

IN THE MATTER OF

A Complaint made under section 34(1) of the Professional Accountants Ordinance, Cap. 50 (the “PAO”)

BETWEEN

The Practice Review Committee of the
Hong Kong Institute of Certified Public
Accountants

COMPLAINANT

AND

Chan Ho Yin Graham (F02039)
Chan Suk King (A13777)

1st RESPONDENT
2nd RESPONDENT

Before a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants (the
“Committee”)

Members: Mr. Fong Wai Kuk Dennis (Chairman)
Mr. Chau Chi Chung
Mr. Hui Cheuk Kit Frederick
Mr. Kwok Kai Bun
Mr. Paul Phenix

Date of Sanctions hearing: 17 April 2024

ORDER AND REASONS FOR DECISION

1. This is a complaint made by the Practice Review Committee of the Hong Kong Institute of Certified Public Accountants (“PRC”) against Chan Ho Yin Graham, CPA (Practising) (the “1st Respondent”) and Chan Suk King, CPA (the “2nd Respondent”) (together, the “Respondents”).
2. The PRC brought the complaint against the Respondents by a letter to the Registrar of the Institute dated 25 November 2021.

BACKGROUND

3. Graham H.Y. Chan & Co. (firm no.: 0676) (the “**Practice**”) was subject to a full-scope practice review which commenced in August 2019 and concluded in May 2020.
4. During the practice review, the practice review team (“**Reviewer**”) reviewed the Practice’s audit of the consolidated financial statement of Client A and its subsidiaries (collectively the “**Group**”) for the year ended 31 December 2018 (“**Financial Statements**”).
5. Client A was incorporated in Cayman Islands and its shares were listed on the Main Board of the Stock Exchange of Hong Kong, and the Group’s principal business involved mining, ore processing, sales of iron ore products and other commodities to steel manufacturers and/or their respective purchase agents in China.
6. The Practice expressed an unmodified auditor’s opinion on the Financial Statements prepared under the International Financial Reporting Standards (“**IFRSs**”). The 1st Respondent was the engagement partner and the 2nd Respondent was the engagement quality control reviewer (“**EQCR**”) in the audit. The auditor’s report stated that the audit was conducted in accordance with Hong Kong Standards on Auditing (“**HKSA**”).
7. In reviewing the workpapers supporting the audit of the Financial Statements, the Reviewer identified audit deficiencies in a number of areas which indicated that the Respondents had failed to obtain sufficient appropriate audit evidence to support the auditor’s opinion expressed.
8. In view of the Reviewer’s findings and the public interest element involved in Client A, the PRC has decided to raise a complaint against the Respondents.

THE PROCEEDINGS

9. By a letter dated 3 January 2022, the Complainant and the 1st Respondent jointly informed the Committee that the 1st 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.
10. The Notice of Commencement of Proceedings against the 1st Respondent was issued on 10 February 2022. Having considered letter from the Complainant and the 1st Respondent, and the 1st Respondent’s admission of the complaint, the Committee approved the parties’ proposal and directed that they made submissions on sanctions and costs within 28 days (i.e. by 10 March 2022).
11. The Notice of Commencement of Proceedings against the 2nd Respondent was also issued on 10 February 2022. On 16 February 2022, the Complainant and the 2nd Respondent jointly informed the Committee that the 2nd Respondent had admitted the complaint against her. 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. The Committee approved the parties’ proposal and directed that they made submissions on sanctions and costs within 28 days (i.e. by 24 March 2022).
12. On 4 March 2022, the 1st Respondent requested the Committee to approve his application of time extension to file written submissions on sanctions and costs by 30 June 2022.
13. On 10 March 2022, the Complainant requested the Committee to grant a time extension to for the Complainant to file submission on sanctions and costs against the 1st Respondent and to approve that a single joint submission for both Respondents to be filed by 24 March 2022.

14. The Committee requested each party to provide submissions on the said requests. The Complainant, 1st Respondent and 2nd Respondent provided their submissions on 22, 28 and 29 March 2022 respectively.
15. Having considered parties' submissions, the Committee directed on 8 April 2022 that each party make submissions on sanctions and costs by 31 May 2022. Parties made their submissions accordingly.
16. After considering parties' submissions on sanctions and costs, on 12 July 2022, the Committee decided that a hearing on sanctions and costs was necessary. The sanctions hearing was subsequently fixed at 2 November 2022, and was later postponed to 7 February 2023.
17. On 18 August 2022, Ms. Mabel Au, a Disciplinary Panel A member stepped down. Parties were informed of the same on 24 August 2022. Parties stated no objection to the Complaint being dealt with by the remaining Committee members.
18. On 31 January 2023, the term of office of the then Chairman ended and rendered the Committee inquorate. The sanctions hearing originally set on 7 February 2023 was postponed.
19. On 24 October 2023, Mr. Fong Wai Kuk Dennis was appointed as the Chairman of the Committee.
20. On 4 December 2023, Mr. Chau Chi Chung and Mr. Hui Cheuk Kit Frederick were appointed as Committee members and parties were informed of the appointments of Mr. Fong, Mr. Chau and Mr. Hui on 5 December 2023.
21. The sanctions hearing was rescheduled to 17 April 2024 after the appointments of the new Committee members.

