

IN THE MATTER OF

A Complaint made under sections 34(1) of the Professional Accountants Ordinance (Cap. 50)

BETWEEN

The Investigation Committee of the  
Hong Kong Institute of Certified Public  
Accountants

COMPLAINANT

AND

KPMG (0035)  
Mr. FUNG, Kwong Ming (F02151)  
Ms. WONG, Sau Ling (F02782)  
Mr. TSE, Hau Yin, Aloysius (F01190)

1st RESPONDENT  
2nd RESPONDENT  
3rd RESPONDENT  
4th RESPONDENT

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

Members: Mr. FUNG, Chi Man (Chairman)  
Mr. CHAN, Kee Sun, Tom  
Mr. LAM, Tsz Chung  
Mr. MA, Chun Fung, Horace

[Ex-Members: Mr. D'SOUZA, Robin Gregory  
Ms. FANG, Xin  
(both stepped down on 1<sup>st</sup> February 2021)]

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**ORDER & REASONS FOR DECISION**

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1. This is a complaint made by the Investigation Committee of the Hong Kong Institute of Certified Public Accountants (the “**Complainant**”) against KPMG (the “**1<sup>st</sup> Respondent**”), Mr. FUNG, Kwong Ming, a certified public accountant (“**Fung**” or the

“2<sup>nd</sup> Respondent”), Ms. WONG, Sau Ling, a certified public accountant (“Wong” or the “3<sup>rd</sup> Respondent”) and Mr. TSE, Hau Yin, Aloysius a certified public accountant (“Tse” or the “4<sup>th</sup> Respondent”).

2. In the course of the proceedings, and before the publication of this Order & Reasons for Decision, Mr. D’SOUZA, Robin Gregory (the then Chairman) and Ms. FANG, Xin (a then Member) stepped down. By two letters both dated 22<sup>nd</sup> February 2021, the Respondents have been notified of the replacement of the Chairman of the proceedings and no objection was taken by the Respondents that the proceedings be dealt with by a 4-person Committee (with the absence of one member).
3. The Complaints are as set out in a letter from the Complainant dated 26 March 2019 which are as follows:-

#### A. BACKGROUND

- (1) Moulin International Holdings Limited and its subsidiaries (collectively “**the Group**” or “**the Moulin Group**”) were in the business of designing, manufacturing, distributing and trading eyewear products. Entities relevant to this complaint include Moulin Optical Manufacturing Limited and Leadkeen Industrial Limited, which were subsidiaries of Moulin Holdings (HK) Company Limited.
- (2) KPMG expressed unqualified audit opinions on the financial statements of the Moulin Group for each of the three years ended 31 March 1999 to 2001. Fung was the engagement partner in the 1999 audit, and Wong was the engagement partner in the 2000 and 2001 audits. Tse was the concurring review partner for all three years.
- (3) Under the direction of the Council of the Institute, an Investigation Committee (the “**IC**”, the Complainant) was constituted to investigate the conduct of CPAs

involved in the audits of the financial statements of the Moulin Group for the relevant periods and to inform the Council as to whether any such CPAs would have a case to answer in respect of a complaint under section 34(1)(a) of the Professional Accountants Ordinance, Cap. 50 (“**PAO**”).

- (4) On 7 March 2018, the IC issued a report of its findings in relation to the 1999 to 2001 audits. The IC considered that the Respondents failed to have proper regard for the technical and professional standards expected of them in all three years of audits. As such, the IC concluded that the Respondents would have a case to answer to a complaint under section 34(1)(a)(vi) of the PAO.

## **B. THE COMPLAINTS**

### *First Complaint*

- (5) Section 34(1)(a)(vi) of the PAO applies to Fung in that he failed or neglected to observe, maintain or otherwise apply professional standard(s) as engagement partner in the 1999 audit of the Moulin Group.

### *Second Complaint*

- (6) Section 34(1)(a)(vi) of the PAO applies to Wong in that she failed or neglected to observe, maintain or otherwise apply professional standard(s) as engagement partner in the 2000 and 2001 audits of the Moulin Group.

### *Third Complaint*

- (7) Section 34(1)(a)(vi) of the PAO applies to Tse in that he failed or neglected to observe, maintain or otherwise apply professional standard(s) as concurring review partner in the 1999 to 2001 audits of the Moulin Group.

*Fourth Complaint*

- (8) Section 34(1)(a)(vi) of the PAO applies to KPMG in that the firm failed or neglected to observe, maintain or otherwise apply professional standard(s) in the 1999 to 2001 audits of the Moulin Group.

