

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 COMPLAINANT
Certified Public Accountants

AND

Mr. FUNG Pui Cheung (F01100) 1ST RESPONDENT
Mr. LEE Ping Kai (F03719) 2ND RESPONDENT
Pan-China (H.K.) CPA Limited (M0268) 3RD RESPONDENT

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

Members: Ms. CHAN Ka Man, Margaret (Chairman)
 Ms. CHAN Wai Kam, Caroline
 Mr. FUNG Wei Lung, Brian
 Mr. LI Peter Po-ting

ORDER AND REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (“**the Institute**”) against Mr. Fung Pui Cheung (“**1st Respondent**”), Mr. Lee Ping Kai (“**2nd Respondent**”) and Pan-China (H.K.) CPA Limited (“**3rd Respondent**”), a corporate practice (collectively the “**Respondents**”).
2. On 23 August 2019, the Complainant submitted a complaint (“**the Complaint**”) to the Council of the Institute on the basis that the Respondents failed or neglected to observe, maintain or otherwise apply professional standards under section 34(1)(a)(vi) of the Professional Accountants Ordinance (“**PAO**”). The particulars of the Complaint as set out therein are as follows:

Background

3. The Complaint concerned auditing irregularities in the consolidated financial statements of Richly Field China Development Limited (“**Company**”) and its subsidiaries (“**the Group**”) for the years ended 31 March 2011 (“**2011 Financial Statements**”) and 31 March 2012 (“**2012 Financial Statements**”), both of which were audited by the 3rd Respondent, whilst the 1st Respondent and 2nd Respondent were respectively the engagement director for the audit of the 2011 Financial Statements (“**2011 Audit**”) and 2012 Financial Statements (“**2012 Audit**”).
4. The Company was incorporated in the Cayman Islands and re-located to Bermuda with limited liability with its shares listed on the Main Board of the Stock Exchange of Hong Kong Limited (stock code: 00313). The Company’s principal activities included property development, property management, building construction and maintenance.

5. The 2011 and 2012 Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards issued by the Institute. In the auditor's report of the 2011 and 2012 Financial Statements, it was stated that the respective audit was conducted in accordance with the Hong Kong Standards on Auditing (“HKSA”).
6. The 3rd Respondent expressed an unmodified opinion in the auditor’s report on the 2011 Financial Statements, and an unmodified opinion on the 2012 Financial Statements with an emphasis of matter paragraph relating to the material uncertainty on the Group’s ability to continue as a going concern.
7. In the 2012 Financial Statements, retrospective restatements were made to correct the errors in the 2011 Financial Statements, namely:
 - (1) Understatement of consultancy fee; and
 - (2) Improper classification of an advance to a related company.
8. In the Company’s financial statements for the year ended 31 March 2013, which was audited by another auditor, retrospective restatements were made to correct errors in respect of:
 - (1) Understatement of construction revenue and the associated costs reported in the 2011 and 2012 Financial Statements; and
 - (2) Improper capitalization of consultancy fee reported in the 2011 and 2012 Financial Statements.
9. Upon investigation by the Audit Investigation Board (“AIB”) of the Financial Reporting Council (“FRC”), irregularities were found in the audit procedures performed by the 3rd Respondent in the 2011 and 2012 Audits on (i) a construction agreement for a PRC construction project

and (ii) a consultancy service agreement in respect of the PRC construction project. The AIB also found irregularities in the 3rd Respondent's audit procedures on the advances made by the Company to certain third parties.

10. On 9 November 2018, the FRC referred to the Institute a report of the AIB pursuant to section 9(f) of the FRC Ordinance, Cap.588.

The Complaints

Complaint 1: Against 1st Respondent and 3rd Respondent

11. Section 34(1)(a)(vi) applies to the 1st Respondent and, through section 34(1AA) of the PAO, applies to the 3rd Respondent, that they failed or neglected to observe, maintain or otherwise apply professional standards in respect of the 2011 Audit.

Complaint 2: Against 2nd Respondent and 3rd Respondent

12. Section 34(1)(a)(vi) applies to the 2nd Respondent and, through section 34(1AA) of the PAO, applies to the 3rd Respondent, that they failed or neglected to observe, maintain or otherwise apply professional standards in respect of the 2012 Audit.

