

IN THE MATTER OF

A Complaint made under section 34(1AAA) of the Professional Accountants Ordinance ("PAO")

BETWEEN

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

AND

Mr. Lam Kwan Anthony                      1<sup>st</sup> Respondent  
Charles HC Cheung & CPA Limited        2<sup>nd</sup> Respondent

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

Members:    Mr. Ng Wai Yan (Chairman)  
                  Ms. Hui Ming Ming Cindi  
                  Ms. Chau Hoi Yan Cecilia  
                  Ms. Chung Kit Yi Kitty  
                  Mr. John Lees

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**REASONS FOR DECISION**

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1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the "**Institute**") against Mr. Lam Kwan Anthony, certified public accountant (practising) (the "**First Respondent**"); and Charles HC Cheung & CPA Limited (the "**Second Respondent**") (collectively "**Respondents**") under Section 34(1)(a)(vi) of the Professional Accountants Ordinance, Cap.50, Laws of Hong Kong ("**PAO**").
2. The relevant particulars of the Complaint admitted by the Respondents and the relevant facts agreed by the parties (the "**Complaint**") are as follows:-

## The Complaint

- (1) Section 34(1)(a)(vi) of the Professional Accountants Ordinance, Cap. 50, Laws of Hong Kong ("**PAO**") applies to the Respondents in that they failed or neglected to observe, maintain or otherwise apply Hong Kong Standards on Auditing ("**HKSAs**") issued by the Institute.

### Background

- (2) The Respondents were the auditors of the financial statements of "The Building Renovation Work Project of Grandview Tower" (the "**Building**") for the period from 1 September 2005 to 4 December 2009 (the "**Financial Statements**"). The Respondents signed an unmodified audit opinion dated 14 July 2010 on the Financial Statements (the "**Audit Report**"). Charles HC Cheung & CPA Limited ("**CHCC**") was also the auditors for the building management account of the Building's Incorporation of Owners ("**IO**") for the years from 30 June 2007 to 2010.
- (3) At an AGM held on 12 May 2005 ("**2005 AGM**"), an external walls renovation project was approved by the owners of the Building ("**EW Renovation**"). The following decisions relating to the EW Renovation were made in the 2005 AGM (minutes of the meeting form part of the Respondents' audit working papers):-
  - (a) The project would receive a subsidy of not exceeding \$2,530,000 to be transferred from the Building's general building management account;
  - (b) The remaining of the project shall be funded by capital contributions from each owner in proportion to the number of undivided shares of each flat or carpark;
  - (c) Management Committee of the IO ("**MC**") was authorized to use the aforesaid proceeds to pay for the following expenses:-
    - (i) Payments to the consultant/project manager, architect A. Lead (the "**Consultant**"), which should be approved by the MC;
    - (ii) Payments to the contractor, on certification of stage payments approved by the Consultant;
    - (iii) Payment of \$50,000 administrative fee to Hang Yick Properties Management Ltd. ("**Hang Yick**"), to be approved by the MC;
    - (iv) other related or unexpected expenses;
  - (d) Although not voted on as a formal resolution, it was indicated by the Chairman of the meeting that the changing of the Building's lifts would only be carried out after the EW Renovation had been completed and that matters concerning the renovation of the Building's lobby as well as lobbies on each

floor would be discussed on another occasion.

Particulars supporting the Complaint

*Breach of HKSA 210 and/or 300 and/or 315 for failure to understand the scope of the audit engagement and/or to plan the audit accordingly*