**C. SUMMARY OF PRINCIPAL ISSUES**

- (9) According to Statement 1.200, certified public accountants are required to carry out professional work with a proper regard for the relevant technical and professional standards.
- (10) The IC found deficiencies in the 1999 to 2001 audits which indicate non-compliance with professional standards by the auditors in the following areas:
- (a) Prepayment of subcontracting charges;
  - (b) Trade receivables;
  - (c) Other receivables; and
  - (d) PRC tax exposures.

*Prepayment of subcontracting charges (“Prepayment”) (1999: HK\$67.1m; 2000: HK\$63.7m; 2001: HK\$113.7m)*

- (11) Prepayment was material in all three years of audits. The amount comprised subcontracting fees prepaid to Ma Wu Bei (“MWB”) as well as other payments and receipts arising from the Group’s business and investment activities in the PRC handled by MWB.
- (12) MWB is a nephew of the Chairman of the Moulin Group and was the general manager of the Group’s PRC operations. The Group prepaid subcontracting charges to MWB to cover the operating expenses of the PRC factories. The Group’s funds arising from its PRC activities handled by MWB were held in his personal bank account.

- (13) In addition, during the financial year ended 31 March 1999, the Group paid:
- (a) HK\$37 million to MWB for the purpose of setting up a co-operative joint venture in PRC which was kept by MWB in the Prepayment account. However, the audit documentation indicated that no such entity was legally established at the time of the audit. There was also insufficient audit evidence showing how the auditors had assessed the existence of this investment and the payment of HK\$37 million.
  - (b) HK\$52 million to MWB's account for the purpose of acquiring MWB's interest in a PRC entity named "Nam Hoi". As the interest was held in MWB's name, the Group and MWB had an agreement that MWB's interests would be held on trust for the Group. There was insufficient audit evidence showing how the auditors ascertained the valuation and existence of this investment.
- (14) Further, the IC identified deficiencies pertaining to the 2000 audit work on a material non-current asset account named "Advances to PRC distributors" (HK\$63.5m) which comprised loans to the distributors in PRC which had long term business relationships with the Group. The confirmations to verify the existence of the loans were not sent and received directly by the auditors. There was also insufficient audit evidence showing how the auditors have assessed the reasonableness and recoverability of these loans and whether the distributors were related parties.
- (15) The IC found that the audit work concerning the Prepayment was deficient in that the Respondents failed to:
- (a) Properly plan the audit to reduce the risks associated with the Prepayment and MWB's application of funds on behalf of the Group to an acceptably

low level that was consistent with the objective of an audit, contrary to paragraph 9 of Statement of Auditing Standards (“SAS”) 100.

- (b) Obtain a sufficient understanding of the accounting and internal control systems of the payments and receipts of the Group’s funds handled by MWB to plan the audit and develop an effective audit approach, contrary to paragraph 2 of SAS 300.
- (c) Obtain sufficient appropriate audit evidence and prepare adequate documentation to support that the funds held by MWB existed and were properly classified, contrary to paragraphs 2 and 10 of SAS 400; and paragraphs 2, 5 and 6 of SAS 230.
- (d) During the 1999 audit, obtain sufficient appropriate audit evidence and prepare adequate documentation to support that the payment of HK\$37 million to MWB should be recognised as an investment in China Joint Venture contrary to paragraph 2 of SAS 400; and paragraphs 2, 5 and 6 of SAS 230.
- (e) During the 2000 audit, obtain sufficient appropriate audit evidence and prepare adequate documentation to support that advances to PRC distributors existed, were reasonable, and were recoverable, contrary to paragraph 2 of SAS 400 and paragraphs 2 and 5 of SAS 230; perform appropriate follow up procedures for those audit confirmations that were not sent directly to the audit team, contrary to paragraph 15 of Statement 3.232; seek corroborating audit evidence supporting management’s representations regarding the advances to the distributors, contrary to paragraphs 11 and 12 of SAS 440; and obtain sufficient appropriate audit evidence to support that related party disclosures were not necessary under Statement of Standard Accounting Practice (“SSAP”) 20, contrary to paragraph 11 of SAS 460; and paragraph 2 of SAS 100.

- (f) Obtain sufficient appropriate audit evidence and prepare adequate documentation to support that related party disclosures were not necessary for transactions with MWB in accordance with SSAP 20, paragraphs 11 and 12 of SAS 440 and paragraph 11 of SAS 460.