Facts and Circumstances in Support of Complaint 1

The Construction Agreement

13. The Company had entered into a construction agreement (“**Construction Agreement**”) with a state-owned entity to provide construction services

for some of the infrastructure and supporting facilities (“**PRC Project**”) relating to the outlets and ancillary residential project in Changsha, Hunan Province, the PRC. The Construction Agreement was at a total consideration of RMB 251.5 million. The construction was to be carried out from 18 March 2010 to 17 September 2011.

14. As at 31 March 2011, the consideration received by the Company for the PRC Project amounted to RMB 218 million (equivalent to approximately HK\$258.8 million). This amount was included in other payables as deposit received in advance for the PRC Project as at 31 March 2011, representing 28% of the consolidated net assets of the Group.
15. The working papers show that the risk of material misstatement in relation to the deposit received for the PRC Project was assessed as high. During the 2011 Audit, the auditor performed site inspection and concluded that the construction work for the PRC Project had not yet begun. The auditor accepted the management's representations that only an insignificant amount of work had been performed and the cost incurred in 2011 for the PRC Project was immaterial.
16. According to the Construction Agreement, the scope of the construction covered the earth work and the drainage work which could not be easily identified by observation through site inspection.
17. However, apart from the site observation and the reliance on management's representations, there was no evidence that the auditor had performed other audit procedures, for instance, obtaining a survey report for the PRC Project or engaging an expert to assess the progress of the construction.

18. Further, the relevant terms of the Construction Agreement showed that the PRC Project was planned to be carried out during 18 March 2010 to 17 September 2011 such that the agreement would have had run two-thirds of its expected duration as at 31 March 2011. If the PRC Project was still in the early stage by then, the auditor should have considered and assessed (i) whether the Company was able to complete the PRC Project within the contract period; and (ii) the implication of any delay in completing the PRC Project (e.g. liquidated damages and the like). Yet, the auditor failed to carry out this critical assessment to ensure that the Construction Agreement was properly accounted for in the 2011 Financial Statements.

19. As such, the auditor failed to perform sufficient procedures to support the conclusion that the Company had complied with Hong Kong Accounting Standard (“HKAS”) 11 “Construction Contracts” in respect of the recognition of profit or loss relating to the Construction Agreement. As a result, the auditor failed to obtain reasonable assurance that the 2011 Financial Statements were free from material misstatement. The 3rd Respondent and 1st Respondent are considered to have failed to comply with paragraph 11 of HKSA 200 and paragraph 6 of HKSA 500.

Consultancy Service Agreement

20. The Company had engaged a consultancy firm to provide financial consultancy service to the Group during the period from 1 June 2010 to 15 October 2010 at a consideration of RMB 20 million (equivalent to approximately HK\$23.7 million) (“**Consultancy Service Agreement**”).

21. The working papers show that the Company had recorded a late accounting adjustment in respect of a consultancy fee payment of RMB

5 million (HK\$5.8 million) that was capitalized in the 2011 Financial Statements. That amount represented the consultancy fee paid by the Company during 2011.

22. Since this late adjustment was an unusual (non-recurrent) entry recorded by the Company near the end of the reporting period, the auditor should have performed proper audit procedures to test the appropriateness of the entry by reviewing the Consultancy Service Agreement and the relevant terms and conditions in accordance with paragraphs 32 and A43 of HKSA 240.
23. However, there was no evidence that the auditor had performed audit procedures on this unusual entry. In its representation to the AIB, the auditor stated that the Consultancy Service Agreement was not selected for review as the amount of HK\$5.8 million recognized in the 2011 Financial Statements was not material.
24. Nonetheless, it is not an acceptable explanation because the minutes of the directors' meeting showed that the Company's directors had approved the consultancy service engagement in May 2010. Had the auditor diligently inspected the directors' meeting minutes, they would have been aware of the consultancy service, including the contracted amount of HK\$23.7 million (audit materiality being HK\$15.5 million) and the whole service was completed in the year ended 31 March 2011 (service period was up to 15 October 2010).
25. Further, the auditor would have realized that the Company's treatment on the subject consultancy fee did not comply with HKAS 1 (Revised) "Presentation of Financial Statements" as it did not recognize the consultancy fee on an accrual basis. According to the working papers,

the Company recognized the consultancy fee to the extent of payment made but omitted to account for the remaining unpaid balance of RMB 15 million (equivalent to approximately HK\$17.9 million) despite the consultancy service was completed in October 2010.