- (4) The Respondents did not identify the characteristics of the audit engagement that defined its scope, nor did they establish the overall audit strategy on the basis of the audit scope. As a result, the Respondents inappropriately concurred with the inclusion of various items unrelated to the EW Renovation as the income or expenditures in the Financial Statements.
- (5) Unrelated income and expenditure items in the Financial Statements included the following:-
  - (a) A sum of \$200,000 transferred from the management fund and recognized as income for EW Renovation, when in fact that sum was unrelated to EW Renovation and concerned other repair or renovation works of the Building;
  - (b) Material costs of \$61,569 (1 June 2008 to 4 December 2009) and \$30,120 (1 September 2005 to 31 May 2008), which were stated in the Financial Statements as being for car park repairs;
  - (c) The balance sheet as at 4 December 2009 shows 2 items – temporary payment of \$9,723,460 and temporary receipt of \$7,038,687, which were again unrelated to EW Renovation and in fact concerned lift renovation and/or lift lobby renovation. As recorded in the minutes of the 2005 AGM, lift repairs and lift lobby renovation were separate items from the EW Renovation.
- (6) There was no evidence that the Respondents' recorded the agreed terms of the engagement in an audit engagement letter or other suitable form of contract. There is a quotation (on CHCC's letterhead) dated 29 June 2007 entitled "Quotation for the Building Renovation Work Project Audit for the period from 1 September, 2005 to 31 July, 2007 of ([the Building])..." (the "**Quotation**"), which was signed by the IO. The Quotation was silent on the scope of the audit engagement, and contains no wording to suggest that the scope of the engagement was confined to the EW Renovation alone.
- (7) The Respondents are unable to provide a copy of any audit engagement letter which clearly sets out the scope of the audit engagement. The Respondents stated that "...[they] have not been provided with the evidence of the detailed scope of the "Building Renovation Project of [the Building]" that was the subject of the audited financial statements".

- (8) There was no documentation showing that the Respondents had understood the risks of material misstatements caused by the inclusion in the Financial Statements of various items unrelated to the EW Renovation.
- (9) In the circumstances, there was a breach by the Respondents of HKSA 210.2 and/or 210.6, HKSA 300.8 and/or 300.9 and HKSA 315.100.

*Breach of HKSA 500 for failure to verify whether the calculation of interest income was correct*

- (10) The minutes of one of the MC meetings suggested that there might have been some missing bank statements.
- (11) Note 2(c) of the Financial Statements states that "interest income from bank deposits is accrued on a time proportion basis by reference to the principal outstanding and at the interest rate applicable". The Respondents did not perform audit work to verify the correct calculation of interest income. The interest income for the whole renovation period ending 4 December 2009 was approximately 9.4% of the total income and would seem to be material to the Financial Statements.
- (12) In failing to carrying out any audit work on interest income, the Respondents were in breach of HKSA 500.2 and 500.19.

*Breach of HKSA 500 for failure obtain audit evidence on the Consultant Fee paid in the sum of \$420,118.57*

- (13) The 2005 AGM decided that payment to the Consultant was subject to approval by the MC. The (undated) contract with the Consultant (signed by Hang Yick) stated that the contractual sum payable to the Consultant was \$350,000.
- (14) In the Financial Statements, the total sum paid to the Consultant was \$420,118.57, which was in excess of the contractual sum. No audit evidence was obtained to verify that the sums paid had received the requisite approval by the MC. In failing to perform this work the Respondents were in breach of HKSA 500.2 and 500.19.

*Breach of HKSA 500 for failure to obtain evidence and HKSA 230 for failure to document any audit work carried out concerning the recovery of liquidated damages from the contractor.*

- (15) There were in total 18 certificates of payment issued by the Consultant (also project manager) to the contractor for stage payments. The certificates suggested that there had been delay in the project and 5 letters issued by the Consultant certified that the IO was entitled to compensation of \$8,000 per day subject to a final evaluation. The last quantified amount for compensation was \$1,280,000.
- (16) There were disputes between the parties on the entitlement and/or quantum of the compensation. There was a mutual agreement between the IO and the contractor that the deduction of compensation from the sums payable to the contractor would not be executed by the IO on the interim payments for the time being. The compensation would be subject to a final assessment in due course. The amount involved is material.
- (17) There was no documentation to show that the Respondents ascertain if the matter had been resolved – ie whether the final assessment had been carried out – when they issued the audit report on 14 July 2010. No audit work had been carried out on evaluating the likelihood or the extent of recovering the compensation, and how the matter should be treated in the Financial Statements. The Financial Statements did not include or disclose any compensation receivable.
- (18) In the letter dated 12 September 2014, the Respondents represented that before they issued the Audit Report, they were informed by Hang Yick that the final assessment had not been completed. Due to uncertainty, they did not record the liquidated damages of \$1,520,000 as income in the Financial Statements. However, the above alleged inquiry taken by the Respondents was not recorded in their audit working papers.
- (19) Therefore, the Respondents failed to obtain any sufficient and appropriate audit evidence on evaluating the likelihood and extent of recovering liquidated damages in breach of HKSA 500.2 and 500.19. The alleged inquiry with Hang Yick, even if carried out, is not sufficient nor appropriate audit evidence which would satisfy HKSA 500.
- (20) In addition, the Respondents failed to document the alleged inquiry with Hang Yick (before issuing the Audit Report) and any information received from that inquiry in the audit working papers, and they were thereby in breach of HKSA 230.

