

IN THE MATTER OF

A complaint made under section 34(1)(a) of the Professional Accountants Ordinance (Cap.50)

BETWEEN

REGISTRAR OF THE HONG Complainant
KONG INSTITUTE OF CERTIFIED
PUBLIC ACCOUNTANTS

AND

Respondent

ORDER

UPON hearing Solicitors for the Complainant and Counsel for the Respondent

IT IS ORDERED that:-

1. In relation to both charges, details of which were set out in the letter from the Complainant to the Council of the Institute dated 18 October 2006, the Respondent shall be reprimanded.
2. For the second charge the Respondent shall pay a financial penalty of \$50,000 within 3 months from the date of this order.
3. The Respondent shall pay costs in the sum of \$250,000 within 3 months from the date of this order.

Dated 30 August 2008

Proceedings No: D040592C

IN THE MATTER OF

A complaint made under section 34(1)(a) of the Professional
Accountants Ordinance (Cap.50)

BETWEEN

REGISTRAR OF THE HONG
KONG INSTITUTE OF
CERTIFIED PUBLIC
ACCOUNTANTS

Complainant

AND

Respondent

ORDER

Dated the 30th day of August 2008

Respondent's objectivity and independence as auditor of [Company B]. That relationship also made it impossible for the Respondent to be seen to be free from interests which might detract from objectivity, The Respondent has also failed to comply with paragraph 51 of Statement 1.203 in that he should not have accepted the appointment as auditor of [Company B]. In addition, the Respondent has failed to comply with paragraph 3 of Statement 1.303 since a limited liability company affiliated with him was a director of his audit client [Company B]."

4. The relevant Statements are reproduced as follows:

(1) Paragraph 2 of Statement 1.203 203 "Professional Ethics - Integrity, Objectivity and Independence" provides-

"A member in public practice should be, and be seen to be, free in each professional assignment he undertakes of any interest which might detract from objectivity. The fact that this is self-evident in the exercise of the reporting function must not obscure its relevance in respect of other professional work."

(2) Paragraph 51 of Statement 1.203 provides –

"A practice should not accept or continue an engagement in which there is or is likely to be a significant conflict of interest between the practice and its clients."

(3) Paragraph 52 of Statement 1.203 provides -

"Whether a significant conflict of interest exists will depend on all the circumstances of the case. The test is whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect the objectivity of the practice."

(4) Paragraph 3 of Statement 1.303 "General Guidance - Restrictions on Appointments as Secretaries and Directors of Audit Clients " provides-

"A director has a duty of care and a direct control over the administration of a company. Hence, the professional independence of a member may be impaired if he is acting both as a director and an auditor of a company.

Accordingly, no partner or employee of a firm of certified public accountants or director or employee of any of its controlled or affiliated companies can be a director of a company which is audited by that firm. Neither can a limited liability company controlled by or

affiliated in any way with a firm of certified public accountants serve as a director in anyway of a company which is audited by a firm."

5. In reaching its said decision on liability, the Disciplinary Committee is fully aware that the two complaints against the Respondent are founded on the same set of facts which are sought to be proved by documents by the Complainant. The essential facts were set out in paragraphs 4 to 7 in the Complainant's Case dated 12 December 2007, which the Disciplinary Committee finds to have been proved, namely:
 - (1) The Respondent, practicing on his own account under a sole proprietorship firm in the name of "[CPA Firm A]", carried out the audit of a company, [Company B], for the auditing period from 17 December 1999 to 31 December 2000.
 - (2) The records maintained with the Companies Registry regarding [Company B] reflect that a company by the name of [Company M] was, until its resignation on 15 July 2002, a director of [Company B]. The balance sheet of [Company B] of 31 December 2000 was approved by way of signature of an authorized signatory of [Company M].
 - (3) [Company M] was in turn beneficially owned by the Respondent through his nominee company, [Company P].
 - (4) [Company M] was a director of [Company B] at the relevant time.
6. In reaching its decision on liability, the Disciplinary Committee is also fully aware and accepts that the burden of proof is always on the Complainant to prove each and every element of the charges, and that the standard of proof for disciplinary proceedings in Hong Kong is balance of probabilities on a sliding scale under the approach of the case of Re H [1996] AC 563. To put simply, the more serious the act or omission alleged, the more inherently improbable must it be regarded. And the more inherently improbable it is regarded, the more compelling will be the evidence needed to prove it on a preponderance of probability (A Solicitor v The Law Society of Hong Kong [2008] 2 HKLRD 576).
7. The Respondent exercised his right not to give evidence before the Disciplinary Committee. The Disciplinary Committee drew no adverse inference from that election and decided the case on the available evidence adduced before the Disciplinary Committee.

