

- (2) The auditor, UC CPA (Practising) Limited (corporate practice no.: S0267) (the "**Practice**"), issued an unmodified opinion on the Client A 2015 Financial Statements on 31 March 2016.
- (3) The Respondent was the engagement quality control reviewer ("**EQCR**") of the audit of Client A 2015 Financial Statements.
- (4) The practice reviewer issued a Reviewer's Report on the Practice on 21 July 2017 and reported inter alia, a number of deficiencies in relation to the audit of Client A 2015 Financial Statements.
- (5) The Practice Review Committee considered that the Respondent did not perform an effective engagement quality control ("**EQC**") review, especially in the areas of impairment assessment of investment property ("**IP**") and prepayments, where significant audit deficiencies have been identified by the reviewer.
- (6) On the basis of the above, the Registrar believed that section 34(1)(a)(vi) of the PAO applied to the Respondent and submitted the facts outlined above to the Council for a referral to the Disciplinary Panels as a complaint, pursuant to section 34(1A) of the PAO.

THE COMPLAINT

- (7) Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he failed or neglected to observe, maintain or otherwise apply a professional standard in relation to his work as the EQCR in the audit of Client A 2015 Financial Statements.

FACTS AND CIRCUMSTANCES IN SUPPORT OF COMPLAINT

- (8) In accordance with paragraph 20 of Hong Kong Standard on Auditing 220 *Quality Control for an Audit of Financial Statements* ("**HKSA 220**"), an EQCR is required to perform an objective evaluation of the significant judgments made and conclusions reached by the engagement team in formulating the auditor's report.
- (9) This evaluation shall involve: (1) discussion of significant matters with the engagement partner; (2) review of the financial statements and the proposed auditor's report; (3) review of selected audit documentation relating to significant judgments made and conclusions reached by the engagement team; and (4) evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate.

- (10) The practice review found non-compliances with a number of professional standards in the audit of Client A 2015 Financial Statements indicating a deficient audit methodology. In particular, the auditor failed to design and perform adequate procedures for the purpose of obtaining sufficient appropriate audit evidence in two audit areas namely, impairment assessment of IP and prepayments of film production expenses.
- (11) In relation to the IP, the carrying amount of the IP was material to the 2015 Financial Statements at US\$5.2 million. This carrying amount was higher than its market value by at least US\$1 million which was estimated by an independent valuer engaged by Client A. However, no provision for impairment had been made.
- (12) There was insufficient audit evidence obtained to ascertain that a proper impairment assessment had been performed when:
 - (a) The IP's carrying amount was higher than its market value at the year-end, which would normally indicate that there was impairment; and
 - (b) Client A supported that no impairment was necessary as the carrying amount was lower than the future minimum lease payments receivable; but there was also no evidence of any audit procedures performed on the minimum lease payments receivable amount.
- (13) In relation to the prepayments of film production expenses, the carrying amount of the prepayments of film production expenses was material at US\$18 million.
- (14) There was no evidence that the engagement team had performed any audit procedures to ascertain that future economic benefits had been established to support that those expenses could be recorded as prepayments.
- (15) As both the IP and prepayments of film production expenses were material and involved judgement, an EQCR would be required to review the audit documentation relating to these matters and evaluate the judgements and conclusions reached by the audit team.
- (16) The lack of audit evidence to support the IP and prepayments as described above show that the Respondent failed to perform an effective EQC review of these two audit areas.
- (17) In a meeting with the reviewer held on 11 August 2017, the Respondent explained how the EQC review was performed. Subsequently, the Respondent also provided information to the reviewer to show his scope of work which were not originally included in the audit working papers. The Respondent explained that:

- (a) He had several meetings with the audit team including the engagement director to understand the audit progress. The audit team had reported to him some issues identified during the audit; e.g. how management assessed impairment of the IP at year-end. The Respondent admitted there was no documentation of the discussion.
 - (b) He sighted copies of lease agreements and contracts related to filmmaking provided by the audit team during his discussions about the (i) change in use of the IP; and (ii) recognition of filmmaking costs as prepayments.
 - (c) He completed and signed off on the EQC Review Worksheet ("**EQCR Worksheet**") to support that his EQC review was satisfactorily performed before the release of the audit report of Client A.
- (18) The reviewer considered that the information provided by the Respondent did not demonstrate an adequate and effective EQCR review:
- (a) Besides the EQCR Worksheet and what seemed to be a working copy of financial information marked with a few casting and editing marks, there was no other documentation of the procedures he performed as the EQCR located in the audit working papers.
 - (b) In the EQCR Worksheet, the Respondent answered "yes" to almost all of the questions as to whether the related procedures had been performed, without further remarks nor cross-reference to other working papers.
- (19) In his response to the practice reviewer's findings, the Respondent represented that he had reviewed working papers related to significant audit matters which were used to form the audit opinion, performed relevant procedures though not demonstrated on paper, and discussed with the audit team as to the impairment test on the IP and prepayments. He also stated that the audit team had provided sufficient evidence to him to ensure that there was no material impairment problem.
- (20) Given the lack of evidence showing that adequate audit procedures had been performed to evaluate the IP impairment assessment and prepayments, it was not clear how the Respondent could conduct an effective and objective evaluation of the significant judgments made by the audit team in this respect.
- (21) Furthermore, there was nothing in the EQCR Worksheet to demonstrate how the Respondent had evaluated the significant audit areas and came to the conclusion that the work done and judgments made by the audit team were appropriate.
- (22) On the basis of the above, the Respondent failed to carry out an EQC review with due care to effectively evaluate the significant judgments made and conclusions reached by the audit team, in breach of paragraph 20 of HKSA 220.

- (23) As HKSA 220 is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent in this respect.

THE PROCEEDINGS

3. By letter signed by the parties dated 21 November 2018, the Respondent admitted the Complaint against him, 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 Respondent, and directed the parties to make written submissions on sanctions and costs. Neither the Complainant nor the Respondent requested for a hearing.
5. The Complaint was found proven on the basis of the admission made by the Respondent.
6. The Complainant and Respondent filed their written submissions on sanctions and costs on 29 March 2019.
7. In considering the proper order to be made in this case, the Disciplinary Committee has had regard to all the aforesaid matters, including the particulars in support of the Complaint, the Respondent's personal circumstances, and the conduct of the Complainant and the Respondent throughout the proceedings.

SANCTIONS AND COSTS

8. The Disciplinary Committee orders that:-
 - 1) the Respondent be reprimanded under Section 35(1)(b) of the PAO;
 - 2) the Respondent pay a penalty of HK\$70,000 under Section 35(1)(c) of the PAO; and
 - 3) the Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant, including the costs of the Disciplinary Committee, in the sum of HK\$42,960 under Section 35(1)(iii) of the PAO.

Dated the 18th day of June 2019

Ms. KOO Kar Chun, Anna
(Chairman)

Mr. CHAN Raymond
(Member)

Ms. CHUA Suk Lin, Ivy
(Member)

Ms. DOE Julianne Pearl
(Member)

Mr. WOO King Hang
(Member)