THE COMPLAINTS

22. First Complaint

Section 34(1)(a)(vi) of the PAO applies to the 1st Respondent in that he failed or neglected to observe, maintain or otherwise apply professional standards in carrying out the audit of the Financial Statements.

23. Second Complaint

Section 34(1)(a)(vi) of the PAO applies to the 2nd respondent in that she failed or neglected to observe, maintain or otherwise apply a professional standard in carrying out the engagement quality control review for the audit of the Financial Statements.

24. The relevant auditing standards applicable to the Complaints are:

(i) First Complaint

- (a) HKSA 230 *Audit Documentation*
- (b) HKSA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*
- (c) HKSA 500 *Audit Evidence*
- (d) HKSA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- (e) HKSA 570 *Going Concern*

(ii) Second Complaint:

(a) HKSA 220 *Quality Control for an Audit of Financial Statements*

FACTS AND CIRCUMSTANCES IN SUPPORT OF THE COMPLAINTS

First Complaint

25. The First Complaint concerns the 1st Respondent's audit deficiencies in the Financial Statements.

Issue 1: Impairment review of a cash generating unit ("CGU") of the mining business

26. The Group entered into a mining agreement with a Malaysian entity beneficially owned by third parties. The Malaysian entity was the registered holder of a mining lease granted by the relevant local authorities for the right to extract and mine iron ores at the Ibam Mine, Malaysia.

27. The Group's assets with regards the Ibam Mine included mining rights and reserves of USD12.7 million, goodwill of USD6.0 million and property, plant and equipment of USD3.2 million (totalling USD21.9 million). These assets were allocated to a cash generating unit ("**Ibam Mine CGU**") for impairment review purposes.

28. The 1st Respondent concurred with management that no impairment was necessary on the assets constituting the Ibam Mine CGU, as the value in use of the Ibam Mine based on the discounted cash flow projections exceeded the Ibam Mine CGU's carrying amount of USD21.9 million.

29. However, there was insufficient evidence that the 1st Respondent performed adequate audit procedure to evaluate the key assumptions and data used in the valuation, including the licenses and approvals for the enlargement of the mining operations, the length of forecast period, forecasted production volume, capital expenditure, costs and selling price and implications of discrepancies between the projections made in prior years and those made in the current year.

30. In addition, for the sensitivity analysis performed by the 1st Respondent in the audit workpapers, the 1st Respondent did not set out the basis or justification for using the series of selling price, production costs and discount rate in the sensitivity analysis that he considered that it was unlikely for the relevant parameters to change to an extent which might result in impairment on the Ibam Mine CGU. Also, there was insufficient evidence to justify the appropriateness of the source data used in the sensitivity analysis.

31. As a result of the above, the 1st Respondent failed to obtain sufficient appropriate audit evidence and adequately evaluate the management estimates in the impairment review of Ibam Mine CGU, and failed to comply with paragraph 33(b)(ii) of HKSA 240, paragraph 6 of HKSA 500, and/or paragraphs 9, 15, 17 and/or 18 of HKSA 540. Alternatively, the Respondent failed to document or adequately document the audit work performed, in breach of paragraph 8 of HKSA 230.

Issue 2: Investment in an associate

32. The Group's subsidiary entered into a joint venture agreement ("**JV Agreement**") with a third-party company in Malaysia to set up a new company ("**Associate A**") for the production of direct reduction iron in December 2018.

