No. A20592) *2nd Respondent*

MR. LUI CHI WANG
(Membership No. A24164) *3rd Respondent*

DELOITTE TOUCHE TOHMATSU
(Firm No. 0166) *4th Respondent*

Before a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants (“**Institute**”).

Members: Mr. LAM Ken Chung, Simon (Chairman)
Ms. CHAN Wai Kam, Caroline
Mr. CHIU Ling Cheong, Anthony
Mr. MA Chun Fung, Horace
Mr. YEUNG Chi Wai, Edwin

ORDER AND REASONS FOR DECISION

I. Introduction

This is a complaint submitted by the Registrar (“**the Registrar**”) of the Institute to the Council of the Institute against the Respondents, pursuant to section 34(1A) of the Professional Accountants Ordinance Cap. 50 (“**the Ordinance**”). The 1st, 2nd and 3rd Respondents are certified public accountants (practising), and the 4th Respondent is a firm of certified public accountants.

2. Upon receipt of the said complaint from the Registrar, the Council referred the complaint to the Disciplinary Panels, and the Disciplinary Committee Convenor duly appointed this Disciplinary Committee (“**the Committee**”) to handle the complaint.

3. The Respondents admitted the complaint, and the salient facts, as well as the sanctions considered to be appropriate, are not in dispute between the Complainant and the Respondents. The Committee therefore considered an oral hearing unnecessary, and decided to dispense with it. Despite the parties’ agreement, however, the Committee conducts its own analysis and reaches its own decision as to whether the complaint is proved and if so what the appropriate sanctions should be, as follows.

II. The salient facts of the case

4. The facts of the case, as contained in a letter from the Registrar to the Council dated 10 January 2018 (“**the Complaint Letter**”), are agreed and summarized as follows.

5. The case concerns the financial statements of a listed company called China Vision Media Group Limited (now known as Alibaba Pictures Group Limited) and its subsidiaries (collectively “**the Company**”), for the years

ended 31 December 2010, 31 December 2011, 31 December 2012 and 31 December 2013 (collectively “**the Financial Statements**”).

6. The 4th Respondent was at all material times the auditor of the Company, and it issued an unqualified opinion in relation to all four of the Financial Statements. The 1st and 2nd Respondents were respectively the 4th Respondent’s engagement partners in relation to the auditing of the Company’s aforesaid financial statements for 2010 and 2011, while the 3rd Respondent was the engagement partner in relation to the auditing of the financial statements for 2012 and 2013.

7. It was subsequently discovered that misstatements were contained in the Financial Statements, in relation to certain convertible bonds (collectively “**CBs**”), in circumstances as shall be set out below.

8. On 3 June 2010, as part of the consideration of an acquisition exercise by the Company, the Company issued two lots of convertible bonds, viz.: (i) bonds amounting to HK\$350 million in total and maturing on 3 June 2013 (“**CB1**”); (ii) bonds amounting to HK\$120 million in total and maturing on 3 June 2015 (“**CB2**”). CB2 was fully converted into shares of the Company on 6 August 2010.

9. On 30 March 2011, the Company issued yet another lot of convertible bonds (“**CB3**”), amounting to HK\$30 million in total and maturing on 30 March 2016.

10. As the CBs were issued in the Hong Kong currency, there was a fixed exchange rate clause in the relevant convertible note agreements, to the effect that the principal amounts and the redemption amounts of the bonds should both be translated to renminbi (“**RMB**”) at the fixed exchange rate of HK\$1 : RMB 0.91. On the other hand, upon redemption, the holders of the CBs would be paid in Hong Kong currency in an amount equivalent to the principal amount (in RMB at the aforesaid fixed exchanged rate) calculated at the prevailing exchange rate at the time of redemption.

11. In the Financial Statements, however, the existence of the aforesaid fixed exchange rate clause was totally ignored. Instead, the values of the CBs, as stated in the Financial Statements in Hong Kong currency, were

based on certain expert valuation reports dated 27 August 2010 (which valued CB1 and CB2 as at the date of their issuance) and 30 July 2011 (which valued CB1 and CB3 as at the date of the reverse acquisition). The value of CB3 as at the date of issuance was merely estimated by the management.

