

IN THE MATTER OF

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

BETWEEN

The Registrar of the Hong Kong Institute  
of Certified Public Accountants

COMPLAINANT

AND

HLB Hodgson Impey Cheng Limited  
(M0402)

FIRST RESPONDENT

Yu Chi Fat (F06857)

SECOND RESPONDENT

Shek Lui (F06628)

THIRD RESPONDENT

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

Members: Mr. Lim Kian Leng, Malcolm (Chairman)  
Mr. Lam Sze Cay, Kevin  
Mr. Miu Liong, Nelson  
Mr. Calum Muir Davidson  
Mr. Fung Wei Lung, Brian

---

**ORDER & REASONS FOR DECISION**

---

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the “**Complainant**”) against HLB Hodgson Impey Cheng Limited (the “**First Respondent**”), Mr. Yu Chi Fat, a certified public accountant (practising) (the

“**Second Respondent**”) and Mr. Shek Lui, a certified public accountant (practising) (the “**Third Respondent**”).

2. The Complaints are as set out in a letter from the Complainant dated 11 May 2018 which was amended on 6 December 2018 (the “**Complaint**”) are as follows:-

**A. BACKGROUND**

- (1) HMV Digital China Group Limited (formerly known as China 3D Digital Entertainment Limited) (“**Company**”) was incorporated in Bermuda and its shares are listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (stock code: 08078).
- (2) The Company's consolidated financial statements for the year ended 30 June 2013 (“**2013 Financial Statements**”) were audited by the First Respondent (“**2013 audit**”).
- (3) The Second Respondent was the engagement director who signed the auditor's report of the 2013 Financial Statements and the Third Respondent was the engagement quality control reviewer (“**EQCR**”).
- (4) The 2013 Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants (“**Institute**”). The auditor's report issued by the First Respondent stated that the 2013 audit was conducted in accordance with the Hong Kong Standards on Auditing (“**HKSA**”) issued by the Institute.
- (5) On 16 March 2018, the Financial Reporting Council (“**FRC**”) referred to the Institute a report of the Audit Investigation Board (“**AIB**”) pursuant to section 9(f) of the Financial Reporting Council Ordinance, Cap.588.

- (6) The AIB found deficiencies in the 2013 audit in respect of the Company's accounting treatment of the significant fair value decline of its investment in a listed company ("**Investee A**") which was classified as an available-for-sale investment ("**AFS Investment**") in the 2013 Financial Statements.

## **B. THE COMPLAINTS**

### *First Complaint*

- (7) Section 34(1)(a)(vi) as applied by section 34(1AA) of the Professional Accountants Ordinance ("**PAO**") applies to the First Respondent in that, when carrying out the 2013 audit, it failed or neglected to observe, maintain or otherwise apply paragraphs 8(a) and 18 of HKSA 540 "*Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*".

### *Second Complaint*

- (8) Section 34(1)(a)(vi) as applied by section 34(1AA) of the PAO applies to the First Respondent in that, when carrying out the 2013 audit, it failed or neglected to observe, maintain or otherwise apply paragraphs 11 and 13 of HKSA 700 "*Forming an Opinion and Reporting on Financial Statements*".

### *Third Complaint*

- (9) Section 34(1)(a)(vi) of the PAO applies to the Second Respondent in that, as the engagement director in the 2013 audit, he failed or neglected to observe, maintain or otherwise apply the fundamental principle of professional competence and due care under sections 100.5(c) and 130.1 of the Code of Ethics for Professional Accountants ("**COE**").

#### *Fourth Complaint*

- (10) Section 34(1)(a)(vi) of the PAO applies to the Third Respondent in that, as EQCR in the 2013 audit, he failed or neglected to observe, maintain or otherwise apply the fundamental principle of professional competence and due care under sections 100.5(c) and 130.1 of the COE.

#### **C. SUMMARY OF PRINCIPAL ISSUES**

##### *In respect of First and Second Complaints*

- (11) The Company's investment in Investee A (the "**Investment**") was measured at fair value based on the quoted market price of Investee A's shares.
- (12) The Investment's fair value as at 30 June 2013 was HK\$3.5 million, which is an 80% decline (i.e. HK\$14.5 million) below the original cost of HK\$18 million. In fact, the Investment's fair value declined by 72% below its cost in the prior year as at 30 June 2012.
- (13) The Company recognized the cumulative fair value decline of HK\$14.5 million in equity under the investment revaluation reserve instead of an impairment loss in the profit and loss accounts. This accounting treatment is a departure from Hong Kong Accounting Standard 39 "*Financial Instruments: Recognition and Measurement*" ("**HKAS 39**") because:
- a. Paragraph 67 of the HKAS 39 states that when there is objective evidence that the AFS Investment is impaired, the cumulative loss that had been recognized in investment revaluation reserve shall be reclassified from equity to profit or loss.
  - b. Paragraph 61 of the HKAS 39 further states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is an objective evidence of impairment. According to paragraph AG 71 of HKAS 39, published prices in an active market are the best evidence of

fair value and when they exist, they are to be used to measure the fair value of financial assets.

