Proceedings No.: D-16-1221H

IN THE MATTER OF

A Complaint made under Section 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. Leung Kin Sun, Sunny (Membership No.: A08842)	First Respondent
Sunny Leung & Company (Firm No.: 1105)	Second Respondent

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

Members: Mr. Chung Kwok Fai (Chairman)
Ms. Kan Wai Mun, Carmen
Mr. Lam Yin Shing, Donald
Mr. Wong Chun Bong, Alex
Mr. Chu Yau Wing, Jason

ORDER AND 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. Leung Kin Sun, Sunny, certified public accountant (practicing) (the "**First Respondent**") and Sunny Leung & Company, a firm (the "**Second Respondent**") (collectively the "**Respondents**").

2. The particulars of the complaint as set out in a letter from the Registrar to the Institute's Council dated 1 February 2018 (the "**Complaint Letter**") are as follows:-

BACKGROUND

(1) Ting Wai Monastery Limited (the "**Company**") is a Hong Kong incorporated company and an approved charitable institution under section 88 of the Inland Revenue Ordinance. It engages in the promotion of Buddhism and receives offerings and donations mainly on a cash basis.

(2) The First Respondent is the sole proprietor of the Second Respondent which audited the financial statements of the Company for the year ended 31 March 2009 ("**Financial Statements**").

(3) The Financial Statements were prepared in accordance with the Hong Kong Financial Reporting Standards ("**HKFRSs**") and the requirements of the Hong Kong Companies Ordinance. The Respondents stated in the auditor's report that they had conducted the audit in accordance with Hong Kong Standards on Auditing ("**HKSA**") and expressed an unmodified audit opinion.

(4) On 2 December 2016, the Respondents confirmed complete audit documentation for the audit of the Financial Statements was provided to the Institute.

(5) A review of the audit workpapers indicated that the Respondents had failed to comply with a number of professional standards issued by the Institute. The Registrar has reason to believe that section 34(1)(a)(vi) of the PAO is applicable to the Respondents in their audit of the Financial Statements.

THE COMPLAINTS

First Complaint

(6) Section 34 (1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 5 of HKSA 320, as they failed to establish an acceptable materiality level for the audit of the Financial Statements.

Second Complaint

(7) Section 34(1)(a)(vi) of the PAO applies to the Respondents (being the auditor of the Financial Statements) in that they failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraphs 2, 9, 13 and 14 of HKSA 550, as they failed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties, the effect of material related party transactions, and failed to confirm the terms and amounts of the transactions with related parties.

Third Complaint

(8) Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 2 of HKSA 500, as they failed to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion in the following areas:

- Bank confirmation requests;
- Sundry income;
- Festivals and religious expenses;
- Insurance expenses;
- Repairs and maintenance expenses;
- Staff costs

Fourth Complaint

(9) Section 34(1)(a)(vi) of the PAO applies to the Respondents (being the auditor of the Financial Statements) in that they failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraph 16 of HKSA 260, as they failed to document, in the audit workpapers, communications of audit matters involving governance issues with those charged with governance and any responses to those matters.

Fifth Complaint

(10) Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply a professional standard, namely paragraphs 12 and 13 of HKSA 580, as they failed to ensure that the management representation letter had been properly dated.

Sixth Complaint

(11) Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply a professional standard, namely sections 100.4(c) and 130 of the Code of Ethics for Professional Accountants ("**COE**"), as they failed to maintain professional knowledge and skill at the level required to ensure that a client receives competent professional service, and to act diligently and in accordance with applicable technical and professional standards when providing professional services.

SUMMARY OF PRINCIPAL ISSUES

In respect of First Complaint

(12) The Respondents admitted that their audit programs in 2009 were inadequate. They represented that they had only assessed the risk of material misstatement and the nature of material misstatement and there was no documentation to quantify the materiality.

(13) The Respondents failed to establish an acceptable materiality level. Accordingly, there was no quantitative threshold set over which items in the income and expenditure accounts could be consistently selected to be subject

to audit procedures. For example, the Respondents failed to determine why high expense items that would have been material to the financial statements including "Messings", "Staff welfare", "Travelling and fares" and "water, gas and electricity" had not been subject to audit procedures but certain other expense items of lower amounts had been selected.

