

IN THE MATTER OF

A Complaint made under Section 34(1A) of the Professional Accountants Ordinance (Cap.50) ("the PAO") and referred to the Disciplinary Committee under Section 33(3) of the PAO

BETWEEN

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

AND

Elite Partners CPA Limited, a corporate practice                      1<sup>st</sup> RESPONDENT  
(M0269)

Yip Kai Yin, CPA (practising) (A23951)                      2<sup>nd</sup> RESPONDENT

Ng Man Chung Siman, CPA (practising) (F05003)                      3<sup>rd</sup> RESPONDENT

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

Members:

Mr. KWONG Chi Ho Cecil (Chairman)

Ms. LAW Wing Yee Wendy (Member)

Mr. NGAI Tak Sing Alfred (Member)

Mr. CHEUNG Yat Ming (Member)

Mr. YEUNG Chi Wai Edwin (Member)

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**ORDER AND REASONS FOR DECISION**

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- (1) This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the "**Institute**") against Elite Partners CPA Limited as the 1<sup>st</sup> Respondent ("**Elite**" or the "**1<sup>st</sup> Respondent**"), Yip Kai Yin as the 2<sup>nd</sup> Respondent ("**Yip**" or the "**2<sup>nd</sup> Respondent**") and Ng Man Chung Siman as the 3<sup>rd</sup> Respondent ("**Ng**" or the "**3<sup>rd</sup> Respondent**"), and together with the 1<sup>st</sup> Respondent and the 2<sup>nd</sup> Respondent, the "**Respondents**").

## Background

- (2) On 1 November 2010, China Agrotech Holdings Limited ("**Company**") acquired the entire interest in Present Sino Group at a consideration of HK\$1,000 million, which comprised HK\$800 million convertible bonds and HK\$200 million promissory notes.
- (3) The Company and its subsidiaries were engaged in trading, manufacturing of fertilizers, pesticides and other agricultural products, and provided technical services in the related areas. At the material time, the Company was listed in Hong Kong.
- (4) Note 35(a) to the Company's financial statements for the year ended 30 June 2011 ("**2011 Financial Statements**"), audited by the previous auditors, disclosed the following regarding the acquisition of Present Sino Group on 1 November 2010:

	<i>HK\$'000</i> <i>(at fair value)</i>
<i>Net identifiable assets and liabilities</i>	<i>1,178,523</i>
<i>Gain from bargain purchase on acquisition of Present Sino Group (note iii)</i>	<i><u>(203,980)</u></i>
<i>Consideration for acquisition</i>	<i><u>974,543</u></i>
<i>Satisfied by:</i>	
- <i>Promissory notes at fair value (note 33)</i>	<i>174,543</i>
- <i>Convertible bonds (note 32(b))</i>	<i><u>800,000</u></i>
	<i><u>974,543</u></i>

- (5) The purchase consideration of the above acquisition included a consideration adjustment provision which was determined based on the future profit of Present Sino Group. If Present Sino Group could not achieve a minimum net profit of HK\$120 million and HK\$150 million for the years ended 30 June 2011 and 2012 respectively, one of the vendors agreed to pay the Company or settle by way of set off against the principal amount of convertible bonds and/or promissory notes with the amount of shortfall on a dollar to dollar basis within 3 months from the date of publication of annual results of the Company for the years ended 30 June 2011 and 2012 ("**Consideration Adjustment**").
- (6) Based on Note 35 of the audited financial statements, the Consideration Adjustment was apparently not included as part of the consideration at the time of the acquisition.
- (7) Present Sino Group did not achieve the guaranteed profits. The net losses amounted to HK\$88.94 million in 2011 and HK\$1.864 million in 2012.

