

IN THE MATTER OF complaint made
under section 34(1)(a) of the Professional
Accountants Ordinance (Cap.50)

BETWEEN

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

Complainant

AND

Respondent

Reasons and Order

1. The Respondent has committed the professional misconduct set out in Complaint 1. He failed to make disclosure of related party transactions in the 2004 Audited Financial Statements, thereby acting in breach of paragraph 20 of SSAP20. Details of the relevant facts are particularized in the Statement of Findings dated 23rd July 2008.
2. The Disciplinary Committee has given careful consideration to the matters which the Respondent mentioned by way of mitigation. The Respondent was cooperative with the Institute in its investigation and indicated his intention to admit to the Complaint shortly after being served with the notice of proceedings, thus saving much time and costs. No monetary damage has been done to the client company or its shareholders. The mistake concerned appeared in only one set of financial statements.

Order

3. In the circumstances, the Disciplinary Committee. orders as follows:
 - a. That the Respondent be reprimanded.
 - b. That the Respondent pays a penalty of HK\$20,000 to the Institute.
 - c. That the Respondent pays a contribution of HK\$30,000 to the costs and expenses of and incidental to the investigation against him by the Institute and the costs and expenses of and incidental to these disciplinary proceedings of the Institute (including the costs and expenses of the Disciplinary Committee) and the Complainant.

Dated the 12th day of September 2008.

IN THE MATTER OF complaint made
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BETWEEN

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Public Accountants

Complainant

AND

Respondent

Statement of Findings

1. The Complaint here was made by the Registrar of the Hong Kong Institute of Certified Public Accountants on 9th April 2008 against [the Respondent], a practising certified public accountant with [CPA Firm A].
2. The Respondent faces two Complaints. Complaint 1 charges him for failing or neglecting to observe, maintain or otherwise apply a professional standard in failing to comply with paragraph 5 of the Statement of Standard Accounting Practice 20 ("SSAP 20") to disclose related party transactions in a set of financial statements he audited, in breach of section 34(l)(a)(vi) of the Public Accountants Ordinance.
3. Complaint 2 charges him, also under the section 34(l)(a)(vi), for failing or neglecting to observe, maintain or otherwise apply a professional standard in failing to comply with paragraph 45 of the Statement of Auditing Standards 600 ("SAS 600") to qualify the financial statements when he had material disagreements with the management of the client company.

4. The Respondent has indicated his admission to the Complaints and the allegations set out in them and the documents attached to them.

5. The following is the findings of facts by the Disciplinary Committee. For a number of years, including 2004 and 2005, [CPA Firm A] provided audit services to [Company A] and the Respondent was the certified public accountant in charge in [CPA Firm A] for those services. Following audit of [Company A]'s accounts, [CPA Firm A] produced an Auditors' Report dated 15th August 2005 in relation to the financial statements of [Company A] for the year ended 31st December 2004 ("2004 Audited Financial Statements"). Likewise, following audit of [Company A]'s accounts, [CPA Firm A] produced an Auditors' Report dated 20th June 2006 in relation to the financial statements of [Company A] for the year ended 31st December 2005 ("2005 Audited Financial Statements").

6. During the two years covered by those audited financial statements, [Company A] organized chess classes, when fees were collected from participants and fees were paid to the tutors concerned. Some of the tutors were directors of [Company A].

7. In the Income Statement in the 2004 Audited Financial Statements, it is stated that [Company A] had "other revenue" of HK\$[x].

8. Note 3 to the Income Statement stated that parts of the "other revenue" were "net surplus" amounts on learning courses:
 - a. For members: HK\$[x]; and

 - b. For government bodies: HK\$[x].

In the management accounts for the same period, those figures were set out as follows:

Tuition fee income from members	[x]
Less: Tutor fee costs	[x]
Net surplus on learning courses for members	[x]
Tuition fee income from government bodies	[x]
Less: Tutor fee costs	[x]
Net surplus on learning course for government bodies	[x]

Those entries show that the accounts of [Company A] booked the tuition fees as income and tutor fees as expenditure. Some of the tutors who received the "tutor fee costs" were directors of [Company A].