Witness

8. The only witness who testified at the hearing was [Mr. X] who gave evidence in support of the Respondent's case. In summary, [Mr. X] testified to the effect that:
- (1) He arranged for [Company M] to act as a nominee director of [Company B] for the sole purpose of complying with the Companies Ordinance before 2002 when the minimum number of directors required by law was two;
 - (2) [Company B] paid [Company M] \$1,800 to the Respondent annually for such an arrangement and service;
 - (3) The appointment of [Company M] as nominee director of [Company B] did not involve any actual control of the affairs and/or management of [Company B] by the Respondent through [Company M];
 - (4) The Respondent was not involved in the operation, meeting, management or administration of the affairs of [Company B];
 - (5) The Respondent was not an authorized signatory of the bank accounts of [Company B]; and
 - (6) [Mr. X] was in complete control of [Company B].
9. Under cross examination, when it was put to [Mr. X] that [Company M] held 76% of the shares of [Company B] according to [Company B]'s annual return dated 17 December 2001, [Mr. X] stated that he did not pay attention to such matters and what mattered to him was that he was in complete control of [Company B]'s business. It was also put to [Mr. X] that in a letter dated 30 August 2005 to the Institute with regards to the present Complaints, he stated that "after signing of the nominee director arrangement and other related documentation during the company's first registration," the Respondent and [Company M] "did not sign any other documents in the capacity of [Company B]'s director or officer"; however, the balance sheet of [Company B] dated 31 Dec 2000 was approved by the board of directors on 13 July 2002 and signed by [Company M]. In response, [Mr. X] stated that the signing was merely to fulfill procedures, and reiterated that he had complete control of [Company B].
10. In re-examination, Counsel for the Respondent asked [Mr. X] if he had requested the Respondent and [Company M] to sign "other related documentation" to allow [Mr. X] to have full control of [Company B], including control of the 76% shares held by [Company M]. [Mr. X] responded by

saying that from his standpoint, he had complete control of [Company B] and that all documents that had been signed by the Respondent and [Company M] would only support [Mr. X]'s full ownership of the company.

Summary of Defences

11. The defences raised by the Respondent in his Skeleton Submissions dated 25 August 2008 can be summarized as follows:

- (1) No actual incident of conflict of interest existed so that the impartiality and independence of the Respondent had been affected [paragraph 3] ("Defence 1");
- (2) Since the Respondent was only a nominee director and had no control or participation in the management and administration of the work of [Company B], there was no actual conflict of interests ("Defence 2");
- (3) There was no evidence that the Respondent was seen by any objective bystander as having detracted from objectivity [paragraph 7] ("Defence 3");
- (4) As a director [Company M] owes a duty to act in the interest of [Company B] to provide a true and fair view of the accounts which duty is not inconsistent with the duty and interests of an auditor [paragraph 13] ("Defence 4");
- (5) If an objective bystander seizes all the relevant facts he will not consider that the objectivity will be likely to be affected [paragraph 15] ("Defence 5"); and
- (6) Case law states that mere potential conflict is not always objectionable -- the court looks for incidents of real conflict [paragraph 18] ("Defence 6");

12. The Respondent raised the following additional points and defences in the Respondent's Case dated 28 January 2008 and its Reply dated 29 February 2008:

- (1) Complaint 1 is too general and lack particulars, relying on the articles of the Basic Law [paragraph 1 of the Respondent's Case and Paragraph 14 of the Respondent's Reply] ("Defence 7");

- (2) Paragraph 3 of Statement 1.303 does not expressly prohibit indirect shareholding by the auditor of a corporate director, and there was no actual control of or affiliation with the director, i.e., [Company M] in this case [paragraphs 15, 16 and 38 of the Respondent's Case] ("Defence 8");
 - (3) There was a practice by big accountants firms that auditors did offer corporate director nominee services such that the proper interpretation of paragraph 3 of Statement 1.303 should be discerned bearing the above in mind [paragraphs 22 and 23 of the Respondent's Case] ("Defence 9"); and
 - (4) The prohibition of right to trade is against the Basic Law and ICESC [paragraph 24 of the Respondent's Case] ("Defence 10").
13. It is noted that the Respondent through his Counsel at the hearing dropped the points raised earlier that the present disciplinary proceeding is criminal in nature and that this was a selective prosecution by the Complainant.
14. The Disciplinary Committee has considered each defence raised by the Respondent and has rejected each one of them for the following reasons:
- (1) Defence 1:
 - (a) The Disciplinary Committee finds this defence to be irrelevant as the test relating to paragraphs 51 and 52 of Statement 1.203 is not whether there was actual conflict, i.e., whether the Respondent's interest in [Company B] did actually affect his objectivity as [Company B]'s auditor; rather the test is objective potential conflict, i.e. *"whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect the objectivity of the practice"*.
 - (b) As the Disciplinary Committee understands the Complainant's case, the essence of the complaints and charges is that the Respondent placed himself in such a position that a reasonable observer would come to a view that the professional independence of the Respondent may be impaired.