(14) In addition, in the audit programs relating to property, plant and equipment, receivables, bank balances and cash, payables, share capital and reserves and the income statements, there was a procedure "Examine any material journal entries or other adjustments made during the course of preparing the financial statements". The Respondents simply stated "Done" without any explanation of what was examined or why. In the absence of any quantitative basis on which selection could be based, the Respondents' selection of the journal entries or other adjustments for testing, if any, would be highly subjectively and quite haphazard.

In respect of Second Complaint

(15) According to Hong Kong Accounting Standard 24 Related Party Disclosures ("HKAS 24"), a party is related to an entity if the party is a member of the key management personnel of the entity of its parent. As such, directors of the Company are considered as related parties.

(16) Paragraph 2 of HKSA 550 states that "the auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effect of related party transactions that are material to the financial statements".

(17) Paragraph 14 of HKSA 550 further states that "given the nature of related party relationships, audit evidence of a related party transaction may be limited...[b]ecause of the limited availability of appropriate audit evidence about such transactions, the auditor considers... [c]onfirming the terms and amount of the transaction with the related party".

(18) The audit program used by the Respondents on related party transactions required the Respondents to "Ensure that there is sufficient appropriate

evidence on the file to support the disclosures made". The Respondents stated "Done".

(19) There was no documentation in the workpapers that dealt with how the Respondents had compiled, if at all, with the requirements of HKSA 550.

Advances to directors

(20) The item of "Prepayments" of HK$112,000 in the balance sheet included advances of HK$ 99,000 (5% of total assets) paid to directors of the Company. These advances were found to be related party transactions, as envisioned under HKAS 24. However, note 9 to the Financial Statements stated that "*The monastery did not enter into any material related party transactions during the year*".

(21) There was no evidence to demonstrate that the Respondents had realized that the transactions were with related parties and, if so, why they were not disclosed as related party balances in the Financial Statements.

Confirmation with a director

(22) In breach of HKSA 550.14, the Respondents did not obtain any signed confirmation from Sun Hung Yuk, one of the directors at the material time, in relation to his interest in contracts with the Company.

(23) The Respondents could not simply comply with their obligations under HKSA 550.14 by obtaining signed confirmations from the remaining five directors. HKSA 550.14 required the confirmation to be with the relevant related party.

(24) There was no evidence that the Respondents had followed up on this matter in breach of paragraphs 2 and 14 of HKSA 550.

In respect of Third Complaint

(25) Paragraph 2 of HKSA 500 states that "the auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion".

Bank confirmation requests

(26) The Respondents did not request a bank confirmation from the Company's banker, HSBC, with which a bank account balance of HK$74,998 was maintained at the year end. The Respondents stated in the audit workpapers that "*Our client said that director confirmation of HSBC(S/A) cannot be sent because no authorized present directors can sign. The bank account is only used to pay electricity and telephone by direct debit from bank in recent years*".

(27) There was no evidence that the Respondents had assessed why no other existing director could be an authorized signatory or, in the absence of such authorized signatory, the Company could not simply instruct the bank to accept another director/person as the authorized signatory.

(28) Nevertheless, by way of an alternative procedure, the Respondents filed in the audit workpapers a copy of the passbook of the bank account showing the balance as at the end of the reporting period.

(29) The Respondents represented to the Institute that they had scrutinized the unusual items of the passbook and did not find any irregularities of bank account. Those representations, however, were found to be lack of support from any contemporaneous evidence in the audit workpapers.

(30) Furthermore, scrutinizing a passbook is of limited effect. Unlike a bank confirmation, the Respondents would not be in any position to confirm the accuracy of the Company's assets and liabilities. Without directly contacting the bank, the Respondents are not in any position to ascertain whether there are any other liabilities with that bank.

Sundry income

(31) Sundry income mainly represented the net income from a fund raising event, which included ticketing income less direct expenses, and other cash donation income, totaling HK$50,840.

(32) In the audit workpapers, the Respondents included an "Income and Expenses Schedule" of the fundraising events and checked the total net income amount to a bank deposit slip.

