Proceedings No: D-16-1140F

IN THE MATTER OF

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

BETWEEN

The Registrar of the Hong Kong Institute of Certified Public Accountants	COMPLAINANT

AND

Lau Shiu Wai, Franklin (F03825)	1st RESPONDENT
Au Yeung Tin Wah (F03806)	2nd RESPONDENT
Lau & Au Yeung C.P.A. Limited (M0005)	3rd RESPONDENT

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

Members: Miss LAU, Queenie Fiona (Chairman)
Ms. CHARLTON, Julia Frances
Ms. HO Man Kay, Angela
Mr. TSANG, Chi Wai
Mr. JAMIESON, Grant Andrew

ORDER AND REASONS FOR DECISION

A. Background

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the **"Registrar"** and the **"Institute"** respectively) against: (1) Mr. Lau Shiu Wai, Franklin (**"Lau"**); (2) Mr. Au Yeung Tin Wah (**"Au Yeung"**); and (3) Lau & Au Yeung C.P.A. Limited (**"Lau & Au Yeung"**) (collectively, the **"Respondents"**).

B. The Complaints

2. The complaints in the present proceedings concern the Respondents' audits of China Environmental Resources Group Limited (the **"Company"**) for the years 2011 and 2012.

3. The Company was incorporated in the Cayman Islands, and its shares are listed on the Main Board of the Stock Exchange of Hong Kong Limited (Stock code: 01130).

4. The Respondents' respective roles in the two relevant audits were as follows:

   4.1 Lau & Au Yeung was appointed as the auditor of the Company.

4.2 Lau was the director responsible who issued the auditor's reports on behalf of Lau & Au Yeung on 30 September 2011 and 26 September 2012 respectively for the financial statements of the Company and its subsidiaries for the years ended 30 June 2011 (the **"2011 Financial Statements"**) and 30 June 2012 (the **"2012 Financial Statements"**) (collectively, the **"Financial Statements"**).

4.3 Au Yeung was the engagement quality control reviewer (**"EQCR"**) for the Financial Statements.

5. The Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards (**"HKFRS"**), and the auditor's reports stated that the audits were conducted in accordance with the Hong Kong Standards on Auditing (**"HKSA"**) and gave a fair and true view on the Financial Statements.

6. The complaints as set out in the Registrar's letter dated 11 April 2017[1] (the "**Complaints**") are as follows:

"First Complaint

*7. Section 34(1)(a)(vi) of the [Professional Accountants Ordinance (Cap.50) (the **"PAO"**)] applies to Lau & Au Yeung in that, as the auditor for the Financial Statements, it failed to comply with*

[1] Prior to the issue of the letter dated 11 April 2017, the Council of the Financial Reporting Council had directed the Audit Investigation Board ("**AIB**") to investigate possible auditing irregularity in relation to the Financial Statements. On 3 February 2016, the Financial Reporting Council referred to the Institute a report of the AIB dated 15 December 2015.

paragraphs 6 and 9 of HKSA 500 because it failed to obtain sufficient appropriate audit evidence to support that re-measurement of contingent consideration in respect of acquiring the interest in Bright Delight Group was not required; and it failed to appropriately evaluate the audit evidence in respect of the loss per share calculation.

Second Complaint

8. *Section 34(1)(a)(vi) of the PAO applies to Lau & Au Yeung in that, as the auditor for the Financial Statements, it failed to comply with paragraphs 8, 9 and 10 of HKSA 230 because it failed to prepare sufficient audit documentation on the audit procedures it performed and discussions of significant matters with management or those charged with governance.*

Third Complaint

9. *Section 34(1)(a)(vi) of the PAO applies to Lau because as the engagement director of the audits of the Financial Statements, Lau & Au Yeung's non-compliances with two professional standards in two-year audits show that he failed to act with professional competence and/or diligently in accordance with section 100.5(c) as elaborated in section 130.1 of the [Code of Ethics for Professional Accountants (the **"COE"**)].*

Fourth Complaint

10. Section 34(1)(a)(vi) of the PAO applies to Au Yeung because as the EQCR of the audits of the Financial Statements, he failed to act with professional competence and/or diligently in accordance with section 100.5(c) as elaborated in section 130.1 of the COE to carry out his review under paragraphs 20 and 21 of HKSA 220."

7. In the aforementioned letter dated 11 April 2017, the principal issues concerning each of the four complaints were set out (which, as explained in the next section, were admitted by the Respondents in June 2017), and can be summarised as follows.

8. The First Complaint concerns:

8.1 Lau & Au Yeung's failure to re-measure contingent consideration payable at year end dates of 2011 and 2012 with respect to the Company's acquisition of the entire interests in Bright Delight Group in the year ended 30 June 2011.