12. The aforesaid misstatements in relation to the valuation of the CBs in turn led to misstatements in goodwill, gain from disposal of subsidiaries, effective interest expenses and exchange difference in the Financial Statements. All these misstatements are collectively referred to as “**the CB Misstatements**” hereinbelow.

13. On 14 August 2014, the Company’s new board of directors, which was formed upon a share subscription, announced that the publication of the Company’s interim results and interim report for the six months ended 30 June 2014 had to be delayed due to the identification of certain possible non-compliant treatment of financial information in the Company’s prior-period accounting records. The trading of the Company’s shares was suspended from 15 August 2014.

14. The Company then engaged an independent firm of auditors (not the 4th Respondent) to conduct an investigation and analysis of the Company’s historical statements, which resulted in, inter alia, the revelation of the CB Misstatements. Thereupon, the 4th Respondent reviewed the Company’s interim results for the six months ended 30 June 2014, apparently including the correction of the CB Misstatements, and the interim results were announced on 19 December 2014. The trading of the Company’s shares was resumed on 22 December 2014.

15. The 4th Respondent resigned from being the Company’s auditor on 21 January 2015. An investigation was carried out by the Financial Reporting Council which resulted in this complaint.

III. The complaints against the Respondents

16. The complaints against the 1st, 2nd and 3rd Respondents are couched in similar terms. It is alleged that they failed or neglected to observe,

maintain or otherwise apply a professional standard¹ while they were engagement partners in the auditing of the financial statements concerned², as required under:

- (a) Paragraphs 5, 8 and 14 of Hong Kong Standard on Auditing 450 (“**HKSA 450**”); and
- (b) Section 100.5(c), as elaborated under sections 130.1 and 130.4 of the Code of Ethics for Professional Accountants (“**the Code**”).

17. The relevant paragraphs of HKSA 450 state as follows:

- (a) Paragraph 5: The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial;
- (b) Paragraph 8: The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements; and
- (c) Paragraph 14: The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

18. Section 100.5 of the Code sets out the fundamental principles that a professional accountant must comply with, viz., integrity, objectivity, professional competence and due care, confidentiality and professional behavior. Section 100.5(c) stipulates as follows:

“Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or

¹ Contrary to section 34(1)(a)(vi) of the Ordinance.

² As set out in paragraph 6 hereof.

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.”

19. Section 130.1 of the Code provides that:

“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.”

20. Section 130.4 of the Code further provides that:

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

21. The complaint against the 4th Respondent is similar, but covers all four of the Financial Statements, as it was the auditor through the entire period concerned.

IV. Whether the complaints are proved

22. The following matters, contained in paragraph 4 of the Complaint Letter and admitted by the Respondents vide written admissions dated 22 February 2018, are relevant:

- (a) The 4th Respondent, in its capacity as the auditor of the Company, was able to identify and quantify the CB Misstatements in the course of the auditing of the Financial Statements in each and every of the years concerned. This is evident from the 4th Respondent’s working papers entitled “The movement of the liability component of the convertible bonds for the year ended ...”

- (b) Each and every of the misstatements constituting the CB Misstatements exceeded the materiality level with the exception of the misstatements relating to: (i) the goodwill in 2012 and 2013; and (ii) the CBs in 2013³.
- (c) In each of the years concerned, the 4th Respondent as the Company's auditor prepared a working paper called "Evaluation of Misstatements and Disclosures" ("**the Misstatement Summary**") documenting, inter alia, materiality levels, uncorrected misstatements identified, their nature, and results of discussion with management as to whether the misstatements noted would be corrected by the management. The CB Misstatements were however not included in any of the Misstatement Summaries.
- (d) There was no evidence that the 4th Respondent, as the Company's auditor, accumulated the CB Misstatements and/or communicated them with the appropriate level of management in a timely manner.

23. It is therefore abundantly clear that the CB Misstatements were identified by the 4th Respondent in the course of its auditing of the Financial Statements in all the years concerned. It is equally clear that the CB Misstatements were of such a degree of materiality that they ought to have been accumulated by the auditor and communicated on a timely basis to the appropriate level of management of the Company, and the auditor should have requested the management to correct the misstatements. If the corrections were not forthcoming, the auditor should have requested a written representation from the management as to whether they believed the effects of uncorrected misstatements were immaterial, individually and in aggregate, to the financial statements as a whole. The 4th Respondent failed to even accumulate and communicate the CB Misstatements to the appropriate level of management of the Company, not to mention requesting the management to correct the misstatements or requesting a written representation from the management. The 4th Respondent was therefore in breach of paragraphs 5, 8 and 14 of HKSA 450, as well as section 100.5(c) (as elaborated under sections 130.1 and 130.4) of the

³ Which however were not trivial.

