

IN THE MATTER OF

A Complaint made under section 42C(1) of the Professional Accountants Ordinance (Cap. 50) (the “PAO”)

BETWEEN

An Investigation Committee
of the Hong Kong Institute of
Certified Public Accountants

COMPLAINANT

AND

Ernst & Young (0422)
Mr. Wu Kwok Keung, Andrew (A01000)

1st RESPONDENT
2nd RESPONDENT

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

Members: Mr. WONG Kit Hin, Peter (Chairman)
Mr. CHU Kin Wing
Mr. LAM Chi Ki
Mr. HO Kam Wing, Richard
Mr. TAM Tak Wah

ORDER AND REASONS FOR DECISION

1. This is a complaint made by an Investigation Committee of the Hong Kong Institute of Certified Public Accountants (the “**Institute**”) against Ernst & Young, a firm of certified public accountants (the “**1st Respondent**”) and Mr. Wu Kwok Keung, Andrew, a certified public accountant (the “**2nd Respondent**”) (collectively the “**Respondents**”).
2. The particulars of the Complaint as set out in a letter from the Investigation Committee to the Acting Registrar of the Institute dated 14 February 2019 (the “**Complaint**”) are as follows:

BACKGROUND

- (1) Under the direction of the Council of the Institute, an Investigation Committee (the “IC”) was constituted to investigate the conduct of CPAs involved in the audits of the financial statements of Moulin Global Eyecare Holdings Limited (formerly known as Moulin International Holdings Limited) (“**Moulin**”) for the periods ended 31 December 2002 and 2003.
- (2) The IC was directed to inform the Council as to whether any CPAs involved in the audits of the financial statements of Moulin for the relevant periods would have a case to answer in respect of a complaint under section 34(1)(a) of the PAO.
- (3) On 30 November 2017, the IC issued a report of its findings (“**Report**”) in relation to the audits of the financial statements of Moulin and its subsidiaries (“**Group**”) for the periods ended 31 December 2002 and 2003 by Ernst & Young (“**EY**”).
- (4) Mr. Wu Kwok Keung, Andrew was the engagement partner responsible for issuing the auditor’s reports for both audits.
- (5) The IC considered that in the 2002 and 2003 audits, the Respondents failed to apply the relevant Statements of Auditing Standards (“**SAS**”) in respect of the following key audit areas:
 - (a) Sales to North American customers;
 - (b) Tax indemnity from the PRC subcontractor; and
 - (c) Other loans and prepayments.
- (6) As such, the IC concluded that the Respondents would have a case to answer to a complaint under section 34(1)(a)(vi) of the PAO.

RELEVANT PROFESSIONAL STANDARDS

- (7) **SAS 100 “Objective and General Principles Governing an Audit of Financial Statements” (Revised February 2002)**

“9. Auditors should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist which cause the financial statements to be materially misstated. (SAS 100.4)”
- (8) **SAS 230 “Documentation” (Issued January 1997)**

“2. Auditors should document matters which are important in providing evidence to support the audit opinion. (SAS 230.1)”

“5. Auditors should prepare working papers which are sufficiently complete and detailed to provide an overall understanding of the audit to another experienced auditor. (SAS 230.2)”

(9) **SAS 400 “Audit Evidence” (Issued January 1997)**

“2. The auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion (SAS 400.1)”

“10. When obtaining audit evidence from tests of control, the auditors should consider the sufficiency and appropriateness of the audit evidence to support the assessed level of control risk (SAS 400.2)”

COMPLAINTS

- (10) Complaint 1: Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply professional standard(s) regarding the audit of sales to North American customers in the 2002 and 2003 audits.
- (11) Complaint 2: Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply professional standard(s) regarding the audit of tax indemnity from the PRC subcontractor in the 2002 and 2003 audits.
- (12) Complaint 3: Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply professional standard(s) regarding the audit of other loans and prepayments in the 2002 and 2003 audits.

SUMMARY OF PRINCIPAL ISSUES

Complaint 1

- (13) The audit working papers indicated that the four North American customers were the largest customers with aggregate sales representing 28% of the Group’s total sales for both 2002 and 2003.
- (14) Despite the significance of North American sales to the Group, the Respondents did not obtain sufficient appropriate evidence to enable them to conclude on the completeness and appropriateness of the accounts in the 2002 and 2003 financial statements.
- (15) As documented in the 2002 audit working papers, the objective of sales testing was to ensure that sales transactions are properly recorded, authorized and accounted for during the year. However, the auditors hadn’t verified customers’ receipts of goods in the Sales System



working papers, which was documented as a selected audit procedure. Instead, the auditors involved its internal IT team to perform the stock movement test and checked to the delivery evidence to substitute the checking of customers' receipt of goods, which was not sufficient.