26. The above evidence demonstrated that the auditor had failed to perform sufficient procedures to ascertain that the subject consultancy fee was properly accounted for in the 2011 Financial Statements and thus failed to obtain reasonable assurance that the 2011 Financial Statements were free from material misstatements.
27. Based on the above, the 3rd Respondent and the 1st Respondent failed to comply with paragraphs 32 and A43 of HKSA 240, paragraph 11 of HKSA 200 and paragraph 6 of HKSA 500.

Advances to Third Parties

28. During the year ended 31 March 2011, the Company made advances to two entities (i.e. Agent A and Agent B) which were engaged to identify investment opportunities of property development projects in the PRC. As at 31 March 2011, advances were made to the said entities totalling RMB 72.2 million (equivalent to approximately HK\$86 million), representing 9.3% of the Group's consolidated net assets.
29. The terms of the loan agreements for the advances show that the advance to Agent A was interest-free provided that Agent A could successfully refer investment opportunities to the Company. The advance to Agent B however was interest-bearing and subject to a condition that Agent B was required to provide a feasibility study report and a report on investment estimate for the potential investment project to the Company by a certain

date.

30. Making advances to the two entities for the provision of service (sourcing investment opportunities) was an unusual practice and outside the normal course of the Company's business. The unusual nature and the amounts involved in the arrangements should heighten the need for professional skepticism and the auditor should have obtained an understanding of the business rationale of the arrangements. They should have also questioned the reasons for providing such a significant amount of money to these entities as a loan (as opposed to paying an agreed service fee) and the Company's relationship with these two entities especially given the more favourable terms afforded to Agent A.
31. The auditor reviewed the loan agreements with Agents A and B. In its representation to AIB, the auditor stated that they had attempted to perform company search on Agent A but to no avail as the registration details of the companies in Hainan area were restricted at the relevant time. Therefore, they requested the Company's management to provide them with a report with details of the entities' directors and shareholders generated from the website of Hainan Province Administration Bureau for Industry and Commerce.
32. However, the report from the Hainan Province authority, as provided by the Company's management, did not contain details of entities' directors and shareholders. Nevertheless, the auditor accepted the information and did not perform further procedures to ascertain the relationship between the Company and the entities. Based on the abovementioned documents provided by the Company and management's representations, the 3rd Respondent concluded that Agent A and Agent B were independent to the Group.

33. The above evidence indicated that the auditor had failed to critically assess the Company's relationship with the entities when inspecting the loan agreements. They also failed to perform other procedures to obtain independent and corroborative evidence to support their conclusion that the entities were not related parties.
34. In addition, whilst they had obtained a credit assessment report for Agent B, there was no evidence that the auditor had performed procedures to evaluate the recoverability of the advance to Agent A as at year end date.
35. Based on the above, the 3rd Respondent and the 1st Respondent failed to comply with paragraph 6 of HKSA 500 and paragraph 15 of HKSA 550 in evaluating the relationship between the Group and the advanced entities and the recoverability of the advance to Agent A in the 2011 Audit.

Facts and Circumstances in Support of Complaint 2

Construction Agreement

36. As at 31 March 2012, the consideration received by the Company for the PRC Project amounted to RMB 218 million (equivalent to approximately HK\$271.6 million), representing 32% of the Group's consolidated net assets. Such amount included in other payables as deposit received in advance for the PRC Project as at 31 March 2012.
37. The working papers show that the risk of material misstatement in relation to the deposit received for the PRC Project was assessed as high. However, the auditor had performed site inspection and continued to rely

on the management's representations that the construction work for the PRC Project was still at the early stage and the cost incurred for the PRC Project was insignificant as at 31 March 2012.