- (14) In its impairment assessment, the Company concluded that no impairment for the Investment was required on the basis that the Company's share of net assets value of Investee A was higher than its investment cost. In concurring with the Company's results of impairment assessment of the Investment, the First Respondent performed audit procedures which included its analysis of HKAS 39 and the engagement of two firms of independent valuers to conduct valuations on Investee A.
- (15) Notwithstanding, there is no evidence to justify why the Company's adoption of net assets value, rather than the share price, was more appropriate to be used as a basis for determining the impairment of the Investment.
- (16) Adopting the quoted market price of Investee A's shares, the drop in the fair value of the Investment since 30 June 2012 would be a significant or prolonged decline and would be objective evidence of impairment under HKAS 39.
- (17) Based on the above, the First Respondent is considered to have failed to properly interpret and/or apply HKAS 39, leading to a failure to evaluate whether the Company's impairment assessment of the Investment had complied with HKAS 39, in accordance with paragraphs 8(a) and 18 of HKSA 540.
- (18) As a result of the misinterpretation and/or misapplication of the HKAS 39, the First Respondent also failed to express an appropriate audit opinion to indicate the Company's non-compliance with HKAS 39 in the 2013 auditor's report, in accordance with paragraphs 11 and 13 of HKSA 700.

*In respect of Third Complaint*

- (19) As the engagement director for the 2013 audit, the Second Respondent is responsible for the performance of the audit engagement in compliance with the professional standards.
- (20) On the basis of the facts and circumstances supporting the First and Second Complaints, the Second Respondent failed or neglected to observe, maintain or otherwise apply the fundamental principle of professional competence and due care under sections 100.5(c) and 130.1 of the COE.

*In respect of Fourth Complaint*

- (21) In view of the significant judgment involved in the impairment assessment of the Investment, an EQCR should have performed an adequate review to enable him to be satisfied with the audit evidence obtained and procedures performed by the audit team. As EQCR for the 2013 audit, the Third Respondent should have reviewed the audit team's work in areas involving significant judgment including the AFS Investment.
- (22) However, the Third Respondent, as the EQCR of the 2013 Financial Statements, failed to identify and address the deficiencies as aforementioned, demonstrating that he failed or neglected to observe, maintain or otherwise apply the fundamental principle of professional competence and due care under sections 100.5(c) and 130.1 of the COE.

**D. The Proceedings**

3. The First Respondent admitted the First and the Second Complaints against them. The Second Respondent admitted the Third Complaint against him. The Third Respondent admitted the Fourth Complaint against him. They did not dispute the facts as set out in the complaints. On 6 December 2018, the parties agreed that the steps set out in

paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules ("DCPR") be dispensed with.

4. The Notice of Commencement of Proceedings was issued to the parties on 20 February 2019. Based on the Respondents' admission and the joint application, the Disciplinary Committee approved the above proposal.
  - (a) The steps as set out in Rules 17 to 30 of the DCPR be waived; and
  - (b) The Disciplinary Committee directed the Complainant and the Respondents to make written submissions on sanctions and costs under Rule 31 of the DCPR.
5. The Complainant made and filed his written submissions on sanctions and costs in respect of the complaints against the Respondents on 12 March 2019.
6. On 12 March 2019, the Respondents applied for 14-day time extension to make written submissions on sanctions and costs. The Disciplinary Committee acceded to the request. The Respondents made and filed their written submissions on sanctions and costs to the Disciplinary Committee on 27 March 2019.
7. The Complainant highlighted that, had the company used the market price in its impairment assessment, a significant decline in the fair value would have resulted, warranting an impairment loss be recorded in the profit or loss accounts. The accounting non-compliance in this case had a significant impact to the 2013 Financial Statements. Had the impairment loss been appropriately recorded in profit or loss, the consolidated loss for 2013 would be increased from HK\$20.9 million to HK\$35.4 million and the Company's loss per share would approximately increase from 1.16 cents to 1.95 cents (i.e. representing an increase of 68% from the reported amount).
8. It was also argued by the Complainant that the matter has been made more serious as it has a significant public interest element.