*Trade Receivables (1999: HK\$280m; 2000: HK\$363m; 2001: HK\$355m)*

- (16) The Group had material trade receivables balances for all three years of audits. The audit team considered that the Group had adequate accounting systems and controls over its sales and receivables transactions which could be relied upon.
- (17) The working papers show irregular sales invoice numbering sequence but there was insufficient audit evidence showing how the auditors have assessed such irregularities and their impact on the effectiveness of controls over the completeness of sales transactions.
- (18) In addition, the working papers on the sales system and controls insufficiently documented how management evaluates customer credit history and how this would impact the auditors' assessment of the credit controls over accounts with long outstanding debts and adequacy of bad debt provisions.
- (19) The auditors relied on debtor confirmations to verify the existence and accuracy of material receivables balances. It was noted that instead of engaging in direct communications with the debtors by the auditors, one confirmation in the 1999 audit was sent and received by Moulin.
- (20) The IC found that the audit work concerning certain trade receivables was deficient in that the Respondents failed to:
  - (a) obtain a sufficient understanding of the sales and receivables cycle, in particular, customer credit control; and to develop an effective audit

approach, contrary to paragraph 2 of SAS 300.

- (b) obtain sufficient audit evidence to conclude that they could rely on the controls, contrary to paragraph 10 of SAS 400.
- (c) perform appropriate follow up procedures for the audit confirmation that were not sent directly to the audit team during the 1999 audit, contrary to paragraph 15 of Statement 3.232;
- (d) During the 2001 audit, to obtain sufficient appropriate audit evidence and prepare adequate documentation to support the existence or recoverability of the trade receivable balances and that no bad debt provision was necessary, contrary to paragraph 2 of SAS 400 and paragraphs 2 and 5 of SAS 230.

*Other Receivables (1999: HK\$94m; 2000: HK\$107m; 2001: HK\$164m)*

- (21) A significant portion of other receivables represented unsecured loans to third parties which are material, even though the Group's principal business activities did not involve money-lending.
- (22) The auditors advised management against lending money in 1999 without considering the legality of the lending practice. The Group continued to lend money to third parties and there was insufficient audit evidence in the working papers showing how the auditors have addressed this matter.
- (23) As part of the audit work on recoverability of loans, the auditors obtained management's representation that the directors have assessed the financial ability of the borrowers without verifying such assertions.
- (24) The auditors also relied on confirmations to verify the existence and accuracy of the loan balances. However, some confirmations during the 1999 audit and one confirmation during the 2000 audit were sent and/or received by Moulin.



- (25) The IC found that the audit work concerning certain other receivables was deficient in that the Respondents failed to:
- (a) properly plan and perform an audit with an attitude of professional scepticism recognizing that circumstances may exist which cause the financial statements to be materially misstated, contrary to paragraph 9 of SAS 100.
  - (b) seek corroborating audit evidence supporting management's assertion regarding the recoverability of cash advances to third parties, contrary to paragraphs 11 and 12 of SAS 440.
  - (c) perform appropriate follow up procedures for those audit confirmation that were not sent to the audit team directly during the 1999 and 2000 audits, contrary to paragraph 15 of Statement 3.232.
  - (d) During the 2001 audit, to obtain sufficient appropriate audit evidence and prepare adequate documentation to support the existence or recoverability of the other receivable balances and that no bad debt provision was necessary, contrary to paragraph 2 of SAS 400 and paragraphs 2 and 5 of SAS 230.

*PRC tax exposures*

- (26) The Group made arrangements with MWB under which all taxes payable and penalties associated with certain PRC enterprises were to be borne by MWB. As such, the Group considered that there was no PRC tax payable in respect of these PRC operations.
- (27) The Respondents were aware of the potential tax liabilities and penalties arising from such PRC operations as estimated by the KPMG tax department. Notwithstanding, they accepted the Group's tax provisions of HK\$10 million

and HK\$8 million respectively in 1999 and 2000 and zero provision for 2001, which were well below the amounts estimated by the KPMG tax department, without sufficient audit evidence or documentation supporting the basis of such tax provisions.

(28) The IC found that the audit work pertaining to PRC tax exposures was deficient in that the Respondents failed to:

(a) obtain sufficient appropriate audit evidence and prepare adequate documentation to support that the amount of PRC tax provision was adequate in light of the estimation made by KPMG's tax department, contrary to paragraph 2 of SAS 400 and paragraphs 2 and 5 of SAS 230.

(b) obtain sufficient appropriate audit evidence and prepare adequate documentation to support that the potential tax penalties which might arise from the PRC operations need not be disclosed as a contingency under SSAP 8, contrary to paragraph 2 of SAS 400 and paragraphs 2 and 5 of SAS 230.

#### **D. The Proceedings**

4. The Respondents admitted the Complaints against them. They did not dispute the facts as set out in the Complaints. On 30 May 2019, the parties agreed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules ("DCPR") be dispensed with.

5. The Notice of Commencement of Proceedings was issued to the parties on 28 August 2019. Based on the Respondents' admission and the joint application, the Disciplinary Committee approved the above proposal.

