

IN THE MATTER OF

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

BETWEEN

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

AND

Mr. Chan Kwok Tung, Gordon (A11272) 1st RESPONDENT

Gordon Chan & Company Certified
Public Accountants (2146) 2nd RESPONDENT

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

Members: Mr. CHIN Vincent (Chairman)
Mr. WAI, Siu Chung, Dominic
Mr. YUEN Tat Tong
Mr. CHOW Dennis Chi In
Mr. SHEN Ka Yip, Timothy

ORDER AND REASONS FOR DECISION

1. This is a complaint made by the Registrar (the “**Complainant**”) of the Hong Kong Institute of Certified Public Accountants (the “**Institute**”) against Mr. Chan Kwok Tung, Gordon, a practising certified public accountant (the “**1st Respondent**”) and Gordon Chan & Company Certified Public Accountants, a firm (the “**2nd Respondent**”) (collectively the “**Respondents**”).
2. The Complainant’s case against the Respondents, set out in the Complainant’s letter to the Council of the Institute dated 4 April 2019 (the “**Complaint**”), is as follows:

BACKGROUND FACTS

- (1) Golden Deep Investments Limited (“GDI”), Stephen M.S. Lai & Co. CPA Limited (“SMSL”) and Deep Top Consultancy (HK) Limited (“DTC”) (collectively the “Companies”) were private limited companies incorporated in Hong Kong. They prepared financial statements in accordance with the Small and Medium-sized Entity Financial Reporting Standards.
- (2) Mr. Chan Kwok Tung, Gordon is the sole proprietor of Gordon Chan & Company Certified Public Accountants. The Respondents audited the financial statements of the Companies for the years ended 31 March 2015 and 2016.
- (3) The principal activity of GDI is property investment. The Respondents expressed unmodified auditor’s opinions on its financial statements for the years ended 31 March 2015 and 2016.
- (4) The principal activity of SMSL is the provision of professional services. The Respondents expressed an unmodified auditor’s opinion on its financial statements for the year ended 31 March 2015, and a qualified auditor’s opinion for the year ended 31 March 2016 due to limitation of scope on certain items of turnover and cost of sales.
- (5) The principal activity of DTC is the provision of professional services. The Respondents expressed unmodified auditor’s opinions on its financial statements for the years ended 31 March 2015 and 2016.
- (6) By letters to the Complainant dated 21 August 2018 and 2 November 2018, the Respondents provided a copy of the complete audit documentation in respect of each of the above audits.
- (7) A review of the audit workpapers indicated that the Respondents had failed to comply with Hong Kong Standards on Auditing (“HKSA”) and the Code of Ethics for Professional Accountants (“COE”) issued by the Institute.

COMPLAINT 1

- (8) The Respondents failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraphs 9 and 10 of HKSA 210 *Agreeing the Terms of Audit Engagements*, as they failed to obtain audit engagement letters.

PARTICULARS OF COMPLAINT 1

GDI, SMSL, DTC – 2015 and 2016 audits

- (9) The Respondents have not obtained engagement letters in respect of the audits, and there was no evidence that the Respondents have agreed the terms of the audit engagements with management or those charged with governance. This is contrary to the requirements of paragraphs 9 and 10 of HKSA 210.
- (10) In the audit workpaper titled “*Planning Memorandum*”, the Respondents stated “*No engagement letter with standard terms of business was obtained. There are no change and reminded their responsibilities*”.
- (11) The Respondents provided no justification whatsoever as to why they considered it was appropriate in the circumstances not to obtain audit engagement letters.

COMPLAINT 2

- (12) The Respondents failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 6 of HKSA 500 *Audit Evidence*, as they failed to design and perform audit procedures to obtain sufficient appropriate audit evidence in the areas of bank confirmation requests and income statements.

