

IN THE MATTER OF

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

BETWEEN

The Practice Review Committee  
of the Hong Kong Institute of  
Certified Public Accountants

COMPLAINANT

AND

Mr. Law Kwong Wah  
(Membership no. F01079)

RESPONDENT

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

Members: Ms. DOE Julianne Pearl (Chairman)  
Ms. CHAN Chui Bik, Cindy  
Mr. CHIU Ling Cheong, Anthony  
Mr. LI Ka Fai, David  
Ms. HO Yuk Wai, Joan

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**ORDER AND REASONS FOR DECISION**

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1. This is a complaint made by the Practice Review Committee of the Hong Kong Institute of Certified Public Accountants (the "**Institute**") as Complainant against Mr. Law Kwong Wah, a certified public accountant (the "**Respondent**"). Section 34(1)(a)(vi) of the PAO applied to the Respondent.
2. The particulars of the Complaint as set out in a letter from the Practice Review Committee to the Registrar of the Institute dated 10 July 2019 (the "**Complaint**") are as follows:

**BACKGROUND**

- (1) The Institute's Quality Assurance Department concluded a practice review on K.W. Law & Co. (Firm no.: 0659) ("**Practice**") in September 2018, and issued a Reviewer's Report dated 10 January 2019.

- (2) The Respondent was the sole proprietor of the Practice which had two non-qualified audit staff, and issued audit reports to approximately 130 audit clients (all real estate management funds or owners' corporations) in the 18-month period from April 2016 to October 2017. The Practice did not have listed or other regulated clients.
- (3) The Reviewer's Report identified significant deficiencies in the Practice's quality control system and audit deficiencies in two audit engagements reviewed by the practice reviewer, concerning the audit of the financial statements of:
  - (3.1) Client P, an owners' corporation, prepared in accordance with the *Hong Kong Financial Reporting Standard for Private Entities* ("HKFRSPE") for the year ended 31 December 2015 ("Client P FS"); on which an unmodified opinion was issued by the Practice on 25 October 2016; and
  - (3.2) Client B, a real estate management fund (the "Fund"), prepared in accordance with *Hong Kong Financial Reporting Standards* ("HKFRS") for the year ended 31 December 2016 ("Client B FS"), on which an unmodified opinion was issued by the Practice on 30 June 2017.
- (4) In view of the significant deficiencies identified, the Practice Review Committee decided to raise a complaint against the Respondent under section 32D(5) of the PAO.

## THE COMPLAINTS

### Complaint 1

- (5) Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he failed or neglected to observe, maintain or otherwise apply professional standards in relation to the audit of Client P's financial statements for the year ended 31 December 2015.

### Complaint 2

- (6) Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he failed or neglected to observe, maintain or otherwise apply professional standards in relation to the audit of Client B's financial statements for the year ended 31 December 2016.

### Complaint 3

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

### Complaint 4

- (8) 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.

## **FACTS AND CIRCUMSTANCES IN SUPPORT OF COMPLAINT 1**

### *(i) Risk assessment and understanding of internal controls*

- (9) The Respondent breached paragraph 32 of HKSA 315 as the working papers lacked documentation to address all aspects required under HKSA 315 such as:
- (9.1) understanding of key elements regarding each of the aspects of the entity and its environment, each of the internal control components, the sources of information from which the understanding was obtained, and risk assessment procedures performed; and
  - (9.2) identification of risks resulting from the understanding of related controls obtained and assessment.
- (10) Such deficient documentation also demonstrated a lack of evidence to support that the Respondent had obtained adequate understanding of the nature, operations, and basis of allocation of the various funds (General Fund, Special Fund, and Renovation Reserves) as reported in the audited financial statements of Client P.
- (11) Based on the above, there was lack of sufficient evidence to support that the relevant risk assessment procedures as required under paragraphs 11, 17-22, 24, and 27-30 of HKSA 315 had been properly performed.
- (12) According to Client P FS, a HK\$18 million-shortfall ("**Shortfall**") existed at the Balance Sheet date when there were outstanding renovation commitments of HK\$77 million while the year-end Renovation Reserves only amounted to HK\$55.1 million.

- (13) Based on the audit planning working papers, there was no evidence that the Respondent had properly carried out analytical procedures in his risk assessment in accordance with paragraph 6(b) of HKSA 315 to demonstrate how he had assessed the Shortfall, discussed with management on whether there might be a going concern issue, and performed any procedures in relation to it.
- (14) The above demonstrated that the Respondent failed to perform a proper risk assessment in accordance with the requirements of HKSA 315, and thus did not properly plan and design audit procedures in order to obtain sufficient appropriate audit evidence.