8.2 For the year ended 2011, the Company erroneously calculated the loss per share, and Lau & Au Yeung admitted that they overlooked the calculation error.

9. The Second Complaint concerns:

9.1 First, the contingent consideration for acquiring the interest in Ally Goal Group in the year ended 2011. The Company had used an external valuation report to determine the fair value of the contingent consideration at acquisition date and year end date respectively, and the contingent consideration was determined upon the actual and guaranteed profits of the Ally Goal Group. However, when the Ally Goal Group did not meet the level of profits forecasted for the year 2011, there was no further write down of the contingent consideration payable. Lau & Au Yeung's audit working papers did not document the rationale based on which they concurred that no further write down of the contingent consideration payable was necessary, and Lau & Au Yeung admitted that their documentation of the work done was not adequate.

9.2 Secondly, the recognition of identifiable assets acquired and liabilities assumed in the Company's acquisitions of the Ally Goal Group and the Bright Delight Group. For both acquisitions, the Company only accounted for the acquirees' assets and liabilities based on those recognised in the management accounts of the acquired groups. The Company did not recognise any patents and/or significant contracts as intangible assets at the acquisition date. Lau & Au Yeung's audit working papers did not show any audit procedure performed to evaluate whether the patents and agreements should be recognised as intangible assets and whether there was any injection of assets and operations into the

Bright Delight Group by the vendor according to the sales and purchase agreement. Although Lau & Au Yeung explained that they had obtained sufficient appropriate audit evidence, their audit working papers did not document the claimed audit procedures taken. They admitted that their documentation of the work done was not adequate.

9.3 Thirdly, the improper impairment assessment concerning patents and related goodwill. Lau & Au Yeung claimed that they had performed audit procedures for impairment assessment concerning patents and related goodwill, but their audit working papers did not show the claimed audit procedures. Lau & Au Yeung should have prepared more documentation on its impairment assessment given that it had relied on a valuation report issued in March 2010, i.e. 15 months before the year end date. They admitted that their documentation of the work done was not adequate.

9.4 Fourthly, the improper impairment assessment of operating rights. Lau & Au Yeung concurred with the Company's decision that no impairment be made on the carrying value of the operating rights, but their audit working papers did not show their considerations that they referred to during the AIB investigation.

10. The Third Complaint is that as engagement director of the audits of the Financial Statements, Lau is accountable for Lau & Au Yeung's abovementioned breaches of the auditing standards.

11. Apart from the calculation of loss per share, the above audit irregularities, especially the re-measurement of the Bright Delight Group's contingent consideration, involved significant judgments, estimation and assumptions made by the audit team, the Company and external valuers. The Fourth Complaint is that Au Yeung, as EQCR for both audits, should have selected the relevant audit working papers to perform an engagement quality control review.

C. <u>The Proceedings</u>

12. By the abovementioned letter dated 11 April 2017, the Registrar submitted the Complaints to the Council of the Institute.

13. By a letter dated 20 June 2017, the Complainant and the Respondents confirmed to the Clerk of the Disciplinary Committee that the Respondents admitted the Complaints. Under cover of that letter dated 20 June 2017 were copies of documents entitled "Admission" in respect of each of the three Respondents, confirming that each of the Respondents admitted the Complaints relevant to them, and also confirming that they do not dispute the facts as set out in the letter dated 11 April 2017 from the Registrar to the Institute's Council. Under the circumstances, the Complainant and the Respondents suggested

that it was no longer necessary for the Complainant to file a Complainant's Case or take any subsequent steps as set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules (the **"Rules"**), and that the admitted complaints be disposed of on the basis of the admission made.

14. The Notice of Commencement of Proceedings and procedural timetable was issued to the parties on 9 August 2017. In addition, by a letter dated 9 August 2017, the Disciplinary Committee agreed to the parties' proposal to dispense with the steps set out in Rules 17 to 30 in light of the Respondents' admission, and directed that the Complainant and the Respondents make written submissions as to sanctions and costs which should be imposed by the Disciplinary Committee pursuant to Rule 31.

15. The Complainant and the Respondents filed submissions on sanctions and costs on 30 August 2017 and 27 September 2017 respectively.

16. By a letter dated 29 September 2017, the Complainant objected to the documentary evidence included at Appendix A of the Respondents' submissions dated 27 September 2017, which had not previously been filed in the course of the proceedings or in the course of the investigation by the Institute or the Financial Reporting Council.