(a) The steps as set out in Rules 17 to 25 of the DCPR be waived; and

(b) The Disciplinary Committee directed the Complainant and the Respondents to make written submissions on sanctions and costs under Rule 31 of the DCPR.

6. The Complainant and the Respondents made and filed their respective written submissions on sanctions and costs in respect of the Complaints on 25 September 2019. The Respondents made and filed further written submissions on 18 October 2019.
7. The Complainant highlighted the seriousness of the breach. In particular, the Complainant argued that the audit work done by the Respondents were deficient and non-compliant with the professional standards in a number of “*significant audit areas*”, which were material to the financial statements. The Complainant contended that, had the audit work been performed appropriately, the audit outcomes may have been different.
8. It was also argued by the Complainant that the audit deficiencies were serious as they spanned over three years of audits. This is particularly undesirable as the Respondents were auditors of a listed company.
9. In the circumstances, the Complainant argued that, despite the Respondents do not have any past disciplinary or regulatory records and had made early admission of liability, given the seriousness of the non-compliance, the Respondents should be reprimanded and be imposed a level of penalty that appropriately reflects their culpability.
10. The Respondents made the following submissions:-
  - (a) First, in respect of the nature and seriousness of the Complaints, the Respondents argued that the Complaints should be viewed as “*moderately serious*”. In particular, the Respondents contended that the Complaints did not involve serious allegations relating to dishonesty, deliberate misconduct or concealment, or the receipt of any inappropriate benefits.
  - (b) In addition, the Respondents contended that the exercise of professional judgment in respect of audit work should be viewed in the context of the professional standards and business practices that were in place at the relevant time;

- (c) Further, the Respondents raised a number of mitigation factors, including the Respondents' full cooperation and early admission, the fact that the Respondents had no previous disciplinary or regulatory record, and that the Complaints were isolated cases; and
- (d) Moreover, on the public interest aspect, the Respondents submitted that given the age of the relevant audits and the development of professional standards during the intervening years, it is unlikely that the sanctions to be imposed would be of great significance.

## **F. DISCUSSIONS**

- 11. In respect of the seriousness of the Complaints, we agree with the Complainant's submissions that the present case involves deficiency and non-compliance of professional standards in a number of significant audit areas. We accept that the Complaints did not involve dishonesty, deliberate misconduct or concealment, or the receipt of inappropriate benefits. However, the non-compliance was serious, particularly in the context of public companies. The financial statements of listed companies concern broader public interest. The sanction should provide a deterrence against such deficiencies in order to maintain and promote public confidence in the profession, as well as to enhance and preserve Hong Kong's position as an international financial centre (see *Case No. D-11-0584F*).
- 12. In considering the appropriate sanctions to be imposed in this case we take into account all the representations made and placed before us by the parties. In particular, we considered the nature and circumstances of the breach and the conduct of the Respondents. We have also taken into account the mitigation factors submitted by the Respondents, as well as past similar cases.
- 13. We consider that the Respondents in this case should be reprimanded and be imposed a level of penalty that commensurate with their culpabilities.

14. In respect of the individual Respondents' culpability, it should be noted that Wong's failures spanned two years of audits, while Fung's failures spanned one year of audit.
15. Tse was the concurring partner in all three years of audits. Given Tse's involvements in the audit and his seniority, he should have given proper regard to the audit requirements but we accept that the professional standards at the relevant time did not clearly specify the role of a concurring partner.
16. KPMG had allowed the audit failures to be repeated in the course of three years and should of course take the lion's share of blame.
17. Taking into account all the circumstances of the case as well as the mitigation submitted by the Respondents, we make the following ORDERS:
  - (a) The Respondents be reprimanded under section 35(1)(b) of the PAO;
  - (b) The 1<sup>st</sup> Respondent do pay a penalty of HK\$400,000, the 2<sup>nd</sup> Respondent do pay a penalty of HK\$100,000, the 3<sup>rd</sup> Respondent do pay a penalty of HK\$150,000, and the 4<sup>th</sup> Respondent do pay a penalty of HK\$50,000, under section 35(1)(c) of the PAO; and
  - (c) The Respondents do pay on a joint and several basis (i) the costs and expenses of and incidental to the investigation against the Respondents under Part VA of the PAO, in the sum of HK\$192,000 under section 35(1)(d)(i) of the PAO, and (ii) the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$23,672 (including the costs and expenses of the Disciplinary Committee) under section 35(1)(iii) of the PAO.

Dated: 29 April 2021

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Mr. FUNG, Chi Man  
Chairman

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Mr. CHAN, Kee Sun, Tom  
Member

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Mr. LAM, Tsz Chung  
Member

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Mr. MA, Chun Fung, Horace  
Member