

IN THE MATTER OF

A Complaint made under Section 34(1) and 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

Mr. Tang Wai Hung RESPONDENTS
(Membership no.: A10201)

Mr. Chow Chi Kit
(Membership no.: A14433)

W. H. Tang & Partners CPA Limited
(Corporate Practice No. M0053)

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

Members: Dr. Wilson Claire (Chairman)
 Mr. Shum Hon Wo
 Ms. Yap Hiu Yee Betty
 Mr. Hills Stuart Martin
 Mr. Chow Tak Sing Peter

ORDER & REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the "**Institute**") against Mr. Tang Wai Hung, CPA (Practising) ("**Tang**"), Mr. Chow Chi Kit, CPA (Practising) ("**Chow**") and W. H. Tang & Partners CPA Limited ("**WH Tang**"), a corporate practice (collectively the "**Respondents**").
2. The Complaint as set out in the letter dated 29 June 2017 from the Registrar to the Council of the Institute (the "**Complaint**") is as follows:-

BACKGROUND

- (1) On 8 November 2016, the Financial Reporting Council ("**FRC**") referred to the Institute a report of the Audit Investigation Board ("**AIB Report**") concerning the financial statements of China Technology Solar Power Holdings Limited (formerly known as Soluteck Holdings Limited) (stock code: 08111) ("**Company**") and its subsidiaries (collectively "**Group**") for the year ended 31 March 2012 ("**2012 Financial Statements**").
- (2) WH Tang issued an unqualified auditor's opinion on the 2012 Financial Statements on 22 June 2012. Tang was the engagement director and Chow was the engagement quality control reviewer ("**EQCR**") of the audit.
- (3) The subject matter concerned an acquisition of a Target Group by the Company on 1 June 2011 for a total consideration of HK\$280,030,000. As part of the consideration for the acquisition ("**Consideration**"), the Company issued convertible bonds ("**CBs**") containing two tranches ("**Tranche I CB**" and "**Tranche II CB**"). Details of the acquisition are as follows:

Cash consideration	HK\$	62,400,000
Issue of 133,000,000 shares at HK\$0.41 per share		54,530,000
Issue of Tranche I CB		113,100,000
Issue of Tranche II CB		<u>50,000,000</u>
	HK\$280,030,000	

- (4) The Company used a valuation report issued on 20 July 2011 by Valuer A in determining the fair values of CBs at 1 June 2011 ("**Valuation A**"). Accordingly, on issuance of the CBs, the Company recorded both liability and equity components of Tranche I CB and Tranche II CB as follows:

	Tranche I CB (HK\$ '000)	Tranche II CB (HK\$ '000)	Total (HK\$ '000)
Liability	29,943	13,238	43,181
Equity	<u>83,157</u>	<u>36,762</u>	<u>119,919</u>
	113,100	50,000	163,100

- (5) According to the Company's circular dated 16 May 2011, the Consideration was determined having taken into account a number of factors, including (i) the Target Profit; (ii) the Consideration Adjustment; (iii) confirmed agreements at an amount of approximately RMB 302 million of the system integration business ("**Revenue Contracts**"); and (iv) preliminary valuation of the power generation business.
- (6) The Consideration Adjustment only applied to Tranche II CB.