Code, for all the years concerned, viz., the years 2010, 2011, 2012 and 2013. The 1st, 2nd and 3rd Respondents are equally responsible for the respective year(s) in which they were the engagement partners of the 4th Respondent.

24. The Committee has found the complaint proved against all Respondents.

V. Sanctions

A. The parties' submissions on sanctions

25. The Complainant highlights the fact that the Respondents' failures spanned over four years of audit, and involved 3 different engagement partners, each repeating the same mistakes. It is submitted that although the Respondents considered the effect of the CB Misstatements not material to the financial statements for any of the relevant years, they were clearly *not* trivial. Had the Respondents included the CB Misstatements in the "Misstatement Summary" which were then provided to the management, so the Complainant submits, the latter could then include the matter in the written representations, which would in turn enable the management to evaluate the effects of the CB Misstatements and take necessary corrective actions. The Respondents' failures deprived the Company of the opportunity to evaluate the impact of the errors and take timely and appropriate remedial actions. The Complainant invites the Committee to consider a reprimand against all Respondents, together with a financial penalty at a level that would provide adequate deterrence to members of the accounting profession.

26. The Complainant proposes a financial penalty of not less than HK\$60,000 against each of the 1st and 2nd Respondents, and one of not less than HK\$80,000 against the 3rd Respondent (who was responsible for two years of audit). The Complainant considers the 4th Respondent "most culpable as it seems to have fostered a culture of lack of due care and complacency which allowed this failure to be repeated over four years", and proposes a financial penalty of at least HK\$150,000 against it.

27. The Respondents admit that they were able to identify the CB Misstatements in the course of their audit work, but took the view that they were

not material, and therefore did not include them in the management representation letter or on the Misstatements Summary. They accept that, with hindsight, the CB Misstatements, even though correctly judged to be non-material, should have been so included.

28. The Respondents further accept that public interest is engaged in this matter given that it involved the audits of a listed company, and that the failures were recurring. They however submit that the following matters have the effect of mitigating the seriousness of the complaints:

- (a) They were unintentional failures that did not involve ethical issues or more serious matters such as professional misconduct, dishonourable conduct or dishonesty;
- (b) The Respondents did not gain any inappropriate or personal benefit;
- (c) There is no evidence that the failures caused monetary loss to any third parties; there is no instance where this could reasonably have been expected to influence the economic decisions of users taken on the basis of the financial statements;
- (d) The Respondents cooperated with the investigation at all stages and admitted culpability early with a view to saving time and costs on all sides;
- (e) The 4th Respondent has taken prompt steps to ensure that there is no recurrence of similar failings through the ongoing training of partners and staff; and
- (f) The 1st, 2nd and 3rd Respondents have been subjected to downgrade through the firm's partner evaluation process, and their compensation awards negatively impacted as a result.

29. The Respondents strenuously deny the Complainant's allegation that the 4th Respondent "fostered a culture of lack of care and complacency", and contend that the 4th Respondent has been included as a respondent only in respect of a vicarious responsibility for the failures of 1st, 2nd and 3rd Respondents. The Respondents also explained that an erroneous decision was made for the year 2010, which was followed in subsequent years without

adequate re-examination. There is complete absence of any evidence of systemic failure, so the Respondents contend.

30. The Respondents further asserted that they had “discussed orally and informally with the appropriate level of management in all the respective years”, and therefore deny that they deprived the Company of the opportunity to evaluate the impact of the errors and take timely and appropriate remedial actions.

31. In conclusion, the Respondents submit that the complaints should be regarded as moderately serious, but accept the sanctions proposed by the Complainant “as a gesture of good faith”.