(ii) Auditor's responsibilities relating to fraud

- (15) The Respondent assessed the risk of management override of controls as high and responded with the audit approach of checking expenditures against management budget. However, there was no evidence in the working papers that such procedure, nor any other procedures (e.g. testing of journal entries) which would address this risk, had been performed.
- (16) As such, the Respondent failed to adequately respond to identified risks of management override of controls in accordance with paragraphs 32(a) and 33 of HKSA 240.
- (17) Further, there was lack of evidence indicating that the Respondent had performed adequate work to follow up on the internal controls test results which showed a possibility that duplicate invoices were being recorded.
- (18) The above demonstrated the Respondent's failure to:
  - (18.1) perform an adequate fraud risk assessment, in accordance with paragraph 16 of HKSA 240; and
  - (18.2) maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, in accordance with paragraphs 12 and A7 of HKSA 240.

(iii) Audit evidence

- (19) According to Client PFS, the entity's total equity of HK\$59 million comprised three funds: (a) General Fund of HK\$2.3 million; (b) Special Fund of HK\$1.6 million; and (c) Renovation Reserves of HK\$55.1 million. HK\$7.9 million in miscellaneous repairs expense was charged to the General Fund; and total expenditures amounted to HK\$9.3 million were deducted from the Renovation Reserves. All items exceeded overall materiality of HK\$200,000 determined by the Practice.

- (20) Based on the working papers regarding the miscellaneous repairs expense (General Fund), the audit procedures of tracing to payments and filing of supporting documents failed to demonstrate that the Respondent had adequately:
- (20.1) tested for proper authorization of the expenditures when there was no evidence that appropriate approval prior to payment had been checked;
  - (20.2) assessed whether the expenses incurred were properly recorded in the correct period when the supporting invoices did not provide information on whether the work was rendered during the year; and
  - (20.3) assessed the reasonableness of the expense item (e.g. by performing analytical procedures) when actual miscellaneous repairs were more than three times the budgeted amount; and there was no evidence of any discussion with management in relation to significant variances.
- (21) Further, the supporting documents filed raised questions on whether expenses were appropriately recorded in the General Fund vs Renovation Reserves; when supporting invoices for expenditures recorded in both accounts showed similar descriptions "大[型]維修" [*major renovations*]. There was nothing in the working papers to indicate how management determined such an allocation to justify that expenditures were being recorded in the correct account; or how the Respondent had assessed such allocations.
- (22) There was no evidence that the Respondent had performed any procedures to test the appropriateness of allocation among funds and obtained an understanding of the basis of allocation. In addition, there was no evidence that the Respondent had identified and performed any work in respect of the Shortfall.
- (23) Any misallocation of expenditures would have a significant impact as such allocations affected the ending balances of various funds and reserves; which also then had a direct impact on the management fees or special levies charged against the property owners. In this respect, the Respondent simply failed to perform adequate work to ascertain the existence, nature, and reasonableness of the expenses.
- (24) Based on above, the Respondent failed to obtain sufficient appropriate audit evidence in respect of two material items in Client P FS (miscellaneous repairs expense in the General Fund and Renovation works expenditure in the Renovation Reserves) in accordance with paragraphs 6 and A10 of HKSA 500.
- (25) As HKSAs are professional standards referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent.

## FACTS AND CIRCUMSTANCES IN SUPPORT OF COMPLAINT 2

### (i) Risk assessment

- (26) The findings as identified in (9) to (11) above also apply to Client B in that there was no evidence that a proper risk assessment was performed. As such, in respect of the audit of Client B FS, the Respondent also failed to comply with the paragraphs 11, 17-22, 24, 27-30, and 32 of HKSA 315.
- (27) The Respondent committed the same deficiency as explained in (15) above in that there was no evidence of procedures performed in response to an assessed high risk of management override of controls, and therefore breached paragraphs 16, 32(a) and 33 of HKSA 240 for his failure to perform an adequate fraud risk assessment in relation to the audit of Client B FS.
- (28) In addition to a deficient risk assessment, the Reviewer's Report also identified audit deficiencies in relation to the following material amounts in Client B FS:
- (28.1) amount due to the manager of the Fund (the "**Manager**");
  - (28.2) expenses recorded and allocated to different funds; and
  - (28.3) management fee receivable.

### (ii) Amount due to the Manager

- (29) The Manager, also the preparer of Client B FS, earned remuneration in the amount of HK\$15.6 million in 2016. As at the year-end date, there was a balance due to the Manager of HK\$14.5 million.
- (30) Given the Manager prepared Client B FS, and would likely to have a self interest in the year-end balance due from Client B, the Respondent performed virtually no procedures to obtain an understanding of the nature of this balance and whether there were any internal controls over the transactions with the Manager, and performed work to ascertain the transactions that made up the balance at the year-end date.