## The Proceedings

3. This Complaint was initially referred by the Council of the Institute to the Disciplinary Committee ("DC") under section 34(1AAA) of the PAO. "A Group of Concerned Owners of Grandview Tower" ("**Original Complainants**") intimated a complaint against the Respondents to the Institute in about November 2013.
4. On 2 December 2014, the Council of the Institute ("**the Council**") offered to the Respondents the Draft Terms of Resolution by Agreement ("**the Draft RBA**") in order to have the Complaint resolved by way of an agreement between the Council and the Respondents.
5. The Respondents executed the Draft RBA agreeing to the proposed terms of sanctions. However, the Original Complainants did not confirm their agreement to resolution by way of the Draft RBA. As a result, the Council referred the Complaint to the DC.
6. In accordance with the Disciplinary Committee Proceedings Rules ("**DCPR**") and the PAO, the DC was constituted and Notice of Commencement of Proceedings was issued on 23 September 2016.
7. On, inter alia, 23 September 2016, 19 October 2016, 13 December 2016, 30 December 2016 and 6 February 2017, the DC gave directions in relation to the case management of the Proceedings.
8. The Original Complainants did not lodge a Complainant's Case and wrote various letters stating, amongst others, that:-
  - (a) The particulars of the Complaint was not the same as the complaints they had lodged with the Institute;
  - (b) They did not consider they should have been joined as a party in the DC proceedings and had not requested the Council to refer the matter to the DC;
  - (c) There were various alleged procedural improprieties within the Institute's complaint handling procedures;
  - (d) They would not pay any costs incurred in relation to the DC proceedings;
  - (e) They raised objections in relation to whether the Chairman and Clerk of the DC should take part in the Proceedings.

9. By a letter from the Original Complainant dated 7 November 2016, the Original Complainant notified the DC that they did not wish to proceed with the Proceedings.
10. On 6 February 2017, the DC directed that there be a preliminary hearing for the parties to apply for the parties' applications and deal with preliminary issues (including, but not limited to, any issues in relation to the composition of the DC and whether the Original Complainants wished to proceed with the Complaint).
11. On 6 April 2017, the Registrar wrote to the DC and applied for the Registrar to intervene and be heard in respect of the Complaint under Rule 40 of the DCPR.
12. The DC directed on 24 May 2017 that there be a preliminary hearing on the matter. The Original Complainant notified that DC on 14 August 2017 that they would not attend the preliminary hearing.
13. The preliminary hearing was held in public on 17 October 2017 and was attended by the legal representatives of the Registrar and the Respondents. The Original Complainant was absent. The parties did not object to the composition of the DC (including the Chairman and Clerk of the DC). Having considered the papers before the DC and the parties' submissions at the preliminary hearing, the DC ordered on 19 October 2017, amongst others, that leave be granted to the Registrar to intervene and to prosecute the Complaint in place of the Original Complainant and gave directions in respect of the procedural time table for the Proceedings.
14. On 25 October 2017, the Respondents admitted the Complaint against them. The Complainant and the Respondents made a joint application to the DC to dispense with the filing of cases and replies and/or take any subsequent steps as set out in paragraphs 17 to 30 of the DCPR, and that the admitted Complaint be disposed of on the basis of the admissions made.
15. On 31 October 2017, the DC approved the parties' joint application and gave directions on the procedural time table for the parties to make submissions on sanctions and costs; and replies to other parties' submissions, if any, thereafter. The Complainant and Respondents provided their submissions on sanctions and costs on 21 November 2017. The Respondents provided a reply on 5 December 2017.
16. On 11 January 2018, the DC requested the Parties to confirm if they required an oral hearing to make submissions on sanctions and costs. On 17 January 2018 and 22 January 2018 respectively, the Respondent's and Complainant's legal representatives wrote to the DC stating that they both agreed to dispense with a hearing on sanctions and costs.