(2) Defence 2 and 3:

- (a) Again, the question to ask is not whether there was any actual conflict of interest, but whether the Respondent was "*seen to be free...of any interest which might detract him from objectivity*". In coming to its decision the Disciplinary Committee relies completely on the notion of the Respondent placing himself where there is a perceived conflict of interest and impairment of independence. The Disciplinary Committee is prepared to accept and proceed on the basis that the Respondent did not control or participate in the business of [Company B], though objectively, the Respondent held 76% of the issued shares of [Company B].
- (b) To substantiate the charges, the Complainant need not adduce evidence of the views of any particular bystander. What a reasonable bystander will think is a question for the Disciplinary Committee. The Disciplinary Committee without any doubt has come to a view that given what the Respondent did, a reasonable bystander seized of the relevant facts would consider that the situation/interest of the Respondent would likely affect the objectivity of his practice and give rise to conflict of interest.

(3) Defence 4:

- (a) The Respondent argues that [Company M] owed a duty as a director of [Company B] to act in the interests of the company and to provide a true and fair view of the accounts, which is consistent with the interests of the auditor.
- (b) However, it is also the Respondent's case that he had no control over [Company M] whatsoever and he as a nominee director merely acted on the instructions given to him by [Mr. X]. In such a scenario, conflict may arise from the real owner/director of the [Company B] requesting the Respondent to conduct himself in a manner contrary to the objective and independent duty of an auditor.
- (c) The relevant Statements basically prohibit the auditing of accounts of a company in which the auditor is a director. It does not matter whether he be a director with decision making power or a nominee director. The objection in all these circumstances is that there will arise a perceived conflict of interest and likely impairment of independence. Therefore, this defence fails.

(4) Defence 5:

- (a) This defence of the Respondent begs the question: to what extent should the objective bystander be seized with the facts?
- (b) It could not be the case that paragraph 52 of Statement 1.203 requires the objective bystander to conduct an investigation of all the relationships of the Respondent, [Company M] and [Company B] to discover, for example, that [Company M] was merely a nominee director of [Company B], particularly having in mind the purpose of the Statements.
- (c) Furthermore, even if the objective bystander were to be armed with all the facts in this case, for the above reasons the Disciplinary Committee finds that he would still consider the Respondent's interest as likely to affect his objectivity as an auditor.

(5) Defence 6:

- (a) The cases cited by the Respondent do not advance his case. In the context of the present case when the ethical and professional rules require accountants to avoid potential conflict of interest and perceived likelihood of impairment of independence, it lies ill in the mouth of the Respondent to assert that mere potential conflict is not always objectionable and that there must be incidents of real conflict before the charges are proved. All such authorities are not relevant for the present purposes because they were decided in a totally different context.
- (b) The cases referred to by the Respondent, including SISU Capital Fund Ltd v Tucker [2005] EWHC 2170, relate to situations such as applications for removal of liquidators on grounds of conflict of interest. The decisions of the cases did not have in mind disciplinary proceedings involving disciplinary rules and ethics which avoid potential conflict of interests.
- (c) Indeed, in the case of SISU (supra), Warren J stated that there is "*a distinction to be drawn between the interests of the insolvency administration and any guidance given by a relevant professional body*", and in fact administrators who were able to resist applications for their removal from office were subsequently disciplined. It shows that these cases were not of any assistance to the Disciplinary Committee.

(6) Defence 7:

- (a) The Disciplinary Committee accepts the Complainant's submission that the complaint letter dated 18 October 2006 with accompanying supporting documents in the appendices state clearly what particulars are relied on by the Complainant and its case.
- (b) Furthermore, it is noted that paragraph 1 of the Guidelines to Statement 1.203 makes clear that members should be "*guided by the spirit of this Statement and the fact that particular conduct does not appear among a list of example does not prevent it from amounting to misconduct*". In particular, paragraph 2 of Statement 1.203 is a high level statement of principle regarding the need for members to be seen to be free from any conflict of interest. It follows that the Statements should not contain conclusive and limited examples or detailed explanations regarding the type of conduct they are designed to regulate and the particulars relied on in support of the charges are sufficient. In any event, the Respondent has experienced no difficulty in defending the charges which involved facts which are clear. Thus the objection based on the Basic Law is irrelevant to the present case.

