Proceedings No: D-12-0756F

IN THE MATTER OF

A Complaint made under section 34(1)(a) and section 34(1A) of the Professional Accountants Ordinance (Cap. 50)("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	
Wong Tak Man Stephen (F02863)	FIRST RESPONDENT
AND	
RSM Nelson Wheeler (Firm No: 1140)	SECOND RESPONDENT

Before a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants ("the Institute").

Members: Mr. LEE Ka Sze, Carmelo (Chairman)
Mr. DONOWHO Simon Christopher
Ms. WOO Lee Wah Cecilia
Mr. MAR Selwyn

Date of Hearing: 1 June 2015

ORDER

At the hearing on 1 June 2015, the Disciplinary Committee found the following complaint against the First Respondent and the Second Respondent proved:

The Respondents were in breach of Section 34(1)(a)(vi) of the Professional Accountants Ordinance in that they failed or neglected to observe, maintain or otherwise apply professional standards, namely, HKAS 39 by failing to ensure that the decline in value of the shares in China Zenith Chemical Group Limited be reflected in profit and loss in the audited consolidated financial statements of Heng Tai Consumables Group Limited for the year ended 30 June 2009.

IT IS ORDERED that:-

1. each of the Respondent pay a penalty of HK$10,000 to the Institute; and

2. the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK$66,800, that of the Clerk in the sum of HK$21,000 and that of disbursements in the sum of HK$7,601. The said costs and expenses shall be borne equally between the Respondents.

IT IS FURTHER DIRECTED that no publicity of the aforesaid sanction should be made unless with the consent of the Respondents.

Dated the 8th day of September 2015

Proceedings No: <u>D-12-0756F</u>

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A Complaint made under section 34(1)(a) and section 34(1A) of the Professional Accountants Ordinance (Cap. 50)("PAO") and referred to the Disciplinary Committee under section 33(3) of the PAO

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Members: Mr. LEE Ka Sze, Carmelo (Chairman)
Mr. DONOWHO Simon Christopher
Ms. WOO Lee Wah Cecilia
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Date of Hearing: 1 June 2015

REASONS FOR DECISION

1. The gist of the matter is whether the requirements of HKAS 39 had been duly complied with when the audited consolidated financial statements of Heng Tai Consumables Group Limited ("Heng Tai") for the year ended 30 June 2009 ("Financial Statements") were being prepared and the Second Respondent (with the First Respondent being the engagement partner) issued an unqualified opinion on the Financial Statements.

2. The Respondents' challenges to the complaint are mainly based on three grounds. The Disciplinary Committee (the "Committee") will deal with them one by one in the same order set out in the oral submission of the Respondents' counsels on 1 June 2015.

3. Ground 1 : Wrong charge being laid against the Respondents

3.1 The Committee originally found the Respondents' argument very attractive. However, the Committee has adopted a "substance over form" approach and concluded that whether the Respondents would be in breach of HKAS 39 or HKSA 700.11 or 700.13, the indisputable fact is that the breach, if any, had originated from the improper interpretation of HKAS 39 by the Respondents when issuing an unqualified opinion on the Financial Statements. As the auditors of Heng Tai, the Respondents should have ensured proper interpretation of HKAS 39. Any failure on the part of the Respondents in this regard is sufficient for the Committee to conclude that HKAS 39 had been breached.

4. Ground 2 : The Respondents' interpretation of HKAS 39 not unreasonable

4.1 The Committee finds the wordings of HKAS 39 clear. On reading the relevant paragraphs in HKAS 39, the Committee is of the view that, as far as the present case is concerned, the only conclusion one would arrive at is that the decline in fair value of the shares in China Zenith Chemical Group Limited ("China Zenith") below their costs at the material time was significant and prolonged, which would warrant an impairment charge in the Financial Statements.

4.2 Paragraph 61 is very clear : "...... A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment".

4.3 The Respondents' submission that paragraph 61 not to be read in isolation has its attraction. However, upon further thoughts, the Committee finds that the intention of HKAS 39 (particularly paragraph 61) cannot be as submitted by the Respondents.

4.4 The Committee finds that for listed/quoted equity instruments such as shares quoted in an active stock market like The Stock Exchange of Hong Kong Limited, a significant or prolonged decline in the quoted share price of a listed company will no doubt be the most objective evidence of impairment.

4.5 The Respondents had not submitted that the decline in share price of China Zenith had not been significant or prolonged. Rather, the Respondents took the view that the evidence of a loss event (such as a decline in the share price of China Zenith) did not by itself justify making impairment loss and one would need to move on to the second stage to evaluate the financial impact, if any, brought about by the loss event on the recovery of the cost of the financial asset. The Committee is of the view that this may be true for equity instruments (such as shares) not listed in an active stock market, in which case one would need to rely on paragraph 59 of HKAS 39 to see if there was any loss event to support the existence of objective evidence of impairment. An available-for-sale financial asset may be listed or unlisted. If it belongs to the former, objective evidence of impairment will be readily available by looking at the price quoted in an active stock market. The Respondents further elaborated on "long-term" investment and "temporary" fluctuations, which will not assist the

Respondents' case since paragraph 61 also covers this by using the phrase "prolonged" or "significant".