PARTICULARS OF COMPLAINT 2

Bank confirmation requests

GDI, SMSL, DTC – 2015 and 2016 audits

- (13) The Respondents did not request bank confirmations from the subject companies’ banks in the audits.
- (14) The Respondents stated in the audit workpapers of GDI for the 2015 and 2016 audits that “*Confirmed by Mandy who is the account of M.S. Lai & Co. CPA Limited to ensure the existence and valuation of the balance and bank loan. Therefore, no bank confirmation was sent*”.
- (15) The Respondents also stated in the audit workpapers of SMSL for 2015 and 2016 audits that “*Confirmed by Mandy who is the account of M.S. Lai & Co. CPA Limited to ensure the existence and valuation of the balance and no other bank loan was obtained. Therefore, no bank confirmation was sent*”.

- (16) The Respondents repeated a similar explanation in the audit workpapers of DTC for 2015 and 2016 audits that “*Confirmed by Mandy who is the account of Deep Top Consultancy (HK) Limited to ensure the existence and valuation of the balance and no other bank loan. Therefore, no bank confirmation was sent*”.
- (17) Nevertheless, in the relevant audit programmes, there was an audit step “*Obtain directly from the bank confirmations for all bank accounts open at any time during the year according to the external confirmation procedures in HKSA 505.7*”, and the Respondents stated “*Done*” or “*confirmed by the accountant the existing bank balance*”.
- (18) The alleged confirmations by the client’s accountant of the bank balances in question were not independent evidence of those balances. The Respondents failed to obtain sufficient evidence towards the accuracy of the companies’ bank balances and bank loans and that there were no other unrecorded liabilities with the banks.

Income statement

SMSL – 2015 audit (audit materiality: HK\$264,973)

Service income

- (19) In the “*Service Income Transaction Test*” in 2015, there were items of service income totalling approximately HK\$658,000 with “*ledger dates*” beyond 31 March 2015. Despite this, the Respondents concluded that “*the service income transactions are properly recorded*” without performing additional procedures on those items.
- (20) There was no evidence that the Respondents had considered the times at which the underlying services of those items had been performed and whether such services should be recognised as having been performed in the relevant period.

SMSL – 2015 audit (audit materiality: HK\$264,973) and 2016 audit (audit materiality: HK\$198,365)

Expenses

- (21) The Respondents provided copies of the company director’s purported credit card statements to support certain expenses of the company in 2015 (i.e. advertising expenses of HK\$1,406,756, medical expenses of HK\$171,919, and entertainment expenses of HK\$176,885). However, the said copies were illegible and, in the absence of any supporting invoices, there was no evidence that any amount stated therein would enable the Respondents to conclude that such items had represented the company’s actual expenses.

- (22) The Respondents represented that they had vouched for the company director's credit card statements and, based on their professional judgement, they took the view that the general ledger which had included these transactions had represented the company's actual expenses. The Respondents further represented that they had reviewed some invoices on a random basis. Nonetheless, such representations did not appear to be supported by any contemporaneous evidence in the audit workpapers.
- (23) The Respondents filed a schedule totalling HK\$613,456.97 in respect of advertising expenses in 2015. There was no evidence that the Respondents had checked any of the individual items in the schedule to ensure that they were actual expenses incurred by the company.
- (24) The Respondents represented that they had checked the said advertising expenses on a sampling basis and confirmed with the director of the company that such expenses had been approved. However, there was no contemporaneous evidence in the audit workpapers to support such representations.
- (25) In respect of an item of commission expense in the amount of HK\$2,116,988 in 2016, the Respondents marked "*checked to the contracts*" and filed a copy of a "*Marketing Service Agreement*". The signed agreement was entered into between "*Mr. Hoang Dinh Thuy and his companies*" and "*Mr. Lai Man Shing and his companies*" in which no contract sum was stated.
- (26) The Respondents represented that the director of the company had authorised the payment for the marketing expenses and that the agreement without contract sum would be sufficient evidence to confirm the underlying service and the expense. The Respondent failed to give any justification as to why an agreement without a contract sum of which the company was not a party would be sufficient.

DTC – 2015 audit (audit materiality: HK\$91,487) and 2016 audit (audit materiality: HK\$50,601)

Other income

- (27) The Respondents stated in the workpapers that the item of other income in the amount of HK\$359,907 in 2015 represented an audit adjustment of "*payroll reallocated with other income*".
- (28) The audit workpapers did not demonstrate the nature and calculation of such an amount and why the amount should be so recognised in the financial statements.