17. By a letter dated 3 October 2017, the Disciplinary Committee directed that the Respondents comment on, and if appropriate, make a proposal in respect of the Complainant's letter dated 29 September 2017.

18. By a letter dated 13 October 2017, the Respondents sought leave for the documentary evidence contained in Appendix A of their submissions dated 27 September 2017, and made submissions on the relevance of the documentary evidence.

19. On 24 October 2017, the Disciplinary Committee granted leave to the Respondents to rely on the additional documentary evidence contained in Appendix A, and directed that the Complainant respond to such evidence within 14 days. The Disciplinary Committee also indicated that if the Respondents wished to respond to the Complainant's response, they should apply for leave within 7 days thereafter.

20. After an extension of time, on 20 November 2017 the Complainant filed submissions on the Respondents' letters dated 27 September and 13 October 2017. The Disciplinary Committee granted the Respondents leave to respond, and the Respondents made further submissions dated 18 December 2017.

D. Discussion

D1. Sanctions

21. The Disciplinary Committee notes that the Respondents' submissions dated 27 September 2017 contain not only submissions strictly on sanctions and costs, but also submissions which are directed at the

question of whether the Complaints are made out or whether the matters stated in the Registrar's letter dated 11 April 2017 are correct. For example:

21.1 The Respondents sought to explain their thinking process concerning the contingent consideration issue (under the First Complaint) at p.4 to 13 of their submissions on sanctions and costs, and stated at p.13 *"[they] hope that the [Disciplinary Committee] may consider favorably the validity of [their] treatment on the consideration shares"*. However, the Complainant had already stated its view at paragraph 16 of the Registrar's letter dated 11 April 2017 that *"Lau & Au Yeung gave an invalid reason why the contingent consideration payable at the respective year end dates should not be re-measured ("deadlock from its legal aspect"), and hence failed to obtain sufficient and appropriate audit evidence on this issue"*, which the Respondents have in June 2017 confirmed they do not dispute.

21.2 As to the issue of contingent consideration for acquiring the interest in Ally Goal Group (under the Second Complaint), whilst the Respondents have submitted at p.15 of their submissions on sanctions and costs that they *"had documented sufficiently [their] rationale and [their] works in the working papers"*, this is contrary to paragraph 22 of the Registrar's letter dated 11 April 2017 which the Respondents had earlier confirmed they do not dispute.

21.3 Similarly, with respect to the recognition of identifiable assets acquired and liabilities assumed in the acquisitions (under the Second Complaint), although the Respondents have submitted at p.17 of their submissions on sanctions and costs that they *"hope [they] have demonstrated to the [Disciplinary Committee] that [their] audit working papers had shown sufficient documentation on audit procedures performed"*, that is inconsistent with the Complainant's view as stated at paragraphs 28 and 29 of the Registrar's letter dated 11 April 2017, which the Respondents confirmed in June 2017 they do not dispute.

21.4 The Respondents now submit at p.20 of their submissions on sanctions and costs in respect of the improper impairment test of patents and related goodwill (under the Second Complaint) that they *"hope the [Disciplinary Committee] will be appreciated [sic] [they] had documented sufficient audit works performed and had well addressed the issues as described in the paragraph 35 of the complaint letter dated 11 April 2017"*. Again however, this runs contrary to the Complainant's view that more documentation should have been prepared by Lau & Au Yeung, and Lau & Au Yeung's admission that their documentation of the work done was not adequate, both of which were recorded in the Registrar's letter dated 11 April 2017.

21.5 As to the Respondents' submissions in respect of improper impairment assessment of operating rights (under the Second

Complaint), they now submit at p.22 and 23 of their submissions on sanctions and costs that their working papers sufficiently show the factors they had considered and the audit procedures. However, this contradicts the Respondents' earlier admission that their documentation of the work done was not adequate, which admission was recorded at paragraph 39 of the Registrar's letter dated 11 April 2017, and which the Respondents stated in June 2017 they do not dispute.

21.6 As to the Third Complaint against Lau, it is now submitted at p.23 of the Respondents' submissions on sanctions and costs that the Respondents *"had exercised appropriate professional judgements and treated appropriately on the transaction concerned [sic]"*, and that *"many assertions and allegations contained in the First and Second Complaint should have been well addressed by the working papers and audit evidences [they] had presented to AIB and/or Institute in the past periods"*. However, whilst the Respondents make such submissions in *"hope [that the Disciplinary Committee] could consider the validity of [their] comments and explanations and mitigate the sanctions and costs on the engagement director"*, the nature of the Respondents' submissions are not in fact in the nature of mitigation, but seek to challenge the Complaints and/or the facts which the Respondents had agreed in June 2017 not to dispute.