- (16) In the 2003 audit, the sales transaction test on the North American customers was insufficient. The procedures designed by the auditor to check postings to the general ledger and the associated sales receipts and cost of sales to the respective accounts were incomplete.
- (17) In both 2002 and 2003 audits, the sales system analysis and test of controls narratives showed no evidence of the auditor's understanding of the reasons for the North American sales to be accounted for using a different invoice sequencing than the Group's other sales. There was also no clear documentation as to how the auditors resolved the different sales invoice sequences.
- (18) The issues identified in paragraphs (15) and (16) above reflect non-compliance with paragraphs 2 and 10 of SAS 400 during the 2002 and 2003 audits.
- (19) Even if the Respondents have conducted the audit procedures that the IC considers lacking, the Respondents did not comply with paragraphs 2 and 5 of SAS 230 in preparing sufficient appropriate documentation to enable another independent experienced auditor to have an overall understanding of the work carried out on the sales to North American customers.
- (20) As SAS 230 and SAS 400 are professional standards referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondents in this respect.

Complaint 2

- (21) The Group had a tax indemnity agreement under which taxes incurred by the Group from certain PRC operations were to be borne by the PRC subcontractor.
- (22) Audit documentation shows that the PRC tax expenses covered by the indemnity agreement were material to the 2002 and 2003 financial statements. The Group did not make any provisions for such PRC tax expenses nor disclose the under-provisions as contingent liabilities in the 2002 and 2003 financial statements.
- (23) The tax indemnity agreement represented only a contractual agreement between two parties but did not eliminate the Group's tax obligations arising from its PRC operations.

- (24) In addition, given the assets and liabilities of the PRC operations were consolidated into the Group's financial statements, the non-recognition of the associated PRC tax liabilities poses an inconsistent accounting treatment.
- (25) The working papers included internal correspondence indicating EY tax department's concerns that the Group would be legally liable for the PRC tax expenses. In the event that the PRC subcontractor failed to make payment, the PRC tax authority may eventually require the Group to pay all taxes owed. There is insufficient documentation in the working papers to explain how this situation was resolved and to support that the tax liability was considered so remote that disclosure of a contingent liability was not necessary under the prevailing accounting standard, namely paragraphs 29 and 86 of SSAP 28 "*Provisions, Contingent Liabilities and Contingent Assets*".
- (26) Although the Respondents claimed that the concerns of its tax department had been resolved during the tax review process and they no longer existed at the conclusion of the audit, the working papers did not show documentation on how these concerns had been addressed.
- (27) There was insufficient documentation supporting EY's conclusion that such PRC tax expenses did not represent obligations arising from the Group's operations which require provision as tax liabilities or disclosure as contingent liabilities.
- (28) As such, the Respondents failed to comply with paragraphs 2 and 5 of SAS 230.
- (29) As SAS 230 is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondents in this respect.

Complaint 3

- (30) The Group had significant loans and prepayments to third parties even though its core business activities did not involve money-lending. A director of the Company had indemnified the Group from any losses arising from such loans.
- (31) It is a fundamental principle that an auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist which cause the financial statements to be materially misstated.
- (32) This attitude of professional skepticism entails the auditor making critical assessments, with a questioning mind, of the validity and reasonableness of the evidence obtained and being alerted to suspicious and unusual transactions when drawing conclusions from audit observations.

- (33) In view of the materiality of the loans and the fact that they were not part of the Group's core business, it is expected that the auditor would make critical assessment of the loans by determining the rationale and reasonableness of the loan transactions.
- (34) The 2002 and 2003 audit working papers did not contain any documentation which explains the criteria, purpose and rationale for the loans to third parties. The documentation also did not explain the rationale for the director to indemnify such loans. There is no evidence in the working papers showing the auditor's critical assessment of the loans.
- (35) On the above basis, the Respondents failed to comply with paragraph 9 of SAS 100 and paragraphs 2 and 5 of SAS 230.
- (36) As SAS 100 and SAS 230 are professional standards referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondents in this respect.

THE PROCEEDINGS

3. By letters signed by the parties dated 4 April 2019, the Respondents admitted the Complaint against them, 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 Respondents, and directed the parties to make written submissions on sanctions and costs.
5. The Complainant made submissions on sanctions and costs by letter dated 17 June 2019.
6. The 1st Respondent and the 2nd Respondent made submissions on sanctions and costs by letters dated 18 June 2019 and 17 June 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 Respondents' personal circumstances, and the conduct of the Complainant and the Respondents throughout the proceedings.

SANCTIONS AND COSTS

8. The Disciplinary Committee ORDERS that:-
- (a) the Respondents be reprimanded under section 35(1)(b) of the PAO;
 - (b) the 1st Respondent do pay a penalty of HK\$350,000 under section 35(1)(c) of the PAO;
 - (c) the 2nd Respondent do pay a penalty of HK\$100,000 under section 35(1)(c) of the PAO; and
 - (d) the Respondents do jointly and severally pay the costs and expenses of and incidental to the proceedings in the sum of HK\$184,690 under section 35(1)(iii) of the PAO.

Dated the 29th day of August 2019

Mr. WONG Kit Hin, Peter
(Chairman)

Mr. CHU Kin Wing
(Member)

Mr. HO Kam Wing, Richard
(Member)

Mr. LAM Chi Ki
(Member)

Mr. TAM Tak Wah
(Member)