- (7) Subsequently, the Company issued a circular on 22 February 2012, informing the shareholders that it had entered into a Supplemental Agreement to amend the terms of the Consideration Adjustment. The reason for the amendment was because, the PRC subsidiary of the Target Group had not yet commenced its system integration services as the contracting parties in the Revenue Contracts were still in the process of obtaining the necessary licenses from the respective government authorities. The Supplemental Agreement provided as follows:
- (i) The Target Profit in the amended terms would be increased from HK\$30 million to HK\$40 million.
 - (ii) The 12-month financial period originally ended at 31 March 2012 was extended by 6 months to 30 September 2012.
 - (iii) The formula of the Consideration Adjustment would be amended such that if the Target Profit was HK\$15 million or less, the principal amount of Tranche II CB would be adjusted to HK\$NIL.
- (8) A total goodwill payment of HK\$260 million arising from the acquisition was allocated to two cash generating units ("CGUs") as follows: (i) power system integration business ("**Power System Integration CGU**") of HK\$236 million; and (ii) solar energy generation business ("**Solar Energy CGU**") of HK \$24million. There was no impairment of goodwill recorded in the 2012 Financial Statements.
- (9) The AIB Report identified a number of instances of non-compliance with financial reporting standards and auditing irregularities in relation to the 2012 Financial Statements concerning the following audit areas:
- (i) measurement of CBs;
 - (ii) recognition and measurement of identifiable assets acquired and liabilities assumed, and the related goodwill at the date of acquisition; and
 - (iii) impairment assessment of goodwill.
- (10) Subsequent to the AIB Report being referred to the Institute, the Respondents made further submissions to the Institute on 28 December 2016 and 10 October 2017 respectively ("**Respondents' Submissions**").

THE COMPLAINTS

Complaint 1: Against WH Tang

- (11) Section 34(1)(a)(vi) and section 34(1AA) of the PAO apply to WH Tang in that, when carrying out the audit of the 2012 Financial Statements with regards to (a) measurement of CBs; (b) recognition and measurement of identifiable assets acquired and liabilities assumed, and the related goodwill at the date of acquisition; and (c) impairment assessment of goodwill, WH Tang failed or neglected to observe, maintain or otherwise apply the following professional standards:

- (i) Paragraph 15 of HKSA 200; and/or
- (ii) Paragraph 6 of HKSA 500; and/or
- (iii) Paragraph 8 of HKSA 500; and/or
- (iv) Paragraphs 17 and 18 of HKSA 540.

Complaint 2: Against Tang

- (12) Section 34(1)(a)(vi) of the PAO applies to Tang in that he failed or neglected to observe, maintain or otherwise apply a professional standard namely section 100.5(c) as elaborated in section 130.1 of the Code of Ethics (“Code”) for failure to act competently and diligently in accordance with professional standards when carrying out the work, as an engagement director, in the audit of the 2012 Financial Statements.

Complaint 3: Against Chow

- (13) Section 34(1)(a)(vi) of the PAO applies to Chow in that he failed or neglected to observe, maintain or otherwise apply professional standards namely (i) paragraphs 20 and 21 of HKSA 220; and (ii) section 100.5(c) as elaborated in section 130.1 of the Code for failure to act competently and diligently in accordance with professional standards when carrying out the work, as an engagement quality control reviewer, in the audit of the 2012 Financial Statements.

RELEVANT STATUTORY PROVISION AND PROFESSIONAL STANDARDS

- (14) Section 34(1)(a)(vi) of the PAO provides that a complaint may be made against any certified public accountant for having failed or neglected to observe, maintain or otherwise apply a professional standard.
- (15) Section 34(1AA) of the PAO provides that a complaint may be made against a corporate practice for having failed or neglected to observe, maintain or otherwise apply a professional standard.
- (16) Relevant sections of the professional standards are illustrated in Attachment 1.

PARTICULARS OF COMPLAINT 1

Measurement of CBs

- (17) As Tranche II CB was in nature a contingent consideration payable as defined in HKFRS 3 (Revised), it should have been recognized as a financial liability in accordance with paragraph 11 of HKAS 32, initially measured at its acquisition-date fair value and re-measured at fair value at year-end in accordance with paragraphs 39 and 58 of HKFRS 3 (Revised).
- (18) However, there was no evidence that Valuer A had considered the effect of the Consideration Adjustment or had taken it into account when determining the fair value of Tranche II CB .

