

3. Background

- 3.1 Under Part IVA of the PAO, the Institute is empowered to carry out practice review on practice units.
- 3.2 The PRC is a statutory committee set up under section 32A of the PAO responsible for exercising the statutory powers and duties in relation to practice review under the PAO.
- 3.3 The practice reviewers, being staff members of the Quality Assurance Department of the Institute, assist and report to the PRC in carrying out those statutory powers and duties.
- 3.4 The Respondent is the sole proprietor of Lacubus CPA (Firm no.: 2217) (the "**Practice**"). The Practice was subject to its first practice review in March 2017. The Reviewer's Report which should be referred to for details in conjunction with this complaint, was issued on 15th January 2018, following submissions which commented on the dated draft Reviewer's Report received from the Practice.
- 3.5 The Respondent, being the sole proprietor and issuer of the audit reports in the name of the Practice, was responsible for the Practice's quality control system and the quality of audit engagements.
- 3.6 The practice reviewer identified significant deficiencies in the Practice's quality control system and in the following two engagements: -
 - (a) Audit of the financial statements of a private company for the year ended 31st March 2016, with audit report dated 12th November 2016 ("**Client L**"); and
 - (b) Audit of the consolidated financial statements of a private group for the year ended 31st December 2015, with audit report dated 13th September 2016 ("**Client R**").
- 3.7 The practice reviewer also found that the Respondent did not comply with the fundamental principles of integrity and professional competence and due care under the *Code of Ethics for Professional Accountants* (the "**Code**"). The nature and seriousness of the Respondent's non-compliance amount to professional misconduct.
- 3.8 The Institute wrote to the Respondent on 24th May 2018 to seek his explanations on the practice reviewer's findings to which he responded without any dispute.

4 Relevant professional standards

- 4.1 Sections 100.5(a) and (c), 110.1 and 130.1 of the Code;
- 4.2 Paragraphs 11 and 16 of Hong Kong Standard on Quality Control 1 “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Service Agreements” (“**HKSQC 1**”); and
- 4.3 Paragraphs 5, 7 and 8 of Hong Kong Standard on Auditing (“**HKSA**”) 230 “Audit Documentation”, paragraph 6 of HKSA 500 “Audit Evidence” and paragraphs 12 and A18 of HKSA 505 “External Confirmations”.

5 The Complaint

Complaint 1

- 5.1 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 for his failure to be straight forward and honest in relation to the practice review conducted on his Practice.

Complaint 2

- 5.2 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 for his failure to maintain an adequate quality control system in the Practice.

Complaint 3

- 5.3 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 for his failure to maintain professional knowledge and skill at a level required to ensure his clients received competent professional services.

Complaint 4

- 5.4 Section 34(1)(a)(viii) of the PAO applies to the Respondent in that his non-compliances as stated in Complaints 1 to 3 above amount to professional misconduct.

6 Facts and circumstances surrounding the Complaint

Complaint 1

- 6.1 Prior to the practice review site visit, the Respondent was informed that the working papers for the audits of Client L and Client R were to be provided to the reviewer at the

site visit for inspection.

6.2 In response to the reviewer's query, the Respondent subsequently admitted that the working papers provided by the Respondent for these engagements at the site visit were prepared after the audit report date and in reaction to the practice review ("New WP"). The New WP were created to replace the original working papers which were prepared before the issuance of the audit report ("Old WP"). The Respondent explained that his reasons for doing so were because he felt nervous about the practice review and erroneously believed that the working papers "could be amended in a perfect way".

6.3 In addition to creating new working papers for Clients L and R, the Respondent also admitted that he had created and/or changed other working papers for the purpose of the practice review. Some examples of the changes included: -

- (a) adding programmes, checklists and working papers;
- (b) replacing certain programmes, checklists and working papers with another set;
- (c) creating or amending working papers on significant items such as revenues, purchases, inventories, receivables and payables; and
- (d) amending wording in signed engagement letters, e.g. removing the outdated/incorrect wordings such as "true and fair view", "true and correct view".

6.4 The Respondent also provided misleading information to the practice reviewer: -

6.4.1 In a meeting with the practice reviewer, the Respondent stated that: -

- (a) certain forms were required to be completed in acceptance and continuance procedures;
- (b) an engagement quality control reviewer was required to complete a worksheet before issuance of the audit report; and
- (c) audit teams were required to prepare certain audit planning documents and programmes before issuance of the audit report.