4.6 Indeed, there might have been diversity of practices over HKAS 39. The Respondents have kindly provided this Committee with instances before July 2009 and after July 2009 where certain companies listed in Hong Kong might not have complied with HKAS 39 and queried why auditors of such companies had not been pursued by the Institute. The Committee took the view that all these are mitigating factors on sanctions but will not exonerate the Respondents from liability.

5. <u>Ground 3 : Published Share Price of China Zenith not reliable for the purpose of impairment assessment</u>

5.1 The Respondents lastly submitted that the share price of China Zenith as at 30 June 2009 was unreliable because of thinness of the market and equate "thinly traded" as "unreliable". The Committee does not agree. In fact, there is no evidence to show that the share price was either unreliable or the market was "thin". A review of the share price data and trading volumes show that:

(i) the share price of China Zenith shares remained relatively stable within the band of approximately HK$0.15 and HK$0.25 per share;

(ii) for most of the time during the post balance sheet event period, the share prices kept below HK$0.2; and

(iii) there was no evidence of an inactive market as there had been a continued trading in China Zenith shares.

5.2 The Committee took the view that the market price of China Zenith shares clearly reflected the fair value that a willing buyer and a willing seller in an arm's length transaction would agree upon (cf. AG 71 of Appendix A). In fact, the quoted market price was adopted to adjust the carrying amount of Heng Tai's investment in the shares of China Zenith apparently in purported compliance with paragraph 55(b) of HKAS 39 (cf. note 24 of the Notes to the Financial Statements contained in Heng Tai's 2009 Annual Report).

6. <u>Conclusion</u>

6.1 The Committee concludes that the complaint against the Respondents substantiated.

6.2 However, the Committee is of the view that there are strong mitigating factors in this case:

(a) this is not a case where the Respondents had been oblivious of the existence of HKAS 39. In fact, the Respondents' had duly carried out its evaluation of Heng Tai's impairment assessment by having :

(i) duly noted the necessity of performing the impairment review;

(ii) duly set out the approach in working progress;

(iii) duly noticed the decline in the value of China Zenith shares; and

(iv) duly assessed the reliability of the published share price by performing tests and performed alternative bases of valuation.

(b) The Respondents had committed an error of judgment and came to the wrong conclusion when performing audit on the Financial Statements. The Respondents' such wrong conclusion had largely been contributed by the lack of authoritative interpretation and diversity in practices as regards HKAS 39. The Institute could have been more proactive at the material time by issuing guidelines and practice notes. If the Institute was not yet ready for the implementation of HKAS 39 back then, it should have postponed the adoption of HKAS 39.

(c) The Committee is also mindful that the decline in fair value of the China Zenith shares, though not recognized in profit and loss, had been reflected as change in fair value of available-for-sale financial assets on page 37 of the 2009 Annual Report of Heng Tai. The basis for not making an impairment was also stated in paragraph 4(j) of the notes to the Financial Statements on page 58 of the 2009 Annual Report. The decline in value was not realized losses. Indeed, in the overall context of Heng Tai's financial position as at 30 June 2009 and consolidated profit for the year ended 30 June 2009 the impact of such decline in value could not be said to be substantial. The Committee takes the view that it is unlikely that any investors would have suffered a loss as a result of this non-complying accounting treatment.

(d) In the circumstances, the Committee takes a very lenient approach on the matter and has decided to mete out only a penalty of HK$20,000 (i.e. HK$10,000 on each Respondent) as sanction. The Committee would further direct that no publicity of the sanction should be made.

6.3 As regards costs, since costs should follow the event, the costs of the Clerk and that of the Complainant should be paid by the Respondents as follows:

(a) the rates of charge per hour for the Institute's staff as submitted are reasonable;

(b) the costs of the Clerk in the sum of HK$21,000 should be allowed, which is arrived at after taking into account that only 7 hours (instead 16 hours as submitted) were incurred for the substantive hearing;

(c) the costs of the Complainant in the sum of HK$66,800 should be allowed, which is arrived at after taking into account that only 7 hours (instead 16 hours as submitted) were incurred for the substantive hearing; and

(d) the photocopying and printing charges in the sum of HK$7,061 are allowed in full.

6.4 The Committee does not consider it appropriate to allow the costs and expenses of Financial Reporting Council in this particular case.

6.5. The Committee therefore orders that:-

(a) each of the Respondents pay a penalty of HK$10,000 to the Institute; and

(b) the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK$66,800, that of the Clerk in the sum of HK$21,000 and that of disbursements in the sum of HK$7,601. The said costs and expenses shall be borne equally between the Respondents.

6.6 The Committee further direct that no publicity of the aforesaid sanction should be made unless with the consent of the Respondents.

Dated the 8th day of September 2015