33. The Group subscribed to 33.33% equity interest of Associate A at a consideration of USD50.0 million, satisfied by the Group's contribution of 9.12% of its equity interest in a subsidiary ("**Equity Interest**") fair-valued at USD548.8 million as at August 2018 by an external valuer using the discounted cash flow method.
34. The other party contributed its existing direct reduced iron plant ("**Plant**") valued at USD80.0 million and cash of USD20.0 million payable in 2019. However, the external valuer determined a higher fair value of USD 146.1 million for the Plant as at April 2018 using the discounted cash flow method.
35. The 1st Respondent adopted the JV Agreement and the valuation reports as the primary source of audit evidence in determining the fair values of the Equity Interest and of the Plant.
36. However, the audit workpapers did not show proper evaluation by the 1st Respondent of the assumptions underlying the two valuations, and there was no information on the supporting documents reviewed by the 1st Respondent before coming to the conclusion that the assumptions were reasonable and supportable. There was also insufficient evidence on any procedures performed by the 1st Respondent in understanding management's reasons for adopting a lower fair value for the Plant. As such, the 1st Respondent had not obtained sufficient evidence on the fair value of Associate A, which would impact the amount of interest in Associate A recognised in the Financial Statements.
37. The Group recognised the entire difference between the book value and the purported fair value of the Equity Interest as a "Gain on disposal" in the other reserves in the Financial Statements.
38. According to Paragraph 28 of the International Accounting Standard 28 *Investments in Associates and Joint Ventures* ("**IAS 28**"), the gain from the Group's contribution of the Equity Interest to Associate A should have been recognised only to the extent of the interest unrelated to the Group. As such, the 1st Respondent has failed to identify that the recognition of the entire gain from the Group's contribution of the Equity Interest to Associate A was a breach of IAS 28.
39. For impairment review purposes, the Group's management projected the future cash flows of Associate A for the years ending 31 December 2019 to 31 December 2038 to be USD106.2 million and determined there was no impairment in the investment in Associate A, which was concurred by the 1st Respondent. The 1st Respondent relied on a feasibility study report and a "stamped" financial forecast to support the assumptions underlying the forecast.
40. The feasibility report was said to be prepared by a third party company. However, there was insufficient evidence that the 1st Respondent had evaluated the adequacy of the expert's qualification and experience in forecasting the production volume of the Plant. The audit papers also did not show sufficient evidence in supporting the adoption of discount rate for the cash flow forecast to be appropriate.

Issue 3: Financial assets at fair value through other comprehensive income

41. The Group acquired equity interests in two private companies in the People's Republic of China, with a total carrying amount of USD 15.3 million being the fair values as determined by an external valuer engaged by the Group (the "**Valuer**"). The Group accounted for both investments as financial assets at fair value through other comprehensive income.

42. The Valuer adopted the price to total assets multiple method under the market approach to determine the fair value of the two investments. The method was based on a selection of eight companies engaged in similar business activities to the two private companies acquired by the Group. The 1st Respondent concurred with the Valuer on the selection of the comparable companies upon which the fair values of the two private companies were calculated.
43. However, the 1st Respondent failed to adequately evaluate whether the Valuer's valuation method was sufficiently supported and appropriate in the circumstances notwithstanding the fact that the 1st Respondent has noticed that there was no sufficient public information about comparable companies and there was insufficient evidence to justify the comparability of the companies on factors other than their business nature.
44. The Valuer considered "total assets" as a key item for the valuation multiple based on the consideration that funds collected by the two private companies were the major drive of revenue and constituted most of the assets.
45. The 1st Respondent concurred with the Valuer, but failed to adequately evaluate and consider whether "total assets" would be an appropriate basis for calculating the multiple, instead of only assets relevant to the businesses of the two investments.

Issue 4: Loan to a third party company

46. The Group held a loan to a third party company with a carrying amount of USD8.8 million, which the repayment was guaranteed by the ultimate shareholder of a company that the Group has equity interest in, an individual third party.
47. In the Group's evaluation, the expected credit loss of the loan receivable balance was determined to be USD8,500 based on two determined parameters "default loss %" and "default %" and therefore was considered immaterial and not recognised in the Financial Statements.
48. The 1st Respondent concurred with management that no expected credit loss be recognised considering (i) that the third party company had settled the interest due, (ii) that the loan monies were being used by a related company of the individual third party which purportedly would generate revenue in the fourth quarter of 2019, and (iii) the financial ability and no significant default history of the individual third party according to a credibility assessment report.
49. The 1st Respondent failed to justify and obtain sufficient evidence in supporting the basis of his considerations in coming to the conclusion that no expected credit loss be recognised.
50. There was also insufficient evidence that the 1st Respondent had performed any procedure to evaluate management's determination of the parameters based on which the expected credit loss was calculated and considered to be immaterial. In this respect, the 1st Respondent failed to justify why any settlement of interest payments would constitute sufficient appropriate audit evidence as to the recoverability of the repayment of principal.
51. The 1st Respondent also failed to obtain sufficient evidence to corroborate management's assertion and to review relevant business plans of the related company of the individual third party. He failed to evaluate whether the Group had actually undertaken any "oversight" of that individual third party and reviewing any of his financial information.

52. As such, the 1st Respondent failed to obtain sufficient evidence to ascertain that the Group had undergone the rigorous exercise as specified by IFRS 9 *Financial Instruments* in evaluating any significant increase in credit risk and measuring the expected credit loss.