However, he later admitted that this was untrue and all relevant documents which appeared to support such representations were created in reaction to the practice review.

6.4.2 Prior to the practice review, the Respondent submitted the 2016 self-assessment questionnaire ("EQS") which reported that the Practice: -

- (a) did not provide non-assurance services to its audit clients when in fact it did; and

(b) did not get business referrals of audit clients from independent service providers but in fact had been receiving referrals on a routine basis from a service company with which the Practice was sharing office premises.

- 6.5 The creation of working papers was clearly the Respondent's deliberate attempt to mislead the practice reviewer. Further, the answers in the EQS, which were clearly untrue, were either furnished by the Respondent falsely or recklessly.
- 6.6 According to sections 100.5(a) and 110 of the Code, a professional accountant must comply with the fundamental principle of integrity which imposes an obligation to be straightforward and honest in all professional relationships.
- 6.7 The above facts, which were not disputed by the Respondent, show that the Respondent had not been straightforward and honest, in breach of the fundamental principle of integrity under the Code, which is a professional standard referred to in the PAO. As such, section 34(1)(a)(vi) applies to the Respondent in this respect.

Complaint 2

- 6.8 Paragraph 11 of the HKSQC 1 requires a practice to have a quality control system which provides reasonable assurance that the practice and its personnel comply with professional standards and issue reports that are appropriate in the circumstances.
- 6.9 Under paragraph 16 of HKSQC 1, such quality control system should address various elements including acceptance and continuance of client relationships, ethical requirements and engagement performance.
- 6.10 In addition to reviewing the working papers of Client L and Client R, the practice reviewer spot-checked ten other engagement files and found the following deficiencies:
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- 6.10.1 There was no evidence that client acceptance and continuance procedures were completed before the Practice accepted the appointments/reappointments. This indicates that the Practice's quality control system was not effective to address the element of client acceptance and continuance.
- 6.10.2 There was no evidence that the audit teams had assessed the Practice's independence on provision of non-assurance services such as accounting and

secretarial services to its audit clients. This indicates that the Practice's quality control system was not effective to address the element of ethical requirements.

6.10.3 There were lack of audit documentation and procedures performed indicating that the Practice had a deficient audit methodology. Findings on Clients L and R, which are explained under Complaint 3 below, also show that the Practice's audit methodology was not compliant with the relevant auditing standards. This indicates that the Practice's quality control system was ineffective to address the element of engagement performance.

6.11 The above deficiencies, which were not disputed by the Respondent, are further explained in the Reviewer's Report in detail. Given the deficiencies, the Respondent, being the sole proprietor responsible for the Practice's quality control, failed to properly discharge his duty to ensure that the Practice has an effective system which meets the requirements under HKSQC 1. As HKSQC 1 is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent in this respect.

Complaint 3

6.12 Sections 100.5(c) and 130.1 of the Code require a professional accountant to maintain professional knowledge and skill at the level required to ensure that clients receive competent professional services and act diligently in accordance with applicable technical and professional standards.

6.13 The Respondent was the engagement partner of the audit of Client L and Client R and issued an unqualified opinion in the respective audit reports.

6.14 As mentioned above, the Respondent admitted that the New WP in respect of Client L and Client R were prepared after the audit report date. Therefore, the New WP should not be considered as part of the audit documentation to support the opinions issued for the audits of Client L and Client R.

6.15 Since the Respondent stated that the Old WP were prepared before the issuance of the audit reports for both engagements, the reviewer obtained from the Respondent a selection of Old WP pertaining to the audit work of certain significant accounts of the financial statements of Client L and Client R for review. The difference between the Old and New WPs, which had been confirmed by the Respondent, are described in pages A7 to A12 of the Reviewer's Report.

6.16 Based on the Old WP, the reviewer found that the Respondent failed to design and perform audit procedures in order to obtain sufficient appropriate audit evidence for both engagements, as required under paragraph 6 of HKSA 500 "Audit Evidence".