- (19) In the audit working papers, there was no evidence to support that WH Tang:
- (i) identified the contingent consideration nature of Tranche II CB and discussed with the Company about its failure to recognize it as a financial liability;
 - (ii) had any discussion with the Company or Valuer A as to how the condition attached to Tranche II CB was incorporated in Valuation A, particularly given the need for the subsequent amendment;
 - (iii) evaluated how three chosen securities were appropriate comparable companies to estimate the discount rate for the Target Group, such as their locations and production sizes as compared to the Target Group; and
 - (iv) documented their procedures performed in the understanding and assessment of the assumptions (including the discount rate and volatility etc.) and methodology adopted in Valuation A.
- (20) WH Tang sought to rely on HKSA 620 "Using the Work of an Auditor's Expert". However, Valuation A was prepared by a management expert rather than an independent auditor's expert and so HKSA 500.8 would apply. Reliance on HKSA 620 meant that WH Tang had applied the wrong auditing standard.
- (21) The CBs were required to be re-measured at fair value at year-end in accordance with HKFRS 3 (Revised). There was no adjustment to the measurement of CBs at year-end. WH Tang's working papers stated the assumption that "no adjustment to the consideration of Tranche II CB by considering that the probability that there will be no consideration adjustment relating to Tranche II CB is over 90%" .
- (22) The above assumption was inconsistent with the Supplemental Agreement that had to be entered into by the Company in February 2012 due to complications with the Revenue Contracts.
- (23) WH Tang should have assessed the reasonableness of management's assumption with respect to the probability of achieving the Target Profit given the difficulties experienced. In breach of HKSA 200.15, WH Tang did not exercise professional skepticism and they simply accepted management representation and Valuation A without performing adequate procedures to support their conclusions.
- (24) Based on the above, WH Tang were also in breach of HKSA 500.6 for their failure to obtain sufficient appropriate audit evidence by designing and performing adequate procedures to properly assess:
- (i) whether the contingent nature of the profit guarantee would render the Tranche II CBs a financial liability;
 - (ii) the values of CBs at recognition; and
 - (iii) whether any adjustment was necessary to the valuation of Tranche II CB at year-end.

- (25) Since the measurement of CBs involved accounting estimates, the above breaches also demonstrated that the Auditor failed to comply with HKSA 540.17 and HKSA 540.18.
- (26) The relevant facts concerning the measurement of CBs are located in section 3 of the AIB Report:

Recognition and measurement of identifiable assets acquired and liabilities assumed, and the related goodwill at the date of acquisition

- (27) The Revenue Contracts of the system integration business gave rise to contractual rights and should be recognized as identifiable assets separately from goodwill at acquisition in accordance with paragraphs 10 and B31 of HKFRS 3 (Revised).
- (28) The Company explained in their submissions to FRC that the Revenue Contracts were not separately identified and recognized as an intangible asset at acquisition as the related business was not commenced at the time of the acquisition and therefore, it was impractical to identify and recognize any intangible asset with sufficient reliability.
- (29) Failure to recognize all identifiable assets acquired at acquisition gave rise to the question whether the Company properly recorded goodwill at acquisition. The Company simply relied on Valuation B in their determination of the market value of the Target Group (excluding the system integration business) at 31 December 2010.
- (30) If the Company could use a discounted cash flow to arrive at the value in use of the CGU (the Target Group) to assess the impairment of assets arising from the acquisition, the Company could also estimate the fair value of the Revenue Contracts by using a similar discounted cash flow method at time of acquisition, factoring the uncertainties into the fair value valuation. In other words, the Company should have measured the Revenue Contracts at fair value at acquisition in accordance with paragraph 18 of HKFRS 3 (Revised).
- (31) WH Tang did not challenge the Company's failure to assess the fair value of the Revenue Contracts and identify them as identifiable assets acquired in acquisition, based on the flawed conclusion that they could not be measured with sufficiency. WH Tang relied on an outdated criterion of "reliability of measurement" under HKFRS 3 (2004 version) which was applicable before 1 July 2009.
- (32) WH Tang also failed to obtain sufficient appropriate audit evidence by designing and performing adequate procedures to:
- (i) ascertain that all identifiable assets acquired and liabilities assumed were recognized at fair value at acquisition in accordance with paragraph 10 of HKFRS 3 (Revised);