(33) The Respondents subsequently asserted to the Institute that they had verified the income to ticket stubs and performed vouching tests for expenses but there was no evidence in the workpapers that those procedures had actually been performed.

(34) There was no evidence showing any test work performed on completeness of the income and validity of expenditure items. The Respondents therefore failed to obtain sufficient appropriate evidence regarding sundry income.

Festivals and Religious Expenses

(35) The amount totaled HK$465,419. The Respondents only checked the amount to cheque payment slips. However, there was no evidence that they had checked the amounts to suppliers' invoices to ensure existence and accuracy.

(36) The Respondents agreed that they did not obtain sufficient evidence to verify the existence of the expenses.

Insurance Expenses

(37) The Company paid investment insurance expenses in the names of two directors, as follows:

(a) Sik Chi Ding – HK$40,560

(b) Sik Chi Keung – HK$35,880

(38) The Respondents only documented that they had checked the amounts to suppliers' receipts. They subsequently represented to the Institute that they agreed the amounts were investment insurance expenses and relied on the director's representations that the amounts incurred were in the ordinary course of operations.

(39) The Respondents failed to obtain sufficient appropriate evidence to justify accounting for the insurance as expense amounts, as they had not performed any procedures to assess:

(a) if those insurance amounts, which involved elements of investment and potential future capital gains in the names of directors, were the Company's expense;

(b) if the amounts had been properly approved by the board of directors, given clause 6 of the Company's memorandum of association which prohibits the Company to pay any benefit in money or money's worth to the directors; and

(c) if the amounts should be accounted for as related party transactions – amounts due from directors instead of being expensed in the Financial Statements.

Repairs and Maintenance Expenses

(40) The amount totaled HK$1,434,611 and it mainly consisted of two sums paid to two suppliers:

(a) Fat Kee Construction Co. (HK$996,000, 264% of deficit for the year) – The amount related to the construction of retaining wall, slope, road, demolition and construction of new house (construction of toilet, bathroom and installation of water, electricity and air-conditioning facilities).

(b) Bonrich Engineering Limited (HK$310,000, 82% of deficit for the year) – The amount related to office project, demolition and construction of store room, conference room and reception area.

(41) Such items, which involved the construction of buildings and ancillary facilities, were reasonably expected to be used for more than one accounting period and were capital in nature. As a result, they would normally be reflected as long-term assets, rather than expenses, in the financial statements.

(42) However, the Respondents had not performed physical inspection or other procedures on such items to assess their physical existence, and to assess why such items had not been capitalised.

(43) The only procedure evidenced in the audit workpapers was checking against suppliers' receipts and invoices. The Respondents subsequently represented to the Institute that they accepted the directors' representations that those were payments for repair work, however there was no documentation of such enquiry ever made in the audit workpapers. The Respondents admitted that they had not physically inspected the items and failed to assess whether those amounts should be capitalized instead of being expensed.

<u>*Staff Costs*</u>

(44) The Company incurred "Staff Costs – Salaries and Allowances" for two directors. Workpaper stated:

(a) Sik Chor Wai, $5,000 or $6,000 per month (HK$64,000)
(b) Sik Chi Ding, $6,000 per month (HK$72,000)

It also stated that "*The director said travelling allowances is re-imbursements expenses and is not belonged to directors' remuneration*".

(45) There was no evidence that the Respondents had assessed whether those amounts expensed to the income and expenditure accounts were actually reimbursements of expenses supported by suppliers' invoices.

<u>*In respect of Fourth Complaint*</u>

(46) The Respondents noted the Company's weaknesses in internal control in various instances as below:

(a) In the workpaper relating to system and internal controls, the Respondents stated under the caption "Comment on effectiveness of system and controls" the following:

- *"Some payments, e.g. Worshipping on special occasion – only cheques issued & mentioned the usage only but without any invoices / receipts can be seen. Suggested client to get more official receipts."*

- *"Suggested client to bank-in all donations whatsoever in cash or cheques."*

- *"No clearly segregation of duty. Suggested client that material payments should be passed in directors' meeting."*

(b) In the workpaper relating to system notes of income and expenditure, the Respondents stated the following:

- *"All offering income will be subjected to receipts issued upon cheque/s and cash received mainly by director Sik Chi Ding solely or the volunteers/part time helpers she assigned to do so."*

- *"All expenditure incurred by the monastery is mainly for operating and administrative purposes."*

- *"Monastery expenses were approved mainly by director Sik Chi Ding for making all payments."*

(c) In the workpaper relating to audit risk assessment, the Respondents stated the following:

- *"Does the entity have a weak control environment?"* The Respondents stated, *"No full time staff to handle the daily accounting records."*

(d) In carrying out the bank confirmation audit procedure, the Respondents were aware that the authorized bank signatures of the HSBC bank account were still in the name of retired directors and had not yet been updated.

