

IN THE MATTER OF

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

BETWEEN

The Registrar of the Hong Kong Institute
of Certified Public Accountants

COMPLAINANT

AND

LAM, Pik Wah (A18103)
BDO Limited (M200)

1ST RESPONDENT
2ND RESPONDENT

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

Members: Ms. LAU, Shing Yan (Chairman)
Ms. HO, Man Kay, Angela
Mr. HUI, Ching Yu
Mr. TSANG, Chi Wai
Mr. PANG, Wai Hang, Arthur

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 Ms. Lam Pik Wah, a practising certified public accountant, and BDO Limited, a corporate practice (collectively “**the Respondents**”).

2. On 27 June 2017, 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**”).
3. On 25 April 2018, the Respondents submitted their joint case whereby the Respondents admitted the Complaint and set out their factual basis upon which the admission was made. The parties then jointly requested that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.
4. In view of the Respondents’ admission, the Disciplinary Committee acceded to the parties’ request to dispense with the further procedural steps and directed the parties to make written submissions on sanctions and costs.
5. On 15 June 2018 and 13 July 2018, the Complainant and the Respondents made their respective submissions on sanctions and costs.

Background

6. China Sandi Holdings Limited (“**the Company**”) is incorporated in Bermuda and its shares are listed on the Main Board (stock code: 00910) of The Stock Exchange of Hong Kong Limited.
7. The financial statements for the Company and its subsidiaries (the “**Group**”) for the years ended 31 March 2012 (“**2012 Financial Statements**”) and 2013 (“**2013 Financial Statements**”) were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards (“**HKFRS**”) issued by the Institute.
8. BDO Limited (“**BDO**”) audited the 2012 Financial Statements and 2013 Financial Statements. BDO’s audit report for the 2012 and 2013 Financial Statements (signed and dated 28 June 2012 and 28

June 2013, respectively), stated that the audits were conducted in accordance with the Hong Kong Standards on Auditing. BDO expressed unmodified opinion with an “emphasis of matter” paragraph relating to the Group's ability to continue as a going concern on both 2012 and 2013 Financial Statements. Ms. Lam Pik Wah was the director responsible for the performance of the audit engagements.

9. The consolidated loss for the year and consolidated net assets of the Group stated in the 2012 Financial Statements was HK\$387 million and HK\$4,120 million respectively.
10. BDO’s audit working paper titled “Set Materiality” stated that the materiality for the audit was HK\$92 million.
11. On 27 June 2013, the Financial Reporting Council (“**FRC**”) received a complaint on the Company’s acquisition of Grandbiz Holdings Limited and Great Peace Global Group Limited in 2012 (“**Acquisition**”) in relation to which retrospective adjustments to restate the consolidated loss for the year ended 31 March 2012 and the net assets as at 31 March 2012 of HK\$632 million and HK\$3,875 million, respectively were made in the 2013 Financial Statements.
12. On 24 March 2014, the FRC directed the Audit Investigation Board (“**AIB**”) in accordance with section 23(3)(b) of the Financial Reporting Council Ordinance (Cap. 588) (“**FRCO**”) to investigate possible auditing irregularities in respect of the Respondents’ audit of the 2012 Financial Statements, in particular, the Acquisition.
13. On 26 November 2014, the AIB sent its draft investigation report to the Respondents for their comments. The Respondents responded on 22 December 2014. The AIB revised its investigation report and sent it to the Respondents on 2 February 2015. Further comments from the Respondents on the revised investigation report were received on 17 February 2015. The Respondents’ comments were included in the AIB’s investigation

report (“**Investigation Report**”) that was adopted by the FRC on 12 March 2015.

14. On 20 March 2015, the FRC referred the Investigation Report to the Institute pursuant to section 9(f) of the FRCO, on the basis that the Respondents had failed or neglected to observe, maintain or otherwise apply professional standards under section 34(1)(a)(vi) of the PAO.

Relevant Professional Standard

15. The following professional standard is relevant and applicable to this complaint:

Hong Kong Standard on Auditing 500 “*Audit Evidence*” (Issued July 2009; revised July 2010) (“**HKSA 500**”)

“6. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.”

“11. If:
(a) audit evidence obtained from one source is inconsistent with that obtained from another; or
(b) the auditor has doubts over the reliability of information to be used as audit evidence,
the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.”

Breach of HKSA 500

16. Prior to the Acquisition, a sum of RMB 200 million (approximately HK\$245 million) (“**Sum**”) had been injected by Mr. Guo Jia Di (“**Mr. Guo**”), a major shareholder of the Company,

through Fujian Tiansan Enterprise Co., Limited ¹ (“**PRC Company**”) into Fujian Sinco Industrial Company Limited (“**Fujian Sinco**”), a company within the acquired group. The injected Sum was treated by the Company as equity of the acquired group in the determination of the gain on purchase.