21.7 As to the Fourth Complaint against Au Yeung, at p.24 of the Respondents' submissions on sanctions and costs Au Yeung confirmed that he admitted the calculation error loss per share for the year ended 2011 but at the same time sought to say that he had otherwise *"acted with professional competent diligently [sic] according to the applicable technical and professional standards when providing professional services in the two-year audits"*. This contradicts paragraphs 41 to 43 of the Registrar's letter dated 11 April 2017, which set out problems with Au Yeung's work apart from the calculation of loss per share.

22. With regard to submissions by the Respondents which are directed at challenging the Complaints or matters stated in the Registrar's letter dated 11 April 2017, the Disciplinary Committee bears in mind that the Respondents have already admitted the Complaints and have also confirmed in June 2017 that they do not dispute the facts set out in the Registrar's letter dated 11 April 2017. The Disciplinary Committee therefore agrees with the Complainant at paragraph 3 of their submissions dated 20 November 2017 that the submissions by the parties at this stage of the proceedings should be in respect of sanctions and costs, and that this is not an occasion for the Respondents to present defences or further defences to the Complaints.

23. Thus, insofar as matters raised by the Respondents may be relevant to sanctions and costs, and in particular the question of mitigation, the Disciplinary Committee considers such matters in that context, but the

Disciplinary Committee does not consider that it should make any findings which are contrary to the admitted Complaints or the facts stated in the letter dated 11 April 2017 that the Respondents have earlier admitted.

24. The Respondents have drawn to the Disciplinary Committee's attention in respect of the First Complaint that the error in the calculation of loss per share for the year ended 30 June 2011 was an isolated case, and that there were no errors in the calculation of loss per share for the years ended 30 June 2010 (restated), 2012 and 2013 respectively. The Respondents have therefore asked that the error with respect to the calculation in the year ended 30 June 2011 be treated leniently. However, in our view, the fact that there were no errors in the years ended 30 June 2010, 2012 and 2013 is not a mitigating factor. If the Company had made errors in other years but the Respondents had properly identified those errors in those years, that might help show that the Respondents' failure to identify the Company's error in the year ended 30 June 2011 was an isolated case. However, there is no indication that the Respondents had correctly identified errors in other years, and had only omitted to do so in the particular instance that is part of the subject of the First Complaint.

25. The Complainant has correctly highlighted that the Disciplinary Committee has a wide discretion on the sanctions it might impose under s.35 of the PAO, that each case is fact sensitive, and that past cases are not binding precedents upon this Disciplinary Committee. Nevertheless,

it is often helpful to bear in mind previous cases which may bear similarity to the present case. Both the Complainant and the Respondents have referred to the decision D-12-0733P dated 21 December 2015. In addition, the Complainant has also referred to the decision D-14-0988F dated 12 September 2016.

26. The Respondents submit that the present case is similar to the case considered in decision D-12-0733P dated 21 December 2015, whereas the Complainant submits that the present case is more serious than the two abovementioned cases. The Disciplinary Committee agrees with the Complainant that the present case is more serious than both of the abovementioned decisions:

26.1 Unlike the previous two cases, which involved failures in one audit area and in one year of audit of a listed company, the present case involves failures in respect of multiple significant audit areas during two consecutive years of audits.

26.2 The failures in the present case were serious, and involve areas which have a significant impact from a shareholder and investor's point of view, such as the failure to evaluate contingent consideration and an the erroneous calculation of loss per share.

26.3 In the present case, there were deficiencies in the Respondents' preparation of documentation, and although that was also a complaint in decision D-12-0733P dated 21 December 2015, there

was no such issue in decision D-14-0988F dated 12 September 2016.

27. It is noted that the 1st Respondent has a clean record, but that the 2nd and 3rd Respondents were issued with a disapproval letter in 2012 for their failure to apply professional standards in assessing and documenting significant audit issues in their audit of a listed company, in respect of which the 2nd and 3rd Respondents have provided further details to the Disciplinary Committee.

28. The Complainant has submitted that if the Disciplinary Committee were minded to impose a reprimand with a financial penalty, the penalty should be of an amount higher than the penalties imposed in the abovementioned two past cases that are less serious. The Complainant urges the Disciplinary Committee to impose a financial penalty that takes into account the relevant audit fees received. According to the Complainant, a disgorgement of some or all of the profits is now a common feature of many modern regulatory sanctions. The Complainant has submitted that the benefit of such approach would be that professionals would be encouraged to improve the quality of their service rather than simply carry on with the same old practices believing that the fees received will cover any financial penalties imposed.