(7) Defence 8:

- (a) As to paragraph 3 of Statement 1.303, the Disciplinary Committee finds that the Respondent did have control over curd was affiliated with [Company M], by reason of the Respondent's beneficial ownership of at least 50% of the shareholding of [Company M] through [Company C] as evidenced by the written declaration of trust. Without any explanations to the contrary, the only proper inference to be drawn is that the Respondent had control over and was affiliated with [Company M] within the meaning and under the terms of the said Statement.
- (b) The Disciplinary Committee also accepts the Complainant's submission that if "control" should be construed to exclude control by shareholding, such a construction would provide members with a simple way of defeating the purpose of Statement 1.303. Such could not be the intention of the relevant Statements.

(8) Defence 9:

- (a) It must be noted first of all that the Statements do not seek to prohibit the provision of nominee directorship services by accounting firms per se. Thus the practice of

providing nominee director service is not objectionable and such a practice is irrelevant and does not assist this defence.

- (b) As the Respondent has abandoned its argument with respect of selective prosecution, it only remains for the Disciplinary Committee to find that whether other firms are conducting themselves in the same way as the Respondent is a question which requires evidence to prove. The Respondent has not provided any evidence to prove the said practice and thus this defence fails.

(9) Defence 10:

- (a) The Respondent's argument based on the Basic Law and Article 6 of the ICESC is ill-founded. Statements 1.203 and 1.303 do not prevent the Respondent from earning his living by working as an accountant or providing nominee directorship services; they merely provide restrictions on such provision of services, i.e., when he is at the same time providing auditing services to such clients.
- (b) The Disciplinary Committee accepts the submission of the Complainant that the said Articles could not have been intended to abrogate the power of professional bodies to lay down professional standards to regulate the conduct of practicing professionals in a particular field.

15. The Disciplinary Committee understands that the spirit and objectives of the rules relied on to charge the Respondent is to uphold the integrity, objectivity and independence of members in the accounting profession. The Disciplinary Committee has reached the conclusion that the acts of the Respondent are exactly what the rules intend to prevent and prohibit.

16. For the above reasons, the Disciplinary Committee finds that both charges against the Respondent were proved on the required standard.

Penalties

17. In deciding on the appropriate penalties, the Disciplinary Committee recognizes the fact that the Respondent had no previous record of misconduct. The Disciplinary Committee further takes into account the Respondent's mitigation, namely that:

- (1) he did not know what he had done was wrong – he did it out of stupidity;

- (2) he had been a member since 1990 and had maintained a clear record;
- (3) he was first informed of the charges five years ago and this matter has been hanging over his head for a long period of time; and
- (4) he has been actively involved in voluntary/charitable/community service work, including Lion's Club and the Scouts.

18. After considering all circumstances of the case, for both charges, the Respondent is to be reprimanded. In addition, a financial penalty of \$50,000 was imposed for the second charge. In imposing the above penalties, the Disciplinary Committee considered that the relevant Statements protecting the integrity and independence of professional accountants are important and must be strictly observed. Confidence of the public or such values cannot be compromised. Since the Respondent derived financial advantage in the way he breached the rules, there should be imposed a financial penalty.

Costs

19. The Disciplinary Committee recognizes the general principle that costs should follow the event. The conduct of the defence by the Respondent necessitated costs to be incurred in the proceedings and none of the defences raised was accepted by the Disciplinary Committee and they are plainly unmeritorious, The Disciplinary Committee made the decision to impose a lump sum cost order of \$250,000 against the Respondent after obtaining an estimate of costs from the Complainant estimated to be approximately \$300,000. There would further be costs incurred by the Institute amounted to approximately \$200,000. As such, the cost order reflects 50% of the total costs incurred.

20. In summary, the order made by the Disciplinary Committee is:

- (1) in relation to both charges, the Respondent shall be reprimanded;
- (2) for the second charge the Respondent shall pay a financial penalty of \$50,000 within 3 months from the date of the Order; and
- (3) the Respondent shall pay costs in the sum of \$250,000 within 3 months from the date of the Order.

Dated this 27th day of September 2008.