38. In September 2011, the Company signed a supplementary agreement to extend the construction period. In July 2012, the Company reached an agreement with the state-owned entity to further redefine the scope of the work for the PRC Project and extend the construction period to 30 June 2014. With the redefinition of the working scope, the Company could have been in a position to make a reliable estimation on the work that was performed and to recognize the contract revenue and the associated cost in accordance with HKAS 11.
39. Nonetheless, the 3rd Respondent only relied on management's representations about the status of the contract without performing additional audit procedures such as engaging an expert to assess the progress and expected outcome of the construction, in order to ascertain whether the Company's recognition of the construction contract was in compliance with HKAS 11.
40. Based on the above, the auditor failed to perform sufficient procedures to support the conclusion that the Company had complied with HKAS 11 and thereby failed to obtain reasonable assurance that the 2012 Financial Statements were free from material misstatements. As a result, the 3rd Respondent and the 2nd Respondent have failed to comply with paragraph 11 of HKSA 200 and paragraph 6 of HKSA 500.
41. Besides, the working papers documented that the Company did not keep separate records for the cost incurred relating to the PRC Project. The lack of records for the PRC Project had resulted in a limitation on the

audit scope in that no audit procedures could be performed to verify the cost incurred for the PRC project.

42. As such, the auditor failed to assess the implication due to the limitation imposed by the Company and thus the 3rd Respondent and 2nd Respondent failed to comply with paragraph 6 of HKSA 705.

Consultancy Service Agreement

43. As at 31 March 2012, a consultancy fee of RMB 20 million (equivalent to approximately HK\$25 million) for the PRC Project was capitalized in investment properties and properties under development for sale. The auditor accepted the capitalization of the cost on the basis of management's representations that the consultancy fee was a direct cost attributable to the construction of the properties.
44. According to the Consultancy Service Agreement, the services provided by the consultancy firm included the provision of financial consultancy services and advice to the Company on marketing and financing strategies for the PRC Project. The nature of these costs was not directly attributable to making the assets operational in the manner intended by management. As such, part of these costs should not be capitalized in accordance with HKAS 2 "Inventories" and HKAS 16 "Property, Plant and Equipment".
45. There was no evidence that the auditor had performed procedures to critically assess whether the consultancy fee for the PRC Project was eligible for capitalization and whether the recognition of the consultancy fee was in compliance with HKAS 2 and HKAS 16. As a result, the

auditor failed to perform audit procedures to obtain sufficient appropriate audit evidence to substantiate the appropriateness of capitalization.

46. On the above basis, the 3rd Respondent and 2nd Respondent failed to comply with paragraph 11 of HKSA 200 and paragraph 6 of HKSA 500.

The Proceedings

47. By letters signed by the parties dated 11 October 2019, the parties requested that the steps set out in rules 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with and that the complaint be disposed on the basis of the admissions made by the Respondents.
48. Based on the findings above, which are not disputed by the Respondents, and their admissions of the complaints, the Committee finds Complaint 1 proved against the 3rd Respondent and 1st Respondent and Complaint 2 proved against the 3rd Respondent and 2nd Respondent.
49. The Committee approved the parties' proposal and directed the parties to provide written submissions on sanctions and costs by 19 February 2020.
50. The Complainant submitted its written submissions on sanctions and costs on 18 February 2020 ("**Complainant's Submissions**").
51. The 2nd Respondent and 3rd Respondent by their respective letters both dated 19 February 2020 informed the Committee that they had no submission on sanctions and costs, whilst the 1st Respondent by his letter

dated 12 February 2020 referred to his previous letter dated 15 July 2019 but made no further submission.

52. On 27 February 2020, i.e. after the deadline for the parties' submissions on sanctions and costs, the 1st Respondent attempted to file his further submissions ("**1st Respondent's Further Submissions**") but did not apply for leave or offer any justification for the late submissions.
53. In consequence, on 9 March 2020 the Committee directed the Complainant to provide a written response on the 1st Respondent's Further Submissions.
54. Having considered the Complainant's submissions dated 11 March 2020 and in view of absence of explanation or justification for the late submissions from the 1st Respondent, and further to ensure the procedural fairness between the parties, leave was not granted for the 1st Respondent to file his Further Submissions out of time.
55. In the meantime, the parties expressed their no-objection to the Complaint being dealt with in the absence of one Disciplinary Committee member.