Insurance expense

- (29) The Respondents represented to the Complainant that the insurance expense in the 2015 financial statements was incurred in the name of Mr. Lai Man Shing, who was neither a director nor a shareholder of the company. In the audit workpaper, the Respondents stated “*checked to the supporting, bank statement*” without any supporting document filed therein. Therefore, there was no evidence as to why such an amount represented the company’s actual expense that should be recognised in the financial statements.
- (30) The Respondents represented that the director of the company had a long outstanding relationship with Mr. Lai Man Shing and approved the payment. It was entirely unclear what the long outstanding relationship might be and there was no evidence to support such representations.
- (31) Further, no similar expense was recognised in the 2016 financial statements. The Respondents have apparently failed to consider, if such insurance expense had indeed been properly attributable to the company in 2015, whether there would have been a potential understatement of similar expenses in 2016.
- (32) The Respondents represented that they were advised by the client company’s personnel that the company’s general ledger did not record the insurance transactions, and that they had reviewed the company’s ledger and concurred that no such expense was to be recognised in 2016. There was no contemporaneous evidence to substantiate such representations.

Rental income and rental expense

- (33) The company recorded no rental income or rental expense in 2015. However, it recorded rental income and rental expense of HK\$390,000 in 2016.
- (34) In the 2016 audit workpapers, the Respondents filed copies of:
- (i) A tenancy agreement entered into between the company and a landlord with the tenancy being effective from 1 September 2014; and
 - (ii) A tenancy agreement entered into between the company and another landlord in 2014 which extended the term of a tenancy agreement entered into in 2010.

- (35) The Respondents further stated that the 2016 rental income was from Stephen M.S. Lai & Co. CPA Limited, and the 2016 rental expense was paid by Stephen M.S. Lai & Co., but no other supporting document was included in the workpapers.
- (36) The Respondents failed to evaluate why no rental expense was recognised in 2015 despite the evidence that the company had leased certain properties during that year. Further, the Respondents failed to substantiate whether there existed any intercompany transactions between the company and Stephen M.S. Lai & Co. CPA Limited in respect of the recharge of rental expense among them in 2016.
- (37) In response to the observation, the Respondents represented that they were only provided with copies of the tenancy agreements during the 2016 audit and so they were unaware of the tenancies in 2015.
- (38) The rental expense was recognised in the 2014 financial statements but not in 2015. In the circumstances, the auditor should have known their client well enough to determine if audit procedures should be performed to ascertain the completeness of such an item in 2015. Nonetheless, no such audit procedure had been performed in 2015.

COMPLAINT 3

- (39) The Respondents failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 9 HKSA 580 *Written Representations*, as they failed to obtain written representations from management.

PARTICULARS OF COMPLAINT 3

GDI, SMSL, DTC – 2015 and 2016 audits

- (40) The Respondents did not obtain management representation letters, contrary to the requirements of paragraph 9 of HKSA 580.
- (41) In the audit workpaper titled “*Final Completion Checklist*”, there was an audit step, namely: “Has a signed letter of representation addressed to the firm been received from management that addresses at least the specific issues required by the HKSA’s (see guidance notes)?” To this, the Respondents stated “No”.
- (42) There is no explanation as to why the Respondents considered it appropriate not to obtain management representations.

COMPLAINT 4

- (43) The Respondents failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 41 HKSA 700 *Forming an Opinion and Reporting on Financial Statements*, as they failed to ensure that the auditor's reports were properly dated.

PARTICULARS OF COMPLAINT 4

SMSL and DTC – 2015 audits

- (44) The auditor's reports were undated and this is contrary to the requirements of paragraph 41 of HKSA 700. The Respondents acknowledged they had "*overlooked*" this matter.

COMPLAINT 5

- (45) The Respondents failed or neglected to observe, maintain or otherwise apply a professional standard, namely sections 100.5(c) and 130 of the COE, as they failed to maintain professional knowledge and skill at the level required to ensure that a client receives competent professional service, and to act diligently and in accordance with applicable technical and professional standards.