(47) Paragraph 15 of HKSA 260 states that "the auditor's communications with those charged with governance may be made orally or in writing". Paragraph 16 further states "when audit matters of governance interest are communicated orally, the auditor documents in the working papers the matters communicated and any responses to those matters".

(48) The Respondents represented that they had meetings with the directors to discuss the weaknesses of internal control. They also told the directors that they would resign as auditor of the Company should there be no improvement on internal controls. They ceased to be auditors of the Company starting from the year ended 31 March 2010.

(49) However, they admitted that they had not prepared a letter of comments to the Board of Directors nor was there any written documentation about the alleged communication of their concerns with those charged with governance in the workpapers.

(50) Such a lack of documentation was a breach of the requirements of HKSA 260.

In respect of Fifth Complaint

(51) Paragraph 12 of HKSA 580 states that the auditor would request that "a management representation letter... be appropriately dated and signed". Paragraph 13 further states that such letter "would ordinarily be dated the same date as the auditor's report".

(52) The Respondents had not obtained a properly dated management representation letter. They admitted that they were careless in this regard.

In respect of Sixth Complaint

(53) Section 100.4(c) of the COE requires a professional accountant to "maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service" and "act diligently and

in accordance with applicable technical and professional standards when providing professional services". Section 130 further elaborates that "competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service" and "diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis".

(54) Paragraph 35 of HKSA 200 (Revised) states that "the requirements of the financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements" and "a complete set of financial statements under HKFRSs... includes a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and notes, comprising a summary of significant accounting policies and other explanatory notes".

(55) The Financial Statements did not include a Statement of Changes in Equity and there was no disclosure explaining why such statement had not been prepared. There was only a note (Note 8 to the Financial Statements "Changes in Equity") disclosing the movements of the "Retained Funds" from 1 April 2007 to 31 March 2009.

(56) The Respondents represented that they had misunderstood that the note of "Changes in Equity" could substitute "Statement of Changes in Equity". This indicated the Respondents' lack of competence in identifying that the Financial Statements, without a statement of changes in equity, were not a complete set of financial statements under HKFRSs.

THE PROCEEDINGS

3. On 3 April 2018, the Respondents made their admission to the First to Sixth Complaints against them, and do not dispute the facts as set out in the Complaint Letter. On 4 April 2018, the parties agreed that the steps set out in Rules 17 to 30 of the Disciplinary Committee Proceedings Rules ("**DCPR**") be dispensed with.

4. In light of the above, having considered sanctions that are commensurate with the deficiencies identified in the complaints, the Respondents' early admission and cooperation in these proceedings, the seriousness of the case,

the objective of maintaining public reputation of the profession, the culpability of each Respondent, and the submissions respectively made by the Complainant and the Respondents, IT IS ORDERED by the Disciplinary Committee that:-

(a) the Respondents be reprimanded under Section 35(1)(b) of the PAO;

(b) the Respondents pay jointly and severally a penalty of HK$80,000 under Section 35(1)(c) of the PAO; and

(c) the Respondents pay jointly and severally the costs and expenses of and incidental to the proceedings, including the costs and expenses of the Complainant in a total sum of HK$60,956 under Section 35(1)(iii) of the PAO.

Dated 2 October 2018

Mr. Chung Kwok Fai
(Chairman)
Disciplinary Panel A

Ms. Kan Wai Mun, Carmen
Disciplinary Panel A

Mr. Wong Chun Bong, Alex
Disciplinary Panel B

Mr. Lam Yin Shing, Donald
Disciplinary Panel A

Mr. Chu Yau Wing, Jason
Disciplinary Panel B