The Parties' Submissions

56. In the Complainant's Submissions, the Complainant brought to the Committee's attention the Respondents' prior disciplinary records:
 - (1) In D-16-1203F (December 2018), the 1st Respondent had been found guilty of breach of multiple professional standards concerning a number of significant areas in the 2010 audit of a listed company. The 1st Respondent as the engagement director

for the subject audit was reprimanded and fined HK\$50,000, having considered that it was his first-time offence. The 3rd Respondent, being the auditor of the subject audit, was also a respondent in that case for which it was reprimanded and fined HK\$250,000.

(2) The 3rd Respondent had been found guilty of breach of professional standards in four past disciplinary cases including the aforesaid case of D-16-1203F. All four cases involved audits of listed companies with three of which concerned audits that took place in or before the audit periods in these proceedings. Based on the past disciplinary orders, the level of financial penalty against the 3rd Respondent had increased from HK\$50,000 in 2015 to HK\$250,000 in 2018.

(3) The 2nd Respondent does not have prior disciplinary record.

57. The Complainant submits that, for the 1st Respondent and 3rd Respondent, this is a case of persistent failure to comply with professional standards, given their prior disciplinary records.

58. Further, as pointed out by the Complainant, it is noted that the complaints concerned a listed company and therefore has a high degree of public interest. The complaints also involved multiple breaches of standards and audit areas of substantial amounts.

59. As aforesaid, the 2nd Respondent and 3rd Respondent made no submission on sanctions and costs. The 1st Respondent invites the Committee to consider the facts, *inter alia*, that he is of an advanced age and he had sought not to practise since the expiry of his practising certificate on 31 December 2018.

Decision and Order

60. In determining the appropriate sanctions to be imposed, the Committee notes that it has a wide discretion on the sanctions and has borne in mind the relevant provisions in the Guideline to Disciplinary Committee for Determining Disciplinary Orders. It is further noted that the Committee is not bound by decisions of a previous committee and that it is for the Committee to determine the appropriate penalty having regard to the specific features of each case.
61. It is the Committee's view that the gravity and serious nature of the complaints warrant a deterrent sanction with a view to conveying a clear message to the Respondents and the profession in general that non-compliances by accountancy professionals should not and would not be condoned.
62. In considering the appropriate sanctions, the Committee agrees with the Complainant that the past disciplinary records of the 1st Respondent and 3rd Respondent, together with the present complaints, all concerning audits for listed companies and involving breach of multiple professional standards, show their repeated failures to comply with professional standards.
63. Having considered the aforesaid matters, including all relevant facts of the complaints, the parties' conduct throughout the proceedings including the Respondents' admissions of the complaints, the parties' submissions, the Respondents' personal circumstances and their relevant disciplinary records, the Committee takes the view that a financial penalty of HK\$220,000 as against the 1st Respondent, HK\$150,000 as

against the 2nd Respondent and HK\$400,000 as against the 3rd Respondent would be appropriate.

64. As for costs, the total sum of HK\$234,018 as per the Statement of Costs submitted by the Complainant, including costs incurred by FRC in the sum of HK\$162,824 and costs of the Clerk to the Committee in the sum HK\$6,002, is considered to be reasonably and necessarily incurred.

65. The Committee hereby orders that:

- (1) The Respondents be reprimanded under section 35(1)(b) of the PAO;
- (2) The 1st Respondent do pay a penalty of HK\$220,000 pursuant to section 35(1)(c) of the PAO;
- (3) The 2nd Respondent do pay a penalty of HK\$150,000 pursuant to section 35(1)(c) of the PAO;
- (4) The 3rd Respondent do pay a penalty of HK\$400,000 pursuant to section 35(1)(c) of the PAO; and
- (5) The Respondents do jointly and severally pay the costs and expenses in relation or incidental to the investigation incurred by the FRC in the sum of HK\$162,824 under section 35(1)(d)(ii) of the PAO and the costs and expenses of and incidental to the proceedings of the Complainant (including costs of this Committee) in the sum of HK\$71,194 under section 35(1)(iii) of the PAO.

Dated the 22nd day of May 2020.

Ms. CHAN Ka Man, Margaret
Chairman

Mr. FUNG Wei Lung, Brian
Member

Ms. CHAN Wai Kam, Caroline
Member

Mr. LI Peter Po-ting
Member