9. In answer to the inquiry by the Institute, the Respondent explained that the Income Statement did not show tuition fees as revenue and the tutor fees as expenditure, but simply booked the "net surplus" amounts as revenue because the management of [Company A] had represented to him that [Company A] acted merely as an agent for the tutors. However, such representation by the management is inconsistent with the management accounts hence should have been rejected or disputed by the Respondent.

10. Paragraph 5 of SSAP 20 reads:

"5. 'Related party' - parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other part in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. "

"'Related party transaction' - a transfer of resources or obligations between related parties, regardless of whether a price is charged".

Paragraph 20 of SSAP 20 reads:

"20. If there have been transactions between related parties, the reporting enterprise should disclose the nature of the related party relationships as well as the types of transactions and the elements of the transactions necessary for an understanding of the financial statements."

11. Clearly [Company A] and its directors at the material times were related parties. The directors had control over the management of [Company A]. In paragraph 5 of SSAP 20, the key feature in the definition of "related party transaction" is the "transfer of resources or obligations between the related parties". During the material times, [Company A] paid a number of the tutors who were directors of [Company A] various "tutor fee costs", presumably with the course fees collected. Each "tutor fee costs" payment therefore involved a transfer of resources - the money concerned - from [Company A] to the director and tutor. The payment was

caught by paragraph 20 of SSAP 20 and the Respondent should have made related party transactions notes in the 2004 Audited Financial Statements.

12. In the 2005 Audited Financial Statements, the Respondent actually made the related party transaction treatment.

13. It follows that in failing to make disclosure of related party transactions in the 2004 Audited Financial Statements, the Respondent failed to comply with paragraph 20 of SSAP 20 and acted well below a proper professional standard of work. The Disciplinary Committee therefore finds Complaint 1 proved against the Respondent.

14. Complaint 2 concerns with paragraph 45 of SAS 600, which reads: -

"45. Where the auditors disagree with the accounting treatment or disclosure of a matter in the financial statements, and in the auditors' opinion the effect of that disagreement is material to the financial statements:

a. the auditors should include in the opinion section of their report;

i. a description of all substantive factors giving rise to the disagreement,

ii. their implications for the financial statements, and

iii. whenever practicable, a quantification of the effect on the financial statements;

b. when the auditors conclude that the effect of the matter giving rise to disagreement is so material or pervasive that the financial statements are seriously misleading, they should issue an adverse opinion; and

c. in the case of to the material disagreements, the auditors should issue a qualified (except for disagreement) opinion indicating that it is expressed except for the effects of the matter giving rise to the disagreement."

15. Said to be based on the same set of allegations as Complaint 1, Complaint 2 essentially concerns the alleged misconduct that the Respondent failed to qualify the 2004 Audited Financial Statements to bring out his disagreement to the non-disclosure of the related party transactions in the tutor's fees. What appears to be the problem with the management of [Company A] is that on the one hand the management accounts booked the tuition fees as income and tutor fees as expenditure, on the other hand the management explained to the Respondent that [Company A] was a mere agent for the tutors hence only the net revenue should be booked as income in the accounts. Despite such inconsistency, the Respondent apparently accepted the management's explanation and failed to reflect the tuition fees from members and tuition fees from government bodies properly in the 2004 Audited Financial Statements. In the process, the Respondent did not disagree, but mistakenly agreed, with the management of [Company A]. More importantly, there is nothing in the materials and information before the Disciplinary Committee to show what, if any, opinion did the management of [Company A] hold as to whether or not related party transaction disclosure should be made in the 2004 Audited Financial Statement. Accordingly, a case did not appear to exist for the Respondent to state his disagreement and qualify the accounts under paragraph 45 of SAS600, even though in proper discharge of his professional duties, he probably should have found the management's accounts questionable. In the circumstances, the Disciplinary Committee dismisses Complaint 2 against the Respondent.

16. The Disciplinary Committee will have to consider the order to be made. The parties are directed as follows:

- a. Within 14 day, to file and serve their written submissions on the order to be made by the Disciplinary Committee; and
- b. Within 7 days thereafter, to file and serve their written submissions in reply, if any.

17. The Disciplinary Committee will make its order after considering the parties' written submissions. Unless otherwise requested for by the parties, the Disciplinary Committee does not propose to hold a hearing.

Dated the 23rd day of July 2008.

Proceedings No: D-05-0144C

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STATEMENT OF FINDINGS

Dated the 23rd day of July 2008.