

IN THE MATTER OF

Complaints made under Section 34(1)(a) 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

1st Respondent

1st RESPONDENT

2nd Respondent

2nd RESPONDENT

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

Members:

REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (“the Institute”) as Complainant against the First Respondent, a certified public accountant (practising) and the Second Respondent, a corporate practice. Section 34(1)(a)(vi) of the PAO applied to the Respondents.
2. The particulars of the Complaint as set out in a letter dated 11 July 2012 (“the Complaint”) from the Registrar of the Institute to the Council of the Institute for consideration of the Complaint for referral to the Disciplinary Panels were as follows:-

- (1) On 6 May 2011, the Institute received a complaint from the Office of the Commissioner of Insurance ("OCI") against the Second Respondent regarding an auditors' compliance report issued by the First Respondent on behalf of the Second Respondent to [Company A] ("Company A") for the year ended 31 March 2008 (the "2008 Compliance Report"). The 2008 Compliance Report, dated 29 September 2008, was issued pursuant to the membership regulations of the Hong Kong Confederation of Insurance Brokers ("HKCIB").
- (2) Company A is a member of the HKCIB, one of the approved bodies of insurance brokers in Hong Kong.
- (3) The OCI was concerned that the Second Respondent had not qualified the 2008 Compliance Report even though it appeared that Company A had failed to maintain adequate Professional Indemnity Insurance ("PII") cover in accordance with the Minimum Requirements for Insurance Brokers specified by the Insurance Authority (the "Minimum Requirements"), as required pursuant to section 70(2) of the Insurance Companies Ordinance, Cap 41 ("ICO").
- (4) The First Respondent was at all material times a member of the Institute holding a practising certificate and was the managing director of the Second Respondent.
- (5) Sections 100 "Introduction and Fundamental Principles" and 130 "Professional Competence and Due Care" of the then effective Code of Ethics for Professional Accountants (Effective on 30 June 2006 until 31 December 2010) ("COE") state that,

"100.4 A professional accountant is required to comply with the following fundamental principles: ...

(c) Professional Competence and Due Care

... A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services."

"130.1 The principle of professional competence and due care imposes the following obligations on professional accountants:...

(b) To act diligently in accordance with applicable technical and professional standards when providing professional services. "

"130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis."

"130.5 A professional accountant should take steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision."

(6) First Complaint

Section 34 (1)(a)(vi) of the PAO applies to the First and Second Respondents in that they failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraph 100.4 "Fundamental Principles – Professional Competence and Due Care" of the COE when they issued an unqualified compliance report to Company A for the year ended 31 March 2009 despite Company A's failure to obtain adequate professional indemnity insurance cover as required under the Minimum Requirements issued by the Insurance Authority.

(7) Second Complaint

Section 34 (1)(a)(vi) of the PAO applies to the First and Second Respondents in that they failed or neglected to observe, maintain or otherwise apply professional standards namely paragraphs 100.4., 130.1(b), 130.4 and 130.5 of the COE when they issued an unqualified compliance report to Company A for the year ended 31 March 2008.

FACTS AND CIRCUMSTANCES IN SUPPORT OF COMPLAINTS

Compliance with Minimum Requirements on Professional Indemnity Insurance

- (8) Pursuant to section 70(2) of the ICO, HKCIB requires its members to comply with the Minimum Requirements for inter alia professional indemnity insurance:

Section C of Part III of the Minimum Requirements states:

"Professional Indemnity Insurance

An insurance broker is required to maintain a professional indemnity insurance policy with a minimum limit of indemnity for any one claim and in any one insurance period of 12 months. The minimum limit of indemnity shall be –

(i) a sum equal to -

- two times the aggregate insurance brokerage income relating to 12 months immediately preceding the date of commencement of the*

professional indemnity insurance cover (applicable to insurance broker who has been in business for more than one year);

- *two times the projected insurance brokerage income for 12 months for the period of the professional indemnity insurance cover (applicable to insurance broker who has been in business for less than one year); or*

(ii) a sum of HK\$3, 000, 000

whichever sum shall be greater, up to a maximum of HK\$ 75,000,000. Cover in excess of this prescribed amount may, of course, be arranged to meet the requirements of individual broker. If as a result of a claim(s), the indemnity available shall fall below the amount determined in (i) above, the broker shall effect a reinstatement of cover up to not less than such minimum determined amount. Where the limit of indemnity has been determined in accordance with (ii) above, the policy shall include provision for one automatic reinstatement to a limit of indemnity of not less than HK\$3,000,000."