- (8) The audit of the Company's financial statements for the year ended 30 June 2012 ("**2012 Financial Statements**") was the first year that Elite carried out the audit. Yip was the engagement partner and Ng was the Engagement Quality Control Reviewer ("**EQCR**") of the audit. They issued an unmodified audit report on the 2012 Financial Statements.
- (9) The audited 2012 Financial Statements were prepared in accordance with Hong Kong Financial Reporting Standards ("**HKFRS**"). The audit was conducted in accordance with Hong Kong Standards on Auditing ("**HKSA**").
- (10) In the audited 2012 Financial Statements, the Company accounted for the Consideration Adjustment as follows:
  - (a) The HK\$120 million for 2011 was recognised as income under the item "Gain from compensation of shortfall of guaranteed profit arising from acquisition", and "other receivable" under current assets;
  - (b) The same item was presented as a cash inflow under investing activities; and
  - (c) The Company was entitled to a compensation of HK\$150 million consideration adjustment (for 2012) which was presented as a non-adjusting event after the reporting period.
- (11) The above accounting treatments do not comply with the relevant HKFRSs and the Respondents, in expressing an unmodified audit opinion, failed to comply with the relevant HKSAAs.
- (12) On 25 November 2016, the Financial Reporting Council ("**FRC**") referred to the Institute a report of the Audit Investigation Board ("**AIB**") dated 27 June 2016 pursuant to section 9(f) of the FRC Ordinance, Cap 588.

#### **Summary of Principal Issues**

- (13) The principal issues in respect of the complaints were explained in the AIB report.
- (14) The Consideration Adjustment was a contingent consideration under HKFRS 3.58 and it is subject to re-measurement on 1 July 2011. The working papers of the Respondents did not show that they had conducted any audit work or assessment of the above.
- (15) The Consideration Adjustment was a non-cash item because it was settled by way of setting off the principal amount of convertible bonds and/or promissory notes with the amount of shortfall on a dollar to dollar basis. The Respondents concurred with the Company's incorrect treatment of the above as a cash flow item in the consolidated cash flow statements.
- (16) The Consideration Adjustments for 2011 and 2012 should be recognised in the respective year in which the shortfall occurred. They should not be recognised in the subsequent year and, for the adjustment relating to 2012, disclosed as a post balance sheet event in the 2012 Financial Statements.

## **The Complaints**

- (17) **Complaint 1:** Section 34(1)(a)(vi) of the PAO applies to Elite and Yip in that they failed to comply with paragraph 6 of HKSA 510 and/or paragraphs 8 and 12 of HKSA 710, as a result of their failure to perform appropriate audit procedures to assess if the opening balances of the 2012 Financial Statements complied with the requirements of HKFRS 3.58.
- (18) **Complaint 2:** Section 34(1)(a)(vi) of PAO applies to Elite and Yip in that they failed to comply with paragraph 6 of HKSA 500 and/or paragraph 18 of HKSA 540, as a result of their failure to obtain sufficient appropriate evidence and/or to make proper evaluation to ensure that the Company comply with HKFRS 3.58 in the valuation of the Consideration Adjustment.
- (19) **Complaint 3:** Section 34(1)(a)(vi) of PAO applies to Elite and Yip in that they failed to comply with paragraph 6 of HKSA 500 as a result of their failure to obtain sufficient appropriate evidence to support their concurrence with the Company's disclosure of the Consideration Adjustment of HK\$150 million as a non-adjusting event, which was contrary to the requirements of paragraph 3 of HKAS 10.
- (20) **Complaint 4:** Section 34(1)(a)(vi) of PAO applies to Elite and Yip in that they failed to comply with paragraph 6 of HKSA 500 as a result of their failure to obtain sufficient appropriate evidence to support their concurrence with the Company's disclosure of profit guarantee of HK\$120 million, a non-cash item, as a cash flow item in the consolidated cash flow statements, which was contrary to the requirements of HKAS 7.43 and 7.44.
- (21) **Complaint 5:** Section 34(1)(a)(vi) of PAO applies to Ng, in that as the EQCR he failed to comply with paragraph 20 of HKSA 220 as a result of him failing to perform an objective evaluation of the significant audit judgements made, and conclusions reached, regarding the Consideration Adjustment as set out above.
- (22) **Complaint 6:** Section 34(1)(a)(viii) of PAO applies to the Respondents in that they were guilty of professional misconduct.