PARTICULARS OF COMPLAINT 5

- (46) The facts of the underlying charges above and the multiple breaches of professional standards clearly demonstrate that the Respondents failed to conduct the engagement with adequate professional competence and due care.

THE PROCEEDINGS

3. By letters signed by the parties dated 10 May 2019, the Respondents admitted the Complaint against them, and the parties requested that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules ("**DCPR**") be dispensed with.
4. The Disciplinary Committee agreed with the parties' request to dispense with the steps set out in Rules 17 to 30 of the DCPR in light of the admission made by the Respondents and directed the parties to make written submissions on sanctions and costs.
5. The Respondents and the Complainant made submissions on sanctions and costs by letters dated 12 July 2019 and 15 July 2019 respectively.

6. In the Respondents letter dated 12 July 2019, the Respondents reiterated that they had previously admitted to the five charges in their letter dated 8 May 2019. The Respondents admitted culpability and did not dispute the facts of the charges. The Respondents understood that they had to bear responsibilities for the mistakes made and considered their case to fall into the category of the moderately serious, proposing sanctions of a reprimand and a financial penalty of HK\$80,000. The Respondents also agreed to pay all costs and expenses incidental to the proceedings. The Respondents have cited the disciplinary case of D-16-1221H (2 October 2018) in support of their submissions (*supra*).
7. In the Complainant's letter dated 15 July 2019, the Complainant cited two disciplinary cases, namely (1) the case of D-16-1221H (2 October 2018), in which the respondent therein was fined HK\$80,000 for admitting to have breached various auditing standards in the audit of a charitable organisation; and (2) the case of D-17-1283C (17 July 2018), in which the respondent therein was fined HK\$70,000 for committing a number of non-compliances with professional standards and other errors in auditing a private company for 6 consecutive years. The Complainant also stated that the Respondents had no past disciplinary records and had been cooperative throughout the proceedings, thereby considering that the appropriate sanctions should be a reprimand for both Respondents and a financial penalty of an amount of between HK\$70,000 and HK\$95,000. The Complainant submitted that the Respondents should pay the costs of and incidental to the proceedings.
8. In considering the proper order to be made in this case, the Disciplinary Committee has had regard to all the aforesaid matters, including but not limited to the supporting evidence provided by and submissions made by the Complainant and the submissions made by the Respondents. The Disciplinary Committee considered that the circumstances of the Complaint were serious and disagreed with the Respondents' submissions that this case fell into the category of the moderately serious. Nevertheless, the Disciplinary Committee has noted the Respondents' clear disciplinary record, cooperation throughout the proceedings, early admission of the charges and that time and costs have been saved on all sides due to early admission. These were mitigating factors serving to reduce the severity of the penalty. Accordingly, we are minded to reprimand the Respondents, impose a penalty of HK\$80,000, and order the Respondents to pay the costs of these proceedings. We emphasise that the severity of the sanctions has been reduced, as the Complainant has particularly urged the Disciplinary Committee to decide *inter alia* whether past penalties imposed can continue to reflect the changing demands and requirements of the present-day profession.

SANCTIONS AND COSTS

9. The Disciplinary Committee ORDERS that:-
- (a) The 1st Respondent and 2nd Respondent be reprimanded pursuant to section 35(1)(b) of PAO;
 - (b) The 1st Respondent and 2nd Respondent jointly and severally pay a penalty of HK\$80,000 pursuant to section 35(1)(c) of PAO; and
 - (c) The 1st Respondent and 2nd Respondent be jointly and severally liable for the costs and expenses of the Complainant of and incidental to the proceedings in the sum of HK\$31,931 pursuant to section 35(1)(iii) of PAO.

Dated the 14th day of November 2019

Mr. CHIN Vincent
(Chairman)

Mr. WAI Siu Chung, Dominic
(Member)

Mr. CHOW Dennis Chi In
(Member)

Mr. YUEN Tat Tong
(Member)

Mr. SHEN Ka Yip, Timothy
(Member)