17. At the time of the audit, the Respondents performed audit procedures and obtained (among other things) the following audit evidence in respect of the accounting treatment of the Sum:
- (1) Mr. Guo’s representative made representations to BDO that (i) the Sum should be treated as a capital contribution (i.e. equity) in Great Team’s accounts² and (ii) an equivalent amount would eventually be treated as capital contribution in Fujian Sinco’s accounts pending approval for capitalisation in the PRC.
 - (2) The management accounts indicated that management treated the Sum as capital reserve (i.e. equity) in Great Team’s accounts and an equivalent amount was treated as long term payable (i.e. liability) in Fujian Sinco's accounts.
 - (3) Confirmation from Mr. Guo that he did not treat the Sum as a loan owed to him in Great Team's accounts. In this confirmation, Mr. Guo confirmed that he owed Great Team certain money, instead of Great Team owing him RMB 200 million.
 - (4) The Supplemental Agreement (signed between Fujian Sinco and the PRC Company) stated that the Sum was injected into Fujian Sinco by the PRC Company as a loan.
 - (5) The Fujian Sinco Confirmation confirmed that the Sum was “held on behalf of Great Team”.

¹ A company beneficially owned by Mr. Guo Jia Di

² Great Team being a company holding a 30% interest in Fujian Sinco

18. The Respondents concurred with the Company's accounting treatment of the Sum as a capital contribution (i.e. equity of the acquired group) in calculating the gain on purchase. However, the Complainant took the view that the Supplemental Agreement (item 4 above) and the Fujian Sinco Confirmation (item 5 above), which suggested that the Sum was a loan, appeared to be inconsistent with the Company's treatment of the Sum and warranted further scrutiny.
19. The Respondents submitted that based on their understanding from the representative of Mr. Guo, the Sum was intended to be treated as a capital contribution in the acquired group. However, there is insufficient audit evidence obtained by the Respondents to support their concurrence of the Company's treating the Sum as a capital contribution.
20. In view of the apparent inconsistency mentioned above, pursuant to paragraphs 6 and 11 of HKSA 500, the Respondents were expected to have performed additional audit procedures to resolve this issue. This would include obtaining a direct confirmation from Mr. Guo of whether the injected sum of RMB200 million into the acquired group was in the nature of a loan or a capital contribution from him / the PRC Company and / or further evidence to show that treating the Sum as equity was justified. There was no evidence of the Respondents obtaining such a direct confirmation or further evidence justifying that the Sum was capital in nature.
21. In the circumstances, the Respondents failed to comply with paragraphs 6 and 11 of HKSA 500 in respect of their failure to obtain sufficient appropriate audit evidence to concur with the Company's accounting treatment of the RMB 200 million in determining the gain on purchase in the Acquisition.
22. As a result, the gain on purchase in the acquisition was retrospectively restated by a reduction of RMB 200 million. The consolidated loss for the group was restated to be HK\$632 million, an increase of 63% (from HK\$387 million).

The Parties' Submissions on Sanctions and Costs

23. Both the Complainant and the Respondents agree that the Disciplinary Committee should impose a penalty in the form of a reprimand and a fine.
24. In their letter of 15 June 2018, the Complainant highlights the fact that this case concerns a listed audit and there is an element of public interest involved. The Complainant further invites the Committee to note that the misstatement in the consolidated loss of the group is considerable, being a difference of 63%.
25. The Respondents, on the other hand, submit that the nature of their breach was moderate. They argue that this is not a case where the engagement team omitted to consider a professional standard or misapplied an accounting treatment but rather (so they argue) it was a failure by the engagement team to prepare an audit confirmation with clear wording to avoid any confusion with respect of management intention.
26. The Respondents further rely on the following matters as mitigating factors:
 - (1) The breach concerns a discrete accounting treatment relating to only one year of audit, rather than an extensive issue that spans across the entire audit or affects various years of audits.
 - (2) The engagement team genuinely believed at the time that sufficient appropriate audit evidence was obtained with respect to the accounting treatment in question.
 - (3) The Respondents admit the Complaint and have cooperated fully and acted reasonably throughout the AIB's investigation and the Institute's disciplinary action.

- (4) The Respondents are remorseful for the breach and this incident highlights to them the need to be very careful when preparing audit confirmations (and other audit evidence) to ensure clear wording to reflect the management's intention and avoid any potential confusion.
 - (5) The breach is an isolated, one-off incident which is unlikely to significantly undermine the reputation of or confidence in the profession (notwithstanding that the Company is listed).
 - (6) The Respondents worked with the Company in the following year to make a prior year adjustment on the accounting treatment.
 - (7) There has not been any suggestion that the Company has suffered loss as a result of the Respondent's breach (and BDO continues to be the Company's auditor and provide assurance services to the Company).
 - (8) There was no fraud, dishonesty, professional misconduct or personal gain involved in the breach and it was inadvertent.
 - (9) The Respondents have been subject to the AIB's investigation (and subsequently this disciplinary action) since 2013 and this has caused stress and strain especially on the part of Ms. Lam.
27. The Respondents suggest that a reprimand together with a fine not exceeding HK\$50,000 for BDO would be proportionate to the nature of the case.
28. As for costs, the Respondents are willing to pay the costs of the Complainant and the AIB's investigation, as well as the costs of the Disciplinary Committee.