B. The Committee’s consideration of and decision on sanction

32. Beside the point about the failures being unintentional, and further subject to what will be said hereinbelow, the Committee accepts the mitigating factors set out in paragraph 28 above. Although the Committee has doubt as to whether the CB Misstatements could be classified or described as “non-material”, there is no evidence that that they have caused monetary loss to anyone, or caused anyone to make incorrect financial decision on the basis thereof. On the other hand, it must be remembered that the public places reliance on the accuracy of information contained in financial statements of listed companies. It may be difficult to say for sure whether any misstatement contained in such statements had caused any member of the public to make wrong decisions and/or suffer loss as a result. Auditors of listed companies therefore bear a heavy duty to the public to exercise due care and attention to ensure that audited financial statements as a whole are free from material misstatements. Auditors also owe the public a duty to bring any misstatements in the financial statements to the attention of the appropriate level of management for their correction in a timely manner. Should the management fail to correct the misstatements, even though they may be immaterial, the auditor has a duty to request from the management a written representation as to why corrections are unnecessary, and to enter the misstatements concerned onto a summary of misstatements.

33. It is therefore grossly improper for staff of the 4th Respondent, after identifying the CB Misstatements, to have “discussed orally and informally” with the management, instead of following the procedure as set out in paragraphs 5, 8 and 14 of HKSA 450. This is a deliberate (*not* unintentional) dereliction of their duties as auditors, and a serious breach of the trust and confidence that the public placed upon them in their capacity as the Company’s auditors.

34. In all the circumstances, the Committee considers that the sanction proposed by the Complainant on the 1st, 2nd and 3rd Respondents to be appropriate.

35. As for the 4th Respondent, while the Committee does not find there to be sufficient evidence to support the Complainant’s suggestion that the 4th Respondent “seems to have fostered a culture of lack of due care and complacency”, the Committee strongly disagrees with the Respondents’ contention that the responsibility of the 4th Respondent “arises purely vicariously” from the failures of the 1st, 2nd and 3rd Respondents, and that “there is no separate stand-alone complaint” against the 4th Respondent. It was the 4th Respondent who was the Company’s auditor. It bore a non-delegable obligation towards the Company and members of the public to exercise due care and diligence to ensure the truthfulness and fairness of information and statements contained in the Company’s financial statements. It is unsettling, to say the least, to see the 4th Respondent trying to shift the blame to individual engaging partners. The fact that the failures were allowed to continue for four consecutive years, and under the hands of three engaging partners, reflects badly on the 4th Respondent. Yet, there is not a single hint of self-reflection on the part of the 4th Respondent. Its explanation, that a mistake was made in the first year, which was followed in subsequent years without adequate re-examination, is simply appalling. The 4th Respondent received a hefty sum of auditing fee every year. It is unthinkable that it would allow a mistake to be repeated for three more years, to be discovered only when a new board of directors of the Company came into being.

36. Had it not been the Complainant’s suggestion, that a penalty in the sum of HK\$150,000 may be sufficient, the Committee would have imposed a heavier penalty.

37. The Committee therefore orders that:
- (a) The 1st, 2nd, 3rd and 4th Respondents be reprimanded under section 35(1)(b) of the Ordinance;
 - (b) The 1st and 2nd Respondents each pay penalty in the sum of HK\$60,000.00 to the Institute under section 35(1)(c) of the Ordinance;
 - (c) The 3rd Respondent do pay penalty in the sum of HK\$80,000.00 to the Institute under section 35(1)(c) of the Ordinance; and
 - (d) The 4th Respondent do pay penalty in the sum of HK\$150,000.00 to the Institute under section 35(1)(c) of the Ordinance.

VI. Costs

38. The Complainant asks for the costs and expenses of and incidental to the proceedings of the Institute, in the sum of HK\$65,048.00, as well as the costs and expenses of the Committee, in the sum of HK\$8,690.00. He also asks for the costs and expenses in relation or incidental to the investigation carried out by the Financial Reporting Council, in the sum of HK\$48,129.70.

39. The sums claimed appear to be fair and reasonable, and the Respondents do not raise any objection thereto. The Respondents are accordingly ordered to pay such costs jointly, under section 35(1)(iii) and 35(1)(d)(ii) of the Ordinance.

Dated the 6th day of March 2019

Mr. LAM Ken Chung, Simon
(Chairman)

Ms. CHAN Wai Kam, Caroline

Mr. MA Chun Fung, Horace

Mr. CHIU Ling Cheong, Anthony

Mr. YEUNG Chi Wai, Edwin