Issue 5: Going concern assessment

53. As at the year-end date, the Group's current assets included, inter alia, cash and cash equivalents of USD183,000, and trade receivables of USD205.1 million. Current liabilities included, inter alia, bank borrowings of USD40.9 million and notes payable of USD37.3 million. The Group's ability to repay the borrowings and notes in the year 2019 depended on its ability to receive and realise trade receivables on a timely basis, which would in turn impact on whether the Group was a going concern and whether the basis of preparation of the Financial Statements was appropriate.
54. In the audit, the 1st Respondent reviewed management's cash flow forecast for the Group for the year ending 31 December 2019, based on assumptions on the timing of receipts from trade receivables, settlement of trade payables and notes and bank loans, etc. The 1st Respondent concurred with management that the Group was able to generate sufficient cash flows to pay off its liabilities due, and considered that the going concern basis adopted by the Group was appropriate.
55. However, the audit workpapers did not show the 1st Respondent had paid sufficient appropriate attention to the fact that the actual settlement pattern of trade receivables was inconsistent with management's assumption of trade receivables settlement and there was insufficient evidence in the audit workpapers of the 1st Respondent verifying any such settlement having been received at the time of issuing the auditor's report on 29 March 2019.
56. The audit workpapers also did not indicate that the 1st Respondent had performed any procedures to evaluate the forecasted revenue figures from March to December 2019 (January and February 2019 were purportedly actual figures). The 1st Respondent failed to obtain sufficient evidence as to ascertain the significantly higher forecasted monthly revenue from March to July 2019 and the lower forecasted monthly revenue from August 2019 onwards.
57. Based on the above findings, the 1st Respondent has failed to adequately evaluate management's assumption underlying trade receivables settlement, which would be critical in justifying whether management's cash flow projection was achievable to support the Group was a going concern and therefore failed to comply with the requirements stated in HKSA 570.

Second Complaint

58. This second complaint concerns the 2nd Respondent as the EQCR in the audit.
59. The audit workpapers showed that the 2nd Respondent had concurred with the audit conclusions drawn by the engagement team, despite the audit deficiencies highlighted above. As the above shows, these audit deficiencies involved significant judgments made by the engagement team on the various valuations and cash flow forecasts as estimated by management.
60. Accordingly, the 2nd Respondent failed to perform her role as EQCR by adequately challenging the engagement team's judgments and conclusions reached, and failed to perform an adequate engagement quality control review in accordance to paragraph 20 of HKSA 220.

DISCUSSION AND DECISION

61. The complaints are all found proven on the basis of the admission made by the Respondents.
62. The outstanding matter is the question of sanctions and costs which ought to be imposed upon the Respondents.
63. Both the Complainant and the Respondents have made their respective submissions on sanctions and costs.
64. It was noted that the Respondents had admitted liability at an early stage of the proceedings. However, the Committee has to take into account the interest of the public in particular as the audit relates to a listed entity.
65. The Committee has also taken note of the fact that there were no previous disciplinary records against the Respondents.
66. In considering the proper order to be made in this case, the Committee has had regard to all the aforesaid matters, including the particulars in support of the complaints, the parties' written and oral submissions on sanctions and costs, the Respondents' clean disciplinary records, and the conduct of the Complainant and the Respondents throughout the proceedings.
67. In terms of costs, the Committee considers that the sum incurred by the Complainant and the Clerk was reasonable and ought to be borne by the Respondents.

SANCTION AND COSTS

68. The Committee orders that: -
- (a) the Respondents be reprimanded under Section 35(1)(b) of the PAO;
 - (b) the 1st Respondent pays a penalty of HK\$150,000.00 under Section 35(1)(c) of the PAO;
 - (c) the 2nd Respondent pays a penalty of HK\$50,000.00 under section 35(1)(c) of the PAO;
 - (d) the 1st Respondent pay the costs and expenses of and incidental to the proceedings of the Complainant and that of the Disciplinary Committee in the sum of HK\$78,555 under Section 35(1)(iii) of the PAO; and
 - (e) the 2nd Respondent pay the costs and expenses of and incidental to the proceedings of the Complainant and that of the Disciplinary Committee in the sum of HK\$45,233 under Section 35(1)(iii) of the PAO.

Dated the 17th day of June 2024

Mr. Fong Wai Kuk Dennis
Chairman
Disciplinary Panel A

Mr. Chau Chi Chung
Member
Disciplinary Panel A

Mr. Kwok Kai Bun
Member
Disciplinary Panel B

Mr. Hui Cheuk Kit Frederick
Member
Disciplinary Panel A

Mr. Paul Phenix
Member
Disciplinary Panel B