6.16.1 For Client L, the working papers show the following deficiencies: -

- (a) Sales: There was no evidence of how the Respondent was able to ascertain the accuracy and completeness of sales; and that sales were properly recorded in the appropriate period.
- (b) Purchases: There was no evidence of how the Respondent was able to ascertain the accuracy and completeness of purchases.
- (c) Trade receivables: There was no evidence of audit work on trade receivables other than the filing of a trade receivables aging report.
- (d) Trade payables: For the payable confirmation requests sent without replies, there was no evidence of alternative procedures done by the audit team to ascertain the accuracy of the account balance.
- (e) Inventory: There was no information showing how the Respondent had ascertained the accuracy of the inventory account given the working papers did not show the (i) details of items selected for inventory count; (ii) results of inventory count; and (iii) details regarding an "inventory price testing" performed.

6.16.2 For Client R, the working papers for the PRC Subsidiary A and PRC Subsidiary B show that inadequate audit procedures had been performed to ascertain the accuracy of the following significant accounts: -

- (a) Sales: There was no evidence that sales transaction test and sales cut-off test had been performed.
- (b) Purchases: There was no evidence that purchase transaction test and purchase cut-off test were performed.
- (c) Trade receivables and payables: There were inadequate procedures performed on these accounts such as lack of alternative procedures on non-replied confirmation and subsequent settlement tests.

6.17 As shown in pages A7 to A12 of the Reviewer's Report, some of the audit procedures not evidenced in the Old WP were shown to have been done in the New WP. However, the Reviewer's Report shows how the New WP were still inadequate to address the audit deficiencies identified in the Old WP.

6.18 The Respondent's submissions seemed to suggest that some audit procedures set out in

the New WP might have been performed before the audit report date. Even if that were true, those audit procedures were not documented before the issuance of the audit reports and as such, the Respondent did not comply with the requirement under HKSA 230 "Audit Documentation" which required the auditor to prepare documentation that provides a sufficient and appropriate record of the basis for the audit reports.

- 6.19 The above audit deficiencies, together with those identified by the reviewer in the spot-checking of ten other audit engagements as mentioned in Complaint 2, show that the Respondent lacks professional competence and due care, in that he failed to maintain the professional knowledge and skill at the level required to ensure his clients received competent professional services, and act diligently in accordance with applicable auditing standards.
- 6.20 On this basis, the Respondent failed to comply with the fundamental principle of professional competence and due care in accordance with sections 100.5(c) and 130.1 of the Code. As the Code is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent in this respect.

Complaint 4

- 6.21 The conduct of adding and amending working papers to mislead the practice reviewer and making false and/or misleading representations to the Institute was unprofessional and casted serious doubt on the Respondent's integrity (Complaint 1).
- 6.22 In addition, the facts and circumstances in support of Complaint 2 revealed that the Respondent failed to ensure his Practice implemented an effective quality control system to ensure its audit quality. As a result, it was no surprise that deficiencies were identified in the audits of Client L and Client R which pointed to the serious lack of professional competence and due care on the part of the Respondent when carrying out professional work (Complaint 3).
- 6.23 The severity of the Respondent's failures as explained in Complaints 1 to 3 above demonstrate a blatant disregard to his obligations as a professional accountant and the requirements under the professional standards and amounts to professional misconduct.

7. The Order

7.1 The Disciplinary Committee having considered all the documents available, the respective submissions made by the representative of the Complainant and the Respondent, the Confirmation by Respondent dated 21st November 2018, and the facts and circumstances as a whole, ordered that:-

- (a) the Respondent be reprimanded under section 35(1)(b) of the PAO;
- (b) the Respondent pay a penalty of HK\$80,000.00 under section 35(1)(c) of the PAO;
- (c) a practising certificate shall not be issued to the Respondent for 2 years effective from 42 days from the date hereof under section 35(1)(db) of the PAO;
- (d) the Respondent be removed from the register of CPAs for 12 months effective from 42 days from the date hereof under section 35(1)(a) of the PAO; and
- (e) the Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$44,053.00 under section 35(1)(iii) of the PAO.

7.2 The decision was made by the Disciplinary Committee's members. All 5 members of the Disciplinary Committee agree with the decision.

Dated 13 June 2019

Mr. LEUNG, Ka Yau
Chairman
Disciplinary Panel A

Ms. HO, Man Kay, Angela
Disciplinary Panel A

Mr. Robin Gregory D'SOUZA
Disciplinary Panel A

Mr. CHAN, Kin Man, Eddie
Disciplinary Panel B

Mr. TSANG, Tin For
Disciplinary Panel B