- (ii) evaluate the appropriateness of Valuation B including the consideration of the relevance and reasonableness of Valuer B's findings, significant assumptions and valuation methods used, as well as the relevance, completeness and accuracy of the source data used; and
 - (iii) assess the appropriateness of the valuation amount of HK\$24 million allocated as goodwill to the Solar Power CGU given there were assets and liabilities of the solar energy business at the time of acquisition.
- (33) As such, WH Tang failed to comply with HKSA 200.15 and HKSA 500.6.
- (34) Since the recognition and measurement of identifiable assets acquired and liabilities assumed, and the related goodwill at acquisition involved accounting estimates, the above breaches also demonstrated WH Tang's failure to comply with HKSA 540.17 and HKSA 540.18.
- (35) The relevant facts concerning the recognition and measurement of identifiable assets acquired and liabilities assumed, and the related goodwill at the date of acquisition are located in section 4 of the AIB Report:

Impairment assessment of goodwill relating to Power System Integration CGU

- (36) In their impairment assessment of goodwill, the Company determined the recoverable amounts of the CGUs using value-in-use calculations. When estimating the growth rate for the Power System Integration CGU, management forecast was prepared based on the assumption that the necessary business licenses had been obtained or could be obtained without difficulty. Accordingly, the Revenue Contracts would have been taken into consideration.
- (37) As confirmed in the Respondents' Submissions, WH Tang relied on management representation and the discounted cash flow forecast projection prepared by management in their assessment of goodwill impairment concerning the Power System Integration CGU.
- (38) When evaluating the Power System Integration CGU's recoverable amount, there was no evidence in the working papers indicating WH Tang had:
- (i) challenged the appropriateness and reasonableness of management's assumptions and valuation when the CGU did not generate any revenue for the year ended 31 March 2012, as the Revenue Contracts were stalled because the contracting parties were still in the process of obtaining the necessary licenses to commence business;
 - (ii) considered and discussed with management the prospect, financial condition, and economic outlook of the power system integration business despite the above;

- (iii) performed procedures (e.g. to obtain a legal opinion) to assess the likelihood that the relevant licenses which were vital to the business would be obtained; and
 - (iv) challenged management or performed any procedures to assess the appropriateness of the discount rate used by management. WH Tang only made reference to inflation rate, without documentation of any consideration of whether adjustments to the discount rate would be necessary; e.g. reflecting specific risks faced by the market or excluding risks irrelevant to the power system integration business cash flows.
- (39) In the circumstances, WH Tang had not performed sufficient and appropriate procedures to support the recoverable amount of the Power System CGU for the impairment assessment of the related goodwill at year-end in accordance with HKAS

Impairment assessment of goodwill relating to Solar Energy CGU

- (40) The assets and liabilities of the Solar Energy CGU were reclassified as "held-for-sale" as the Company was considering to dispose of the Solar Energy CGU and in negotiation with an independent third party on a possible sale. Goodwill of HK\$24 million was included in the assets classified as held-for-sale in the 2012 Financial Statements. As such, the Company was required to measure the held-for-sale assets at the lower of carrying amount and fair value less costs to sell at year-end in accordance with paragraph 15 of HKFRS 5.
- (41) The Company adopted the value-in-use calculation in their impairment assessment of goodwill relating to the Solar Energy CGU, using the same valuation data in Valuation B as at 31 December 2010, to determine the CGU's recoverable amount and concluded that there was no impairment as at 31 March 2012.
- (42) WH Tang failed to apply HKFRS 5 and claimed that adequate procedures had been performed in reaching their conclusion that no impairment of goodwill was necessary at year-end concurring with management. There was no evidence in their working papers to indicate that they had:
- (i) discussed with management or challenged management's use of the same valuation data for Valuation B as at 31 December 2010 in their impairment assessment as at 31 March 2012;
 - (ii) performed any procedures to justify their conclusion that the assumptions used in Valuation B as at 31 December 2010 were applicable and appropriate in assessing the goodwill as at 31 March 2012; and
 - (iii) performed any procedures to ascertain that the Solar Energy CGU, being reclassified as "held-for-sale", was being measured in accordance with HKFRS 5 at year-end.

