

BACKGROUND

3. At the relevant times, the Respondent was the practising managing director of a corporate practice, Larry Brendon C.P.A. Limited (“**Practice**”).
4. The Practice was newly appointed as the auditor of the following five private companies (collectively “**Companies**”) for the year/period ended 31 December 2017:
 - Elite Bright International Limited (“**Elite Bright**”),
 - Leader Hill Technology Limited (“**Leader Hill**”),
 - High Honest International Limited (“**High Honest**”),
 - BB In Technology Co., Limited (“**BB In**”), and
 - Winking Inspiration Holdings Limited (“**Winking Inspiration**”)
5. The Respondent was the engagement director responsible for the five audits. He expressed unmodified auditor’s opinions on the Companies’ financial statements which were stated to have been prepared in accordance with the Small and Medium-sized Entity Financial Reporting Standard (“**SME-FRS**”). The auditor’s reports stated that the audits were performed in accordance with the Hong Kong Standards on Auditing (“**HKSAs**”).
6. In response to the Institute’s request, the Respondent provided, on 21 January 2020, workpapers and confirmed that they were complete documentation of the five audits.
7. Based on a review of the workpapers, the Institute found deficiencies indicating that the Respondent had failed to comply with various requirements under the HKSAs and the Code of Ethics for Professional Accountants (“**COE**”) in all five audits.

The Complaint

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 professional standard(s) in respect of the audits of the Companies’ financial statements for the year/period ended 31 December 2017.

Recognition of revenue and costs of services

9. According to the audited financial statements, the Companies generated material amounts of “Services income” and “Services costs” in 2017 as below:

	Services income (USD)	Services cost (USD)
Elite Bright	7,519,618	6,568,774
Leader Hill	7,479,805	6,781,660
High Honest	2,379,585	2,209,566
BB In	1,771,296	1,670,104
Winking Inspiration	11,554,298	9,803,590

10. The Notes to all of the Companies' financial statements stated that "Services income" was recognized when the services were provided.
11. The audit workpapers documented that all five Companies were engaged in the business of development of computer software, which services included "market research services", "development of web-site design" and "system development on CRM service".
12. The workpapers documenting the "business flows" of the five Companies were identical and indicated the following information:
 - (a) After the Companies had received order requests from customers, they would outsource the service to service providers.
 - (b) After the service providers completed the services and submitted a report to the Companies, the latter would request their customers to confirm the service completion or the stage of completion.
 - (c) Upon customers' confirmation the Companies would recognize the revenue and the corresponding cost of services.
 - (d) There were no written contracts signed between the Companies and their customers, or between the Companies and their service providers.
13. According to the Respondent, the Companies were not acting as agents for the customers because the Companies were responsible for selecting and engaging the external service providers. In addition, the Companies had to bear full risks and costs if the software products developed by the service providers were not accepted by the end customers.
14. The workpapers show no documentation of the details and scope of services rendered to the customers and the basis for determining the completion and/or percentage of completion based on which to recognize service income and corresponding costs.
15. The workpapers also show no evidence of the (i) auditor's assessment of the risks of material misstatements arising from over/understatements of service income and costs of services; and (ii) audit procedures designed to address those risks.
16. Regarding service income:
 - (a) The Companies issued sales invoices after the customers confirmed the services completion or the stage of completion. There is a lack of documentation on the process regarding customers' acceptance of services and the issuance of sales invoices by the Companies. The working papers show no evidence indicating how the Respondent had ascertained (i) the basis for determining the revenue based on the percentage of completion of work and (ii) that there was no material misstatement of income for services provided and accepted, but not yet billed, or vice versa.

- (b) Three of the Companies, namely Elite Bright, Leader Hill and Winking Inspiration, reported amounts of "Receipt in advance" and "Deposit received" in the financial statements. Given the audit documentation on "*business flows*" indicated that customers would only make payment after confirmation of completion of work (and sales invoices issued by the Companies), the workpapers show no evidence of the auditor's assessment of the nature of the "Receipt in advance" and "Deposit received" to determine the validity of the transactions and accounts classification. There was also no evidence of auditor's assessment to ascertain whether there were other similar advances/deposits received which could be wrongly recognized as service income, resulting in overstatement of income.

17. Regarding costs of services:

- (a) There is no indication as to the time lag between customers' acceptance of services and the Companies recording of the corresponding costs based on the invoices issued by the service providers. The workpapers show no evidence of auditor's work to (i) assess the Companies' matching of costs of services to the income recognized; and (ii) ascertain whether there was any under/overstatement of costs of services.
- (b) The workpapers show no evidence of how the auditor had ascertained whether there was any understatement of costs arising from the work completed by the service providers but not accepted by the customers.
- (c) The financial statements of all five Companies reported nil salary expenses. The workpapers indicated that "costs invoices" were received by Amelie, the Companies' Accountant; and that the auditor's planned procedures included a review of payroll records for all the Companies. However, the workpapers show no evidence of work done on payroll records and auditor's assessment on the reasonableness of nil salary expenses reported in the Companies' financial statements.