## **Summary of Principal Issues - Complaints 1 & 2**

- (23) The Consideration Adjustment was a contingent consideration under HKFRS 3.58. It should have been included as part of the "Consideration for acquisition".
- (24) When Elite performed the audit of the 2012 Financial Statements as the incoming auditor, the Respondents reviewed the 2011 annual report and were aware that:
- (a) Present Sino Group did not achieve the guaranteed profit in 2011; and
  - (b) the Company did not recognise the Consideration Adjustment at acquisition date (Nov 2010) for the year ended 30 June 2011.
- (25) The audit documentation did not record that the audit team had conducted any audit work or assessment on whether HKFRS 3.58 applied.

- (26) The audit team should have assessed the re-measurement of the fair value of the Consideration Adjustment on 1 July 2011 (2012 opening) by taking into account the fact that the Present Sino Group did not achieve the said target in 2011 and 2012. According to HKFRS 3.45, the Company shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and if known, would have affected the measurement of the amounts recognised as of that date. The auditors have failed to ensure that the Company comply with the above requirement. In failing to do this, the auditors failed to comply with paragraph 6 of HKSA 500, and/or paragraph 6 of HKSA 510, and/or paragraph 18 of HKSA 540, and/or paragraphs 8 and 12 of HKSA 710.

### Summary of Principal Issues – Complaint 3

- (27) The audited 2012 Financial Statements discloses the following:

*"43. NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD*

*(i) The Company is entitled to a compensation of HK\$150 million, being consideration adjustment arising from the profit guarantee given by one of the vendors in respect of the acquisition of Present Sino Limited, upon publication of the audited results of the Company for the year ended 30 June 2012."*

- (28) Present Sino Group incurred a loss for the year 30 June 2012. The loss did not arise after 30 June 2012; instead, it represented the conditions existing at 30 June 2012. The disclosure of the item as a non-adjusting event after the reporting period did not comply with paragraph 3 of HKAS 10 "Events after the Reporting Period". The audit team did not obtain evidence sufficient to support their concurrence with the departure from HKAS 10.

### Summary of Principal Issues – Complaint 4

- (29) The Consolidated Statement of Cash Flows disclosed the following:

<i>Investing activities</i>	<i>HK\$'000</i>
<i>Gain from compensation of shortfall of guaranteed profit arising from an acquisition</i>	<i>120,000</i>

- (30) Note 34 (a) to the 2012 Financial Statements disclosed the following:

*On 1 November 2010, the Group acquired the control of Present Sino Limited ... at a total consideration of HK\$1,000,000,000.*

*The consideration was satisfied by the Company in the following manner:*

- (i) as to HK\$800,000,000 by the issue of convertible bonds; and*  
*(ii) as to HK\$200,000,000 by the issue of promissory notes.*

*The consideration is subject to the following adjustments:*

*... In the event that the guaranteed profit is not met, [the Second Vendor] shall pay to the Company or settle by way of set off against the principal amount of convertible bonds and/or promissory note any shortfall amount on a dollar-to-dollar basis ...*

- (31) Disclosing the gain from compensation of shortfall of guaranteed profit of HK\$120 million as a cash flow item was a non-compliance with paragraph 43 of HKAS 7, as the settlement of the amount was by a set-off with a liability and there was no cash flow involved. The audit team did not obtain evidence sufficient to support their concurrence with the departure from HKAS 7.

#### **Summary of Principal Issues – Complaint 5**

- (32) Valuation of the Consideration Adjustment involves significant judgement and estimation by the Company. The amount of Consideration Adjustment recognized in profit or loss represented over 88% of the profit for the year ended 30 June 2012 and it is material. However, there was no documentation to show that the EQCR had properly evaluated the significant judgements made, and conclusions reached, by the engagement team, in particular:
- (a) whether the treatment of the Consideration Adjustment complied with the requirements of HKFRS 3.58; and
  - (b) why the profit guarantees of HK\$120 million and HK\$150 million should not be recognised in the year in which the profit shortfall occurred.
- (33) Given the non-compliance with HKFRS 3 as well as other non-compliance with auditing and accounting standards were significant, the EQCR should have identified them during his review. Failure to do so indicates that Ng failed to perform an objective evaluation of the significant judgements made, and conclusions reached, in the audit, in breach of paragraph 20 of HKSA220.