- (9) In order to confirm that its members have complied with the Minimum Requirements and, in accordance with Section B of Part V of the Minimum Requirements, the HKCIB requires its incorporated members, within 6 months following the end of their financial year, to file an auditors' compliance report expressing whether, in his opinion, the member satisfies the minimum requirements for inter alia professional indemnity insurance as at the end of the financial year and 2 such other dates in the financial year as the auditor may elect, provided that the intervening period between those 2 dates shall not be shorter than 3 months.
- (10) The Institute has issued Practice Note 810.1 "INSURANCE BROKERS - COMPLIANCE WITH THE MINIMUM REQUIREMENTS SPECIFIED BY THE INSURANCE AUTHORITY UNDER SECTIONS 69(2) and 70(2) OF THE INSURANCE COMPANIES ORDINANCE" (September 2004 Issue) ("PN810.1") to assist its members in the preparation of the Auditors' Compliance Report.
- (11) Paragraph 6 of PN 810.1 reminds members that, as auditors of insurance brokers who are members of HKCIB, they should make reference to the Minimum Requirements and where appropriate, to the membership rules and regulations of the HKCIB.

First Complaint

- (12) Pursuant to its obligations under the Minimum Requirements, Company A was required to ensure that it had adequate PII coverage for the period covering 2 April 2008 to 1 April 2009.

- (13) Based upon the formula set out in the Minimum Requirements the level of P11 coverage should have been HK\$4.22 million, calculated as follows:

Year ended 31 March 2009:	
P11 cover period:	2/4/08 to 1/4/09
Two times the insurance broker income relating to 12 months preceding the date of commencement of the P11:	April 07 to March 08 brokerage income of HK\$2,111,781 (per audited financial statements) x 2 times
Minimum level of P11 cover required:	=HK\$4,223,562

- (14) However, based upon the insurance policy dated 28 March 2008 provided to the OCI, the level of P11 coverage was only HK\$3,800,000 leaving a shortfall of HK\$423,562.
- (15) In September 2009, the Second Respondent issued its auditors' compliance report for the year ended 31 March 2009 (the "2009 Compliance Report") in which it was reported that :

"We are not aware of any instances where the company has failed to maintain a professional indemnity insurance policy in accordance with the minimum requirements specified by the Insurance Authority under section 70(2) of the Ordinance."

- (16) In his letter to the Institute dated 13 June 2011, the First Respondent accepted that the Second Respondent had made a mistake:

"We had taken certain steps to ensure the compliance with the minimum requirements specified by the Insurance Authority."

'After discussing with our staff, we discover that he misinterpreted the word meaning set out in PN810.1 that the required indemnity amount be at least twelve-month brokerage income. Indeed, it should be at least two times the aggregate insurance brokerage income ..."

- (17) Given that the actual P11 cover for the year ended 31 March 2009 did not satisfy the Minimum Requirements, the First Respondent and the Second Respondent should have qualified the 2009 Compliance Report.
- (18) In the circumstances, the First Respondent and the Second Respondent were in breach of s.34(1)(a)(vi) of the PAO as they failed to comply with paragraph 100.4 of the COE by not acting in accordance with the applicable technical and professional standards when issuing the 2009 Compliance Report to Company A.