18. The above findings show deficiencies in all five audits in that the auditor did not carry out adequate procedures and obtain sufficient evidence to ascertain that the Companies' recognition of revenue and corresponding costs had complied with Section 11 of the SME-FRS which required that the transaction involving the rendering of services should be recognised when all the following conditions are satisfied:

- (a) the amount of revenue can be measured reliably;
- (b) it is probable that the economic benefits associated with the transaction will flow to the entity;
- (c) the state of completion of the transaction at the reporting period can be measured reliably; and
- (d) the costs incurred for the transaction and the costs to complete the

transaction can be measured reliably.

19. The deficiencies show that the Respondent failed to:
- (a) identify and assess the risks of material misstatements in relation to the service income and costs of services, in breach of paragraphs 25, 26 and 32 of HKSA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.
 - (b) design and perform further audit procedures which are based on and responsive to the assessed risks of material misstatement at the assertion level, in breach of paragraph 6 of HKSA 330 *The Auditor's Responses to Assessed Risks*.
 - (c) Obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion that the Companies' recognition of revenue and corresponding costs complied with Section 11 of the SME-FRS, in breach of paragraph 6 of HKSA 500 *Audit Evidence*.
 - (d) Prepare audit documentation that is sufficient to enable an experienced and independent auditor to understand the audit procedures performed and the results thereof, as well as the significant professional judgments made by the auditor in reaching their conclusions, in breach of paragraph 8 of HKSA 230 *Audit Documentation*.

Circularisation of bank confirmations

20. The workpapers show that the bank confirmations were not issued and/or received directly by the Respondent (or the Practice). The returned bank confirmations indicated that they were received in the first instance, by another CPA practice, Grand Concept Certified Public Accountants (Practising) Limited. There was no evidence of procedures taken by the Respondent to ensure the integrity of the returned bank confirmations which he accepted as sufficient appropriate evidence.
21. As such, the auditor failed to maintain adequate control over the bank confirmation procedure, in breach of paragraph 7 of HKSA 505 *External Confirmations*.

Professional skepticism

22. The workpapers show that all of the accounts payable and receivable confirmations were met with no response. The Respondent was satisfied that the alternative procedures, which were mainly vouching to the invoices and bank transactions were sufficient to establish the existence and accuracy of the amounts. There was no evidence that the Respondent had performed audit procedures to elicit responses such as contacting the customers / suppliers by other means, and ascertain the reasons for non-response.

23. The non-response from all accounts payable and receivable confirmation requests should have raised the Respondent's concern about the occurrence of the service income and cost of services transactions and the existence of the customers and service providers. Furthermore, given there were no written service contracts between the Companies and the customers, and between the Companies and the service providers, it is reasonable to expect that the auditor would perform further audit procedures to verify the existence of customers and service providers and the services rendered; especially when this is the Respondent's first audit of the Companies.
24. The lack of audit procedures on service income and cost of services described above indicate that the Respondent failed to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated, in breach of paragraph 15 of HKSA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Professional Competence and Due Care

25. In summary, the Respondents had breached HKSA 200, HKSA 230, HKSA 315, HKSA 330, HKSA 500 and HKSA 505 in the above-mentioned five audits.
26. Sections 100.5(c) and 130 of the COE require a professional accountant to 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 services, and act diligently in accordance with applicable professional standards.
27. The multiple breaches of HKSAs explained above show that the Respondent failed to carry out the five audits with the level of professional competence and due care expected of a professional accountant, in breach of sections 100.5(c) and 130 of the COE.
28. As the HKSAs and the COE are professional standards referred to in the PAO, section 34(1)(a)(vi) of the PAO applies to the Respondent in this respect.

THE PROCEEDINGS

29. By a letter dated 12 November 2020, the parties jointly informed the Committee that the Respondent had admitted the complaint against him. They also suggested that it is no longer necessary for the parties to follow the steps set out in paragraphs 17 to 20 of the Disciplinary Committee Proceedings Rules.
30. The Notice of Commencement of Proceedings was issued on 27 November 2020. Having considered the parties aforementioned joint letter and the Respondent's admission of the complaint, the Committee approved the parties' proposal and directed that they made submissions on sanctions by 24 December 2020.
31. The Committee is satisfied by the admission of the Respondent and evidence adduced before it that the complaint is proved.

32. The Complainant and Respondent provided their written submissions on sanctions and costs on 24 December 2020.

SANCTIONS AND COSTS

33. 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 12 months under section 35(1)(db) of the PAO; and
- (3) 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\$107,443 under section 35(1)(iii) of the PAO.

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

Dated: 5 February 2021

Ms. Ho Man Kay Angela
Chairman
Disciplinary Panel A

Mr. Chan Fung Cheung
Wilson
Member
Disciplinary Panel A

Mr. Guen Kin Shing
Member
Disciplinary Panel B

Ms. Chan Yiting Bonnie
Member
Disciplinary Panel A

Mr. Woo King Hang
Member
Disciplinary Panel B