### Key particulars of Submissions on Sanctions

- (a) The Complainant submitted that the Respondents shall face the sanctions of public reprimand, a financial penalty of HK\$35,000 and costs of HK\$10,000 pursuant to the proposed terms of sanctions in the Draft RBA.
- (b) The Respondents also submitted the sanctions of a financial penalty of HK\$35,000 and costs of HK\$10,000 pursuant to the proposed terms of sanctions in the Draft RBA.
- (c) With regards to costs, the Complainant and Respondents submitted that the additional time spent on this matter was incurred as a result of the actions of the Original Complainant rather than the Respondents. It is felt that it would be unfair to hold the Respondents liable to these additional costs. Given this approach, the costs were proceeded on a lump sum basis.
- (d) The Complainant filed further submissions and referred the DC to 5 disciplinary cases involving audit breaches for similarly sized clients, namely, D-12-0685C, D-11-0528C, D-04-0583C, D-05-0154C and D-05-AZKP. In all of those cases, the respondents received reprimands and orders to pay financial penalties and costs. These cases are relevant but not binding on the DC.

### **Order and Sanctions**

- 17. In considering the proper order to be made in this case, the DC has had regard to all the aforesaid matters, including the submissions of the Parties, the 1<sup>st</sup> Respondent's personal circumstances, and the conduct of the Respondents throughout the proceedings. In particular, the DC considered the following:-
  - (a) In the basis of the admissions by the Respondents, the DC finds that the Complaint has been proved.
  - (b) As to the nature and degree of seriousness of the breach, aspects of the Respondents' work fell below the standard expected of the profession.
  - (c) However, this matter did not involve dishonesty on the part of the Respondents.
  - (d) The Respondents had not previously been the subject of any disciplinary action or been issued with any disapproval letter prior to this Complaint.



- (e) The Original Complainant was very unhappy with the Respondents' standard of care and this adversely impacted on the reputation of the profession.
  - (f) The Respondents had offered to issue revised audited Financial Statements without any charge<sup>1</sup>.
  - (g) The Respondents have cooperated with the investigations of the Institute.
  - (h) There has been substantial delay since the date of the Draft RBA offered by the Council on 2 December 2014, which was not the fault of the Respondents and the Respondents incurred substantial time and costs in dealing with the Original Complainant's correspondence and procedural matters which the Original Complainant did not proceed with
  - (i) Since the Complaint was lodged in December 2014, the Respondents had resigned from providing further accounting or auditing services to the said IO and this matter has been hanging over the Respondents since then.
  - (j) The DC may have regard to the Guidelines to the Disciplinary Committee for Determining Orders, but the DC is not bound by such guidelines and each case should be considered on its own merits.
  - (k) The DC had regard to the cases referred to in the Complainant's submissions and although not binding, the DC saw no reason to depart from previous decisions that in this case the Respondents should also be given a reprimand and ordered to pay a financial penalty and costs.
  - (l) The level of financial penalty and costs should be proportionate having regard to all the circumstances of the case.
18. The DC considers that costs should follow the event and that the Respondents should pay the costs and expenses of the proceedings.
19. However, the DC agrees with both parties' submissions that a substantial proportion of the time and costs incurred on this matter could have been avoided had the matter been resolved by way of the Draft RBA. The DC considers that that the Respondents should pay the Complainant's costs in the sum of HK\$10,000.

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<sup>1</sup> Letter issued to the IO dated 12 September 2014

20. The DC therefore orders that:-

- (a) the Respondents be reprimanded under Section 35(1)(b) of the PAO;
- (b) the Respondents pay a penalty of HK\$35,000 under Section 35(1)(c) of the PAO;
- (c) the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$10,000 under Section 35(1)(iii) of the PAO.

Dated 1 March 2018