### (iii) Expenses recorded and allocated to different funds

- (31) Within the General Fund, income and expenditures were allocated among six phases concerning the residential blocks, plus the car parks, and three other categories namely, "Residential common", "Development common" and "Remaining portion road". Based on the working papers, there was no evidence that the Respondent had documented the basis of allocation; or performed any work to ascertain the appropriateness of the allocation among the phases/funds.

- (32) Further, for virtually all expense items, the working papers failed to demonstrate how sufficient appropriate audit evidence had been obtained when they simply contained schedules showing the breakdown by phases, and filing of some supporting documents such as invoices or ledgers.
- (33) The Respondent failed to demonstrate how he had obtained sufficient appropriate audit evidence that the expenses had been properly allocated (a) to the appropriate fund (e.g. General Fund vs. Building Management Fund or the Special Fund); and (b) among different phases within the General Fund.
- (iv) Management fee receivable
- (34) Management fee receivable totaling HK\$4.5 million was due from property owners as at 31 December 2016. According to note 4 to Client B FS, approximately HK\$1.9 million (41%) of this balance was over 90 days overdue, and there was no impairment.
- (35) The Respondent did not send out confirmation requests to confirm the management fee receivable balance. Instead, the Respondent documented that the alternative procedure of checking subsequent settlements was performed.
- (36) However, there were no details of which debtor accounts / transactions were selected for testing and the description of the procedure and the results.
- (37) Based on the above, serious doubts arose as to whether the Respondent had obtained sufficient appropriate audit evidence in respect of the amount due to the Manager, management fee receivable, as well as the proper recognition and allocation of expenses in Client B FS, in accordance with paragraphs 6 and A10 of HKSA 500.
- (38) As HKSAs are professional standards referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent.

### **FACTS AND CIRCUMSTANCES IN SUPPORT OF COMPLAINT 3**

- (39) The Respondent was responsible for the Practice's quality control system and its compliance with HKSQC 1.
- (40) The significant deficiencies identified above in the engagements of Client P and Client B demonstrated a flawed audit methodology under which the auditor failed to properly conduct a risk assessment including consideration of fraud risks, plan and design procedures to obtain sufficient appropriate audit evidence, in accordance with professional standards.
- (41) Further, the Respondent acknowledged that such flawed audit methodology was also applied to other applicable audits.

- (42) It then demonstrated the Respondent's breach of paragraph 32 of HKSQC 1 for the Practice's failure to establish policies and procedures designed to provide it with reasonable assurance that engagements were performed in accordance with professional standards, and that the reports issued were appropriate in the circumstances.
- (43) Based on the above, the Respondent also failed to ensure that the Practice had established and maintained a system of quality control to provide it with reasonable assurance that professional standards had been complied with, and the reports issued were appropriate in the circumstances, in accordance with paragraph 11 of HKSQC 1.
- (44) As HKSQC 1 is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent.

#### **FACTS AND CIRCUMSTANCES IN SUPPORT OF COMPLAINT 4**

- (45) According to sections 100.5(c) and 130.1 of the *Code of Ethics for Professional Accountants*, ("Code"), a professional accountant must comply with the fundamental principle of professional competence and due care by maintaining professional knowledge and skill at the level required to ensure that clients receive competent professional service and act diligently in accordance with applicable professional standards.
- (46) The multiple breaches of HKSAAs as stated in Complaints 1 and 2 above show that the Respondent failed to act diligently in accordance with applicable professional standards in the audits of Client P and Client B.
- (47) The breach of HKSQC 1 as stated in Complaint 3 revealed the Respondent's failure to apply an appropriate audit methodology in compliance with professional standards which seriously affected the quality of the audits conducted by the Practice.
- (48) The above show that the Respondent did not maintain the level of professional competence and due care expected of him to ensure his clients received competent professional service, in breach of sections 100.5(c) and 130.1 of the Code.
- (49) As the Code is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO also applies to the Respondent in this respect.

## THE PROCEEDINGS

3. By letter signed by the parties dated 14 August 2019, 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 complaints were all 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 October 2019 and 28 October 2019 respectively.
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 notes that the Practice had ceased its practice and had been removed from the register effective 22 January 2019 and the Respondent had ceased to be a practising certificate holder effective 8 September 2019, and orders that:-
  - 1) the Respondent be reprimanded under section 35(1)(b) of the PAO;
  - 2) a practising certificate shall not be issued to the Respondent for 18 months under section 35(1)(db) of the PAO;
  - 3) the Respondent do pay a penalty of \$50,000 under section 35(1)(c) of the PAO; and
  - 4) 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\$51,785 under section 35(1)(iii) of the PAO.

Dated the 4th day of February 2020

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Ms. DOE Julianne Pearl (Chairman)

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Ms. CHAN Chui Bik, Cindy  
(Member)

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Mr. LI Ka Fai, David  
(Member)

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Mr. CHIU Ling Cheong, Anthony  
(Member)

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Ms. HO Yuk Wai, Joan  
(Member)