Breach of professional standards in relation to impairment assessment of goodwill

- (43) Based on the above, WH Tang failed to exercise professional skepticism, and design and perform adequate procedures to obtain sufficient appropriate audit evidence in their impairment assessment of goodwill and therefore, they did not comply with HKSA 200.15 and HKSA 500.6.
- (44) Since the impairment assessment of goodwill involved accounting estimates, the above breaches also demonstrated WH Tang's failure to comply with HKSA 540.17 and HKSA 540.18.
- (45) The relevant facts concerning the impairment assessment of goodwill are located in section 5 of the AIB Report.

PARTICULARS OF COMPLAINT 2

- (46) In view of the above breaches of professional standards by WH Tang, the engagement director did not comply with sections 100.5(c) and 130.1 of the COE for failure to carry out the audit diligently in accordance with the applicable professional standards.

PARTICULARS OF COMPLAINT 3

- (47) Audit irregularities noted above involved a major transaction of the Company (the acquisition) resulting in material items recorded in the 2012 financial statements (the convertible bonds, goodwill, and assets classified as held-for-sale), the measurement of which items involved significant judgment, estimation, and assumptions made by management and/or external valuers.
 - (48) It is therefore reasonable to expect the EQCR would select the relevant audit working papers to perform an engagement quality control review in accordance with HKSA 220.
 - (49) There was no information recorded in the audit working papers indicating how the EQCR followed up issues noted in the planning stage of the audit, performed a diligent quality control review of the engagement, provided comments and discussed with engagement team, and evaluated results of the engagement team's decisions.
 - (50) A diligent engagement quality control review should have identified the audit deficiencies as noted above. Therefore, the EQCR did not comply with sections 100.5(c) and 130.1 of the COE for failing to perform the engagement quality review in accordance with paragraphs 20 and 21 of HKSA 220.
 - (51) The relevant facts concerning the engagement quality control review are located in section 6 of the AIB Report, which should be referred to for full details.
3. The Respondents admitted the complaints against them. They did not dispute the facts as set out in the Complaint. On 7 December 2017, the parties agreed 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 to the parties joint application to dispense with the steps set out in Rule 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 complaints were all found proven on the basis of the admissions made by the Respondents.
6. The Complainant provided their submissions on sanctions and costs on 7 February 2018. Submission on sanctions were provided by Tang and Chow on 1 February 2018. WH Tang did not provide a separate written submission on sanctions and costs.
7. In considering the 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 Complaints, the Respondents' personal circumstances, and the conduct of the Respondents throughout the proceedings.
8. The Disciplinary Committee orders that:-
 - (a) all of the Respondents be reprimanded under Section 35(1)(b) of the PAO;
 - (b) Tang pay a penalty of HK\$100,000 under Section 35(1)(c) of the PAO; Chow pay a penalty of HK\$75,000 under Section 35(1)(c) of the PAO; and WH Tang pay a penalty of HK\$150,000 under Section 35(1)(c) of the PAO;
 - (c) the practising certificates issued to Tang and Chow be cancelled under Section 35(1)(da) of the PAO;
 - (d) a practising certificate shall not be issued to Tang for 2 years and the same shall not be issued to Chow for 18 months under section 35(1)(db) of the PAO; and
 - (e) the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$103,483.20 under Section 35(1)(iii) of the PAO.

The above shall take effect on the 40th day from the date of this Order.

Dated 15 May 2018

Dr. Wilson Claire
Chairman

Mr. Shum Hon Wo
Disciplinary Panel A

Mr. Hills Stuart Martin
Disciplinary Panel B

Ms. Yap Hiu Yee Betty
Disciplinary Panel A

Mr. Chow Tak Sing Peter
Disciplinary Panel B