29. According to the 2012 Financial Statements, the Respondents received a total of $1,570,000 in audit fees for the 2011 and 2012 audits, and the Complainant has suggested that an appropriate level of penalty be

imposed at a minimum 10% of the total audit fees ($157,000) for Lau & Au Yeung, and 5% of the total audit fees ($78,500) for each of Lau and Au Yeung. The Complainant submits that the resulting penalty would be similar in the range of financial penalties adopted by the two precedent cases provided but increased to reflect the more serious level of deficiencies of the present case.

30. The Respondents have not expressly stated what sanctions they propose, but as mentioned above have submitted that the present case is similar to decision D-12-0733P dated 21 December 2015, where all three respondents were reprimanded, the two individual respondents were ordered to pay a penalty of HK$12,000 each and the respondent firm was ordered to pay a penalty of HK$50,000.

31. The Disciplinary Committee's attention has not been drawn to any previous case where the computation of the relevant penalty was determined with reference to the level of audit fees. Also, the Disciplinary Committee notes that the audit fees were payable to Lau & Au Yeung (but not directly to Lau or Au Yeung). Further, no information has been presented to the Disciplinary Committee concerning the level of profit or earnings of the Respondents, as opposed to the level of audit fees.

32. In any event, in the present case it is not necessary for the Disciplinary Committee to make any determination as to whether it is appropriate to determine penalties with reference to the level of audit fees. As the

Complainant has pointed out, the penalties that it proposes, namely $157,000 for Lau & Au Yeung, and $78,500 for each of Lau and Au Yeung, would in fact be similar to financial penalties adopted by the two precedent cases provided, though increased to reflect the greater seriousness of the present case.

33. In considering the appropriate sanctions, the Disciplinary Committee also bears in mind that when the Complainant made its abovementioned proposals concerning the level of appropriate sanctions, the Complainant had not yet seen the Respondents' submissions dated 27 September 2017, where the Respondents essentially sought to reopen a large number of factual matters that they had earlier admitted and/or agreed not to dispute. In our view, it is of concern that the Respondents took such a course of action in their submissions dated 27 September 2017.

34. Whilst the Respondents' admission of liability has led to the saving of time and costs in the present proceedings, the nature of the submissions made by the Respondents in their submissions dated 27 September 2017 suggest that the Respondents are not remorseful, and indeed do not fully understand the deficiencies in their work (which deficiencies they had earlier admitted). Under the circumstances, the Disciplinary Committee is minded to impose a sanction which is of slightly greater severity than that proposed by the Complainant.

35. In considering the proper order to be made in this case, the Disciplinary Committee has had regard to all the aforesaid matters, the parties' submissions, the previous cases referred to us (although we bear in mind that each case must be decided upon its own particular facts) and the conduct of the Complainant and the Respondents throughout the proceedings.

D2. Costs

36. The Complainant has asked that the Respondents pay the costs and expenses of and incidental to the proceedings of the Institute, including the costs and expenses of the Committee. A Statement of Costs has been provided to the Disciplinary Committee, amounting to HK$154,567.90.

37. On the other hand, the Respondents have submitted at p.26 of their submissions on sanctions and costs that many issues that are the subject of the Complaints *"should have been well addressed by the working papers and audit evidences [sic] [they] had presented to AIB and/or Institute in the past periods. As such, [they] hope that the [Disciplinary Committee] may consider to order the Respondents to bear lesser costs and expenses incurred by the FRC and the Institute."*

38. Given that the Respondents have admitted the Complaints and confirmed in June 2017 that they do not dispute the facts set out in the Registrar's letter dated 11 April 2017, the Disciplinary Committee does

not accept the Respondents' submission that the Disciplinary Committee can or should proceed on the basis that some factual matters alleged by the Complainant have not been made out.

39. The Disciplinary Committee considers that the aforesaid sum of HK$154,567.90 was incurred reasonably and ought to be borne by the Respondents.

E. Sanctions and costs

40. The Disciplinary Committee orders that:

40.1 The Respondents be reprimanded under section 35(1)(b) of the PAO;

40.2 The 1st Respondent do pay a penalty of HK$100,000.00 pursuant to section 35(1)(c) of the PAO;

40.3 The 2nd Respondent do pay a penalty of HK$100,000.00 pursuant to section 35(1)(c) of the PAO;

40.4 The 3rd Respondent do pay a penalty of HK$180,000.00 pursuant to section 35(1)(c) of the PAO; and

40.5 The Respondents do pay the costs and expenses of and incidental to the proceedings of the Institute in the sum of HK$154,567.90 under section 35(1)(iii) of the PAO.

Dated the 27th day of March 2018