Second Complaint

- (19) Following a further enquiry letter from the Institute dated 11 August 2011, the First Respondent wrote to the Institute on 24 August 2011 and provided a copy of the Second Respondent's checklist entitled "Checklist for the auditors' report to Hong Kong Confederation of Insurance Brokers ("HKCIB")" (the "Checklist"). The Checklist was prepared for the purpose of the 2008 Compliance Report.
- (20) Part III (paragraphs 5-6 of the Checklist) concerned the auditors' confirmation of P11 compliance with the Minimum Requirements.
- (21) Based upon the information recorded on the Checklist it is clear that the audit staff of the Second Respondent committed a fundamental error when checking Company A's compliance with the Minimum Requirements for the year ended 31 March 2008. In ascertaining whether Company A had adequate PII coverage for the year ended 31 March 2008, the audit staff should have:
- (a) made reference to the PII policy in force during the period 2/4/2007 to 1/4/2008 and not the PII policy for the subsequent year (i.e. 2/4/2008 to 1/4/2009); and
 - (b) used the insurance brokerage income derived from the year ended 31 March 2007 to calculate the level of coverage required rather than use the insurance brokerage income for the year ended 31 March 2008.
- (22) In his cover letter, the First Respondent represented that:
- "In order to rectify the misinterpretation we have made, we will perform the following corrective actions:*
- 1. Amend our checklist as soon as possible; and*
 - 2. Educate our audit staff regarding the minimum requirements for professional indemnity insurance."*
- (23) Clearly, the audit staff assigned by the First Respondent and the Second Respondent to the Company A engagement lacked the necessary capabilities and competence to perform the engagement in accordance with the professional standards, regulations and legal requirements.
- (24) Nevertheless, had the First Respondent conducted a diligent review of the work performed by the audit staff, before he issued the 2008 Compliance Report, he should have realised that they were not in accordance with the applicable technical standards.

- (25) In the circumstances, the First Respondent and the Second Respondent were in breach of s.34(1)(a)(vi) of the PAO as they failed to comply with paragraphs 100.4, 130.1(b), 130.4 and 130.5 of the COE when issuing the 2008 Compliance Report to Company A.
3. The Respondents admitted the Complaints against them. They did not dispute the facts as set out in the Complaint. The parties agreed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.
 4. By a letter dated 26 September 2012 addressed to the Complainant and the Respondents, the Clerk to the Disciplinary Committee ("DC"), under the direction of the DC, informed the parties that they should make written submissions to the DC as to the sanctions and costs and that the DC would not hold a hearing on sanctions and costs unless otherwise requested by the parties.
 5. By a letter dated 17 October 2012, the Complainant referred the Committee to a previous disciplinary case of Mr. X [xx] ("Mr. X") insofar as it involved a breach of paragraphs 130.1 and 130.4 of the COE and the ICO.
 - (1) The case against Mr. X concerned his failure to report in his Audit Report of non-compliance with the Minimum Requirements regarding the maintenance of separate client accounts as required by the ICO.
 - (2) Mr. X, on his own admission, was found guilty of failing or neglecting to observe, maintain or otherwise apply the Institute's professional standards namely paragraphs 130.1 and 130.4 of the COE and of professional misconduct. He was reprimanded, penalised HK\$5,000 and ordered to pay the entire costs and expenses of the disciplinary proceedings.
 - (3) Notwithstanding the above, pursuant to s.35 of PAO, this Committee has an absolute discretion in the sanctions that it might wish to impose and is not bound by any earlier decision. Each case is fact sensitive.
 - (4) However, the present case is serious. Unlike the Mr. X case, this was not a case involving a mere failure to report. Rather, this case also demonstrated an unprecedented lack of due care by the Respondents of two regulatory audits for the same client:
 - Not an isolated incident – in the Mr. X case, the failure to report was a one-off breach covering only one audit and auditor's report. However, in the present case, the deficiency covered two years of audit and auditor's report. Had the error not been discovered by the OCI, it would quite likely have continued;
 - Complete lack of due care – a review of the "facts and circumstances in support of the complaints" clearly reveal that:

- The staff assigned to carry out the audit appeared to be unfamiliar with the requirements of the ICO, the Minimum Requirements or PN810.1;
 - The staff carrying out the audit had committed fundamental errors of basic accounting skills; and
 - These basic accounting errors and failure to comply with the ICO had not been picked up by the reviewer prior to signing off of the audits.
- (5) Both the Mr. X case and the present case involve a regulatory audit and as such, there is a public interest element. In the Mr. X case there was no suggestion that client monies had been lost or otherwise put at risk by the broker's failure to maintain a separate client account. However, in the present case, members of the public would be at risk when adequate professional indemnity insurance is not maintained.
- (6) In the circumstance, this Committee may consider that a reprimand and penalty would not be adequate and more serious sanctions would be warranted.
- (7) Finally, in respect of costs, the Complainant submits that the Respondents should be jointly and severally liable to pay the costs and expenses of and incidental to the proceedings of the Institute (including the costs and expenses of the Committee) of an amount not less than HK\$49,640.
- (8) In this regard, the Committee has regard to the fact that the legal costs incurred by the Institute in disciplinary proceedings are financed by membership subscriptions and registration fees. Since it was the Respondents' conduct which has brought them with the disciplinary process under the PAO, it is only fair that they should pay the costs and expenses of the proceedings and not have them funded or subsidized by other members of the Institute.
- (9) The Respondents have admitted the complaints and do not dispute the facts as set out in the Registrar's letter to the Council dated 11 July 2012. The Complainant has no objection to any regard which the Committee might have, in considering the order to be made, to the fact that the Respondent admitted the Complaint, thereby avoiding the need of a formal hearing taking place.
6. The Respondents did not make any submission despite two letters respectively dated 26 September 2012 and 22 October 2012 were issued to them by the Clerk under the respective directions of this Committee inviting the Respondents to do so.
7. Nonetheless, the Committee has taken into account of the remedial measures made by the Respondents as stated under paragraph 2(22) herein.

8. The DC orders that:-

- 1) Both Respondents be reprimanded under Section 35(1)(b) of the PAO;
- 2) the Respondents pay a penalty of HK\$50,000 under Section 35(1)(c) of the PAO;
- 3) the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$49,640 under Section 35(1)(iii) of the PAO; and
- 4) the Respondents shall be jointly and severally liable to pay the penalty and cost and expenses to the proceedings.

Dated the 12th day of March 2013

IN THE MATTER OF

Complaints made under Section 34(1)(a) 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

1st Respondent

1st RESPONDENT

2nd Respondent

2nd RESPONDENT

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

Members:

ORDER

Upon reading the complaint against [the 1st Respondent], a certified public accountant (practising), the FIRST RESPONDENT, and [the 2nd Respondent], a corporate practice, the SECOND RESPONDENT, as set out in a letter from the Registrar of the Hong Kong Institute of Certified Public Accountants ("the Complainant") dated 11 July 2012, the written submission of the Complainant dated 17 October 2012, and the relevant documents, the Disciplinary Committee is satisfied by the admission of the Respondents and evidence adduced before it that the following complaints are proved:

1. Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they had failed or neglected to observe, maintain or otherwise apply paragraph 100.4 of the Code of Ethics for Professional Accountants by not acting in accordance with the applicable technical and professional standards when issuing the 2009 Compliance Report to [Company A].
2. Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they had failed or neglected to observe, maintain or otherwise apply paragraphs 100.4, 130.1(b), 130.4 and 130.5 of the Code of Ethics for Professional Accountants when issuing the 2008 Compliance Report to [Company A].

IT IS ORDERED that:-

1. both Respondents be reprimanded under Section 35(1)(b) of the PAO;
2. the Respondents do pay a penalty of HK\$50,000 under Section 35(1)(c) of the PAO;
3. the Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$49,640 under Section 35(1)(iii) of the PAO; and
4. the Respondents shall be jointly and severally liable to pay the penalty and costs and expenses to the proceedings.

Dated the 12th day of March 2013