#### **Summary of Principal Issues – Complaint 6**

- (34) Based on the audit documentation, the Respondents never assessed if the Company should perform a re-measurement of the fair value of the Consideration Adjustment on the opening balance according to the requirements of HKFRS 3.58. The Respondents were aware that the Consideration Adjustment provision was triggered. However, the Respondents did not appear to be aware of the relevant applicable provisions in HKFRS 3, either in their audit of the opening balances of the financial statements, or their treatment of the Consideration Adjustment of HK\$150 million for the year ended 30 June 2012. Their audit documentation contains no mention of HKFRS 3 at all, not to mention any audit procedure or assessment carried out regarding that standard.

- (35) The above is borne out by the explanation given by the Respondents to AIB regarding their auditing treatment of the Consideration Adjustment:-
- (a) Initially, in their letter dated 24 October 2014, they explained that the gain was recognized in the subsequent year (ie HK\$120 million recognized in 2012, and HK\$150 million in 2013), and that it was appropriate to classify the item under "investing activities" in the consolidated statement of cash flows. There was not even any mention of HKFRS 3 in this letter.
  - (b) Subsequently, when asked by AIB as to how their treatment would comply with HKFRS 3, they accepted that the standard applied, but suggested that the fair value of the Consideration Adjustment was "trivial or immaterial", or "approximate to zero", apparently on the ground that the fair value of the assets acquired "...already captured substantially all of the future profits...", and therefore recognition of the guaranteed profit would be a "double-counting of future profit". This is the position maintained by the Respondents even after they were sent the draft report from AIB and asked to comment.
  - (c) They also maintained, in their letter of 28 January 2015, that the Consideration Adjustment was not a financial asset under HKAS 39. Rather it was a contingent asset under HKAS 37. However they did not appear to adhere to this view anymore after being sent the draft AIB report, in which this view was rebutted by the AIB.
  - (d) Regarding the treatment in the cash flows statement, after AIB has pointed out the non-compliance with paragraph 43 of HKAS 7, the Respondents accepted that there was actually no cash flows here. However they continued to defend their treatment, initially on the ground that "...not to report any cash flows....may be seen as a violation of the HKAS 7.24...", and then later on the vague and unspecified ground that their "...presentation can provide better financial information for financial statements users".
- (36) The Complainant submitted that, the Respondents' views on the auditing and accounting treatment on the Consideration Adjustment as set out above are not only wrong, but also reveal that the Respondents' knowledge (or the lack thereof) of technical and professional standards are far below an acceptable level of professional competence. In fact some of the views as set out above are so erroneous that they can only be described as grossly incompetent.
- (37) AIB in their report states that the Respondents failed to understand HKFRS 3.58, in particular they confused the accounting requirements of "contingent consideration" with that of "measurement period adjustment". They had misconceptions about the concept of contingent asset. Also, the Respondents' comments on the non-cash item in the consolidated statement of cash flows were "entirely incorrect and clearly reflected that [Elite] failed to understand the objectives and fundamental concepts in preparing a statement of cash flows....".

- (38) The Complainant submitted that each of the Respondents has faced disciplinary proceedings previously of which they have been reprimanded and fined. Their disciplinary record and the low standard of work seen in this case points to a blatant and persistent failure on the part of the Respondents to ensure that their professional services were those expected from competent professional accountants. Therefore, they were guilty of professional misconduct.