9. In the circumstances, the Complainant argued that while the Complainant considers the level of work documented in the Respondents' working papers indicate that the audit irregularities did not appear to occur as a result of recklessness or serious disregard for regulatory requirements, and that the matter was also an isolated breach in the Respondents' audit of the 2013 Financial Statements, it has to be concluded that the breach of professional standards by the Respondents is only moderately serious and the level of sanctions should reflect such an assessment.
  
10. The Respondents drew attention to the following matters:-
  - (a) The Complaints involve only unintentional breaches of professional standards in relation to the accounting treatment on impairment. As a result, the Respondents submitted that the present case does not involve any 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) The Respondents' malpractice was based on the exercise of professional judgement in circumstances where there was limited professional guidance or where uncertainties in the interpretation of that professional guidance existed - at the relevant time, significant diversity had existed in practice on issues surrounding what constituted a "significant or prolonged decline" in the fair value of an equity instrument; and
  - (d) The Complaints should be considered as "moderately serious" being at the least serious end of the spectrum and therefore the Disciplinary Committee should take a more lenient approach to the present case.

## **F. DISCUSSION**

11. The Complainant referred us to a list of cases with similar features to the current Complaints, with the intent of providing useful guidance in terms of how the Disciplinary Committee should exercise its discretion to impose similar sanctions in the present case, while being fully aware that the Disciplinary Committee is not bound by any decision of previous committees.

12. The cases provided by the Complainant had similar characteristics to the present proceedings. For example in those cases, the auditors had acknowledged early on their failure to perform the adequate work required, and having committed an error of judgment due to their wrong interpretation of HKAS 39 - although the Complainant highlights that the Respondents in this present case could and should have relied on the International Financial Reporting Interpretations Committee ("**IFRIC**") reminder that had been published almost four years before this event while the same was not available to the parties of the mentioned precedent cases<sup>1</sup>.
13. In the Respondents' submissions, the Respondent focused mostly on similar cases that took a mild or lenient approach to the error of professional judgments committed by the auditors involved in those breaches. The cases highlighted primarily serve the purpose to substantiate the Respondents' position that the committees' past decisions imposed sanctions against the various respondents while taking into consideration that the misinterpretation of the accounting standard on impairment losses was caused by the significant complexities and diversities in that area.
14. In the present case, we note that the Complainant agrees with the Respondent that the Second and Third Respondent have a clean disciplinary record and that all Respondents have been co-operative during the investigation of the matter and have demonstrated remorse by admitting the Complaints at an early stage of the present disciplinary proceedings.
15. Moreover, both parties agree that due to HKAS 39 having been replaced by HKFRS 9 and the use of the significant or prolonged test is no longer relevant, all past cases used as precedents in the parties' submissions, as well as the present event, are unlikely to be repeated given the introduction of the new regulatory standard.

---

<sup>1</sup> Except for one of the audits concerned which was completed nine months after the IFRIC reminder was issued

16. Finally, it has been brought to the Disciplinary Committee's attention that the First Respondent has a good compliance history, notwithstanding having been issued with a disciplinary order previously, but for a different nature than this case and as such not considered relevant for the purpose of this proceeding; and the Second and Third Respondents have an unblemished disciplinary record, have been serving the Institute over the years on a voluntary basis as members of various committees and they had occasionally provided unremunerated public services in Hong Kong and Mainland China.
17. In considering the appropriate sanctions to be imposed in this case we take into account all the representations made and placed before us by the parties. In particular we have to take into account certain mitigating factors such as the lack of authoritative interpretation and diversity in practices regarding the application of HKAS 39 and, taking into account the risks, uncertainty and complexity surrounding the accounting treatment, and that they engaged two independent firms of professional valuers to conduct valuations.
18. In taking into account all the circumstances of the case as well as the mitigation submitted by the Respondents, we make the following ORDERS:
  - (a) The Respondents be reprimanded under section 35(1)(b) of the PAO;
  - (b) A penalty under section 35(1)(c) of the PAO of the total sum of HK\$60,000 be imposed jointly and severally against all the Respondents; and
  - (c) The Respondents do pay and bear equally (i) the costs and expenses of HK\$48,256.40 in relation to or incidental to the investigation incurred by the FRC under section 35(1)(d)(ii) of the PAO and (ii) the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$68,799 under

section 35(1)(iii) of the PAO, in the total sum of HK\$117,055.40.

Dated 24th June 2019

---

Mr. Lim Kian Leng, Malcolm  
Chairman

---

Mr. Lam Sze Cay, Kevin  
Member

---

Mr. Calum Muir Davidson  
Member

---

Mr. Miu Liong, Nelson  
Member

---

Mr. Fung Wei Lung, Brian  
Member