Decision

29. The Institute has recently published a new Guideline to Disciplinary Committee for Determining Disciplinary Orders (“**the Guideline**”) which provides the general approach to sentencing and the type of factors which should be considered.
30. Paragraph 6.2 of the Guideline concerns the level of financial penalty. Sub-paragraph (1) states that cases which are considered as not serious enough to warrant disciplinary action would generally be concluded by a Resolution by Agreement which entails a public reprimand and financial penalty of an amount not exceeding HK\$50,000. Cases that are referred to the Disciplinary Panels, as in the present Complaint, are considered more severe and would expect heavier sanctions.
31. Paragraph 6.2(2) states that the level of financial penalty should reflect the seriousness of the offence. In determining the seriousness of the breach, the considerations as set out in paragraphs 5.2 and 5.3 are relevant. For example:
 - (1) Nature and circumstances of the breach, such as:
 - (a) nature of failure and/or offence
 - (b) level of public interest involved (e.g. professional services provided for listed company, misleading/false statements on information to be relied upon by the public or other regulators)
 - (c) whether the breach could undermine confidence in the standards of the profession
 - (d) whether the breach may damage the reputation of the profession
 - (e) whether the breach was isolated or recurring.
 - (2) Conduct of the respondent, e.g. whether the offence committed was intentional or deliberate, or occurred as a result of carelessness or recklessness.

- (3) The seriousness of the offences could be increased by, e.g. recklessness or blatant disregard for regulatory requirements or principles, nature and impact of the breach, degree of high public interest, and/or detrimental effect on reputation of and confidence in the profession.
32. The Disciplinary Committee agrees with the Complainant that a high level of public interest is involved in the present case as it concerns the audit of a listed company. The nature and impact of the breach is also serious as it led to a 63% misstatement in the group's consolidated loss which, on any view, is very significant. These matters have increased the seriousness of the breach.
33. The Committee does not agree with the Respondents' submissions that the nature of the breach is only moderate or that it merely concerns the engagement team's failure to draft an audit confirmation with appropriate wording. Instead, in this case, the Respondents were given documents which, on their face, were inconsistent with the Company's treatment of the Sum (especially the Supplemental Agreement). Notwithstanding, the Respondents adopted the management's treatment without carrying out additional verification as required under paragraphs 6 and 11 of the HKSA 500.
34. The reputation of the accounting profession is, to a considerable extent, dependent upon the members' ability to exercise independent professional judgment in particular when faced with conflicting or ambiguous information in the course of performing their services as certified public accountants. In this case, the Respondents have given undue weight to the management's representations and accounting treatment of the Sum, thereby failing to perform additional audit procedures and properly resolve the apparent inconsistency. In the circumstances, the Respondents' conduct in this case could undermine the public's confidence in the standards of the profession.
35. Both the Complainant and the Respondents have referred to the case of D-16-1138P in their submissions. In that case, which also

concerned the audit of a public company, the respondent failed to perform sufficient audit procedures to support the valuation of a convertible bond. The respondent was reprimanded and fined a sum of HK\$60,000 plus costs.

36. The Committee must emphasise that each case is fact sensitive and it is not bound by the decision of a previous committee. Although there are similarities between that case and the present case, in D-16-1138P there was no direct evidence that the subject company's profit and loss had been materially misstated as a result of the respondent's breach, whereas in this case the consolidated loss was increased by 63%. Moreover, in this case, the Respondents failed to perform additional audit procedure despite the presence of audit evidence indicating that the Sum was a loan (where in D-16-1138P there appears to be no such conflicting evidence). The Committee is of the view that the nature and impact of the breach in this case is more serious, in particular when the interests of the investing public are taken into account.
37. Having considered all the relevant facts of the Complaint and the parties' submissions, the Committee considers that a fine of HK\$100,000 is appropriate. As the Complaint was made against the two Respondents collectively and no differentiation has been made as to the extent of their breach, the fine of HK\$100,000 should be paid by the Respondents jointly and severally.
38. As for costs, the Disciplinary Committee considers that the total sum of HK\$134,394.60 is reasonable as the underlying transaction is a complicated one. This is expressly admitted by the Respondents in their submissions dated 13 July 2018. Such costs should also be paid by the Respondents jointly and severally.
39. The Disciplinary Committee makes the following order:
 - (1) The Respondents be reprimanded under section 35(1)(b) of the PAO;

- (2) The Respondents do jointly and severally pay a penalty of HK\$100,000 pursuant to section 35(1)(c) of the PAO;
- (3) The Respondents do jointly and severally pay the costs and expenses of and incidental to the proceedings of the Complainant (including the costs of the Disciplinary Committee) in the total sum of HK\$134,394.60 under section 35(1)(iii) of the PAO.

Dated the 12th day of September 2018.

Ms. LAU, Shing Yan
Chairman

Ms. HO, Man Kay, Angela
Member

Mr. HUI, Ching Yu
Member

Mr. TSANG, Chi Wai
Member

Mr. PANG, Wai Hang, Arthur
Member