## **THE SANCTIONS**

- (39) By a letter dated 24 October 2017, each of the Respondents have admitted to the Complaints applicable to him/it. There is no dispute as to the background and the facts leading to the Complaints. The only outstanding matter is the question of sanctions which ought to be imposed upon the Respondents.
- (40) The Complainant submitted that a cancellation of practising certificate is appropriate sanction with regard to the Complaints while the Respondents submitted that cancellation is inappropriate.
- (41) Both the Complainant and the Respondents provided various written submissions on sanctions which the Disciplinary Committee has fully and thoroughly considered. In addition, two sanctions hearings were conducted on 10 September 2018 and 27 February 2019 for the Disciplinary Committee to hear submissions from both the Complainant and the Respondents regarding sanctions.
- (42) In the course of the written submissions and the two hearings, both the Complainant and the Respondents have thoroughly analysed past cases decided by past disciplinary committees of the Institute. In addition, both the Complainant and the Respondents have made helpful submissions on the Guideline to Disciplinary Committee for Determining Disciplinary Orders. These analysis and submissions are not repeated here.
- (43) When determining the sanctions of the present Complaints, the Disciplinary Committee considered the seriousness of the Complaints. The Disciplinary Committee has also made enquiry as to the role of each Respondent with regard to each of the Complaints.
- (44) This proceeding has six Complaints. Complaints 1 to 4 are applicable to Elite and Yip. Complaint 5 is applicable to Ng. Complaint 6 is applicable to all of the Respondents. After due and careful consideration, the Disciplinary Committee concluded that the Complaints, whether considered individually or considered together as a whole, are serious.
- (45) The Disciplinary Committee considered that due to the seriousness of the Complaints, a cancellation of practising certificate for not more than one year and a financial penalty is appropriate.

## **DECISION**

- (46) In arriving at the proper sanctions to be imposed on the Respondents, the Disciplinary Committee considered all aggregating factors and mitigating factors put forward by both the Complainant and the Respondents. The Disciplinary Committee noted that the Respondents have admitted to the Complaints at an early stage of the proceeding which is a significant mitigating factor.



- (47) On the other hand, even though the Respondents admitted the Complaints at an early stage of the proceeding, the Disciplinary Committee is concerned with the competency of the Respondents as shown in the course of the proceeding.
- (48) Having considered the above facts and matters and all other factors the Disciplinary Committee deem appropriate, we make the following orders and direction:
- (a) All Respondents be reprimanded under section 35(1)(b) of the PAO;
  - (b) The 1<sup>st</sup> Respondent, the 2<sup>nd</sup> Respondent and the 3<sup>rd</sup> Respondent pay a penalty of HK\$100,000, HK\$50,000 and HK\$50,000 respectively under section 35(1)(c) of the PAO;
  - (c) The Respondents jointly and severally pay the costs and expenses of and incidental to the proceedings of the Complainant and the Clerk to the Committee under section 35(1)(iii) of the PAO, and the costs and expenses in relation or incidental to the investigation incurred by the FRC under section 35(1)(d)(ii) of the PAO. The Complainant shall lodge a statement of costs (including the costs and expenses of the Disciplinary Committee's Clerk and the FRC), within 14 days from the date hereof. The Respondents are at liberty to comment on the Complainant's statement of costs within 14 days thereafter. The Disciplinary Committee's order on cost is reserved.
  - (d) The practising certificate issued to the 2<sup>nd</sup> Respondent and 3<sup>rd</sup> Respondent be cancelled on the 40<sup>th</sup> day from the date of this order under section 35(1)(da) of the PAO; and
  - (e) A practising certificate shall not be issued to the 2<sup>nd</sup> Respondent for a period of 9 months from the date that the Respondent's practising certificate is cancelled under sub-paragraph (d) above under section 35(1)(db) of the PAO; and
  - (f) A practising certificate shall not be issued to the 3<sup>rd</sup> Respondent for a period of 6 months from the date that the Respondent's practising certificate is cancelled under sub-paragraph (d) above under section 35(1)(db) of the PAO.

Dated the 9th day of December 2019

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Mr. KWONG Chi Ho Cecil  
Chairman

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Ms. LAW Wing Yee Wendy  
Member

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Mr. CHEUNG Yat Ming  
Member

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Mr. NGAI Tak Sing Alfred  
Member

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Mr. YEUNG Chi Wai Edwin  
Member