

IN THE HIGH COURT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF APPEAL

CIVIL APPEAL NO. 28 OF 2010

(ON APPEAL FROM THE DECISIONS OF THE DISCIPLINARY
COMMITTEE OF THE HONG KONG INSTITUTE OF CERTIFIED PUBLIC
ACCOUNTANTS DATED 29 JUNE 2009 AND 24 DECEMBER 2009)

BETWEEN

Ng Kay Lam

Appellant

and

The Registrar of the Hong Kong Institute of Certified Public Accountants

Respondent

Before: Hon Rogers VP, Le Pichon JA and Barma J in Court

Date of Hearing: 17 November 2010

Date of Handing Down Judgment: 30 November 2010

J U D G M E N T

Hon Rogers VP:

1. I agree with the judgment of Le Pichon JA.

Hon Le Pichon JA:

2. This is an appeal by the respondent from (1) a decision of the Disciplinary Committee (“the Committee”) of the Hong Kong Institute of Certified Public Accountants (“the Institute”) of 29 June 2009 finding the complaint that the respondent had breached section 34(1)(a)(vi) of the Professional Accountants Ordinance, Cap. 50 (“the Ordinance”)

proved and (2) an order of 24 December 2009 that the respondent be reprimanded, pay a penalty of \$50,000 to the Institute and costs in the amounts specified in the order. At the conclusion of the hearing judgment was reserved which we now give.

Background

3. The facts are undisputed and can be summarised as follows.
4. The respondent is a certified public accountant practising as a sole proprietor under the name of K.L. Ng & Company (“the firm”). The firm carried out the audit of Linfoot (Asia Pacific) Ltd (“LAPL”) for the year ended the 31 December 2003. The audit report is dated 13 August 2004.
5. Until March 2005, the respondent had a part-time employee called Robert Lam (“Mr Lam”) who was a former colleague. Mr Lam did not work in the office and his involvement with the firm “was minimal”.
6. Mr Lam introduced LAPL to the firm in 1997. According to the respondent, he asked Mr Lam to prepare accounts and perform audit work on behalf of the firm for LAPL. Mr Lam was “always [his] primary point of contact” with LAPL.
7. Mr Lam became the company secretary of LAPL on 1 September 2003. At about the same time, the respondent agreed to Mr Lam’s request to allow LAPL to use the firm’s address as LAPL’s registered office. The Financial Statements for the year ended the 31 December 2003 were prepared by Mr Lam who also carried out the audit. Mr Lam did not receive any remuneration as company secretary.
8. At the material time Mr Lam also acted as LAPL’s accountant and according to him, it was out of friendship to one of the shareholders and directors and he had provided those services free of charge.
9. For the audit work performed, Mr Lam was remunerated by way of a percentage of the audit fee of the firm.
10. The chairman of LAPL made a complaint against the respondent to the effect that the respondent had failed or neglected to observe, maintain or otherwise apply paragraph 2 of Statement 1.203 (Professional Ethics - Integrity, Objectivity and Independence) in the audit of the financial statements of LAPL for the year ended the 31 December 2003.
11. At the material time LAPL was a small private company with no salaried staff and derived its income mainly from dividends from its Chinese subsidiaries. LAPL had seven members. The list of directors and the respective members represented by them is set out below:

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<u>Name of director</u>	<u>Member(s) represented</u>	<u>Percentage Shareholdings</u>
Mr. Ho Chi Kong	Mr. Ho Chi Kong	14.50%
Mr. Ma Iu Ki	Mr. Ma Iu Ki	18.75%
Mr. Brian O'Donnell	Brian O'Donnell Nominees Pty Ltd	20.25%
Mr. Graham Devenish	Penola Pty Ltd	20.25%
Mr. Robert Stanley Linfoot	Harewood Pty Ltd	14.00%
	Linsmith Investments Pty Ltd	10.75%
Ms. Wong Ling Ha (resigned on 3 September 2003)	Mr. Ma Iu Ki (husband of Ms. Wong Ling Ha)	1.50%
		<u>100.00%</u>

The relevant provisions

12. In pertinent part, Statement 1.203 provides:

“1. Professional independence is a concept fundamental to the accountancy profession. It is essentially an attitude of mind characterised by integrity and an objective approach to professional work.

2. A member in public practice should be, and be seen to be, free in each professional assignment he undertakes of any interest which might detract from objectivity. The fact that this is self-evident in the exercise of the reporting function must not obscure its relevance in respect of other professional work.”

13. The Statement contains Guidelines including the following:

“12. Close personal or business relationships can affect objectivity. There is a particular need, therefore, for a practice to ensure that its objective approach to any assignment is not endangered as a consequence of any such relationship ...

52. Whether a significant conflict of interest exists will depend on all the circumstances of the case. The test is whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect objectivity of the practice ...”

This appeal

14. The main thrust of the submissions of Mr Pang (who appeared for the respondent) was that the auditors' role was to protect the shareholders. In the present case, the directors were the directly appointed representatives of the shareholders who together owned 100% of the company. The directors and, hence, the shareholders knew and approved of the tripartite role played by Mr Lam - as company secretary, accountant and auditor. They considered that there was no conflict of interest. In those circumstances, and having regard to the fact that no prejudice had been caused to any party, the Committee was wrong in finding that there had been a breach of professional standards on independence.

15. As to the auditors' role, Mr Pang referred to the House of Lords decision in *Carparo Industries PLC v Dickman* [1990] 2 AC 605, 625 where Lord Bridge cited with approval a passage from the judgment of Bingham LJ in the Court of Appeal [1989] QB 653, 680-61 describing the role of the auditors:

“... he is employed by the company to exercise his professional skill and judgment for the purpose of giving the shareholders an independent report on the reliability of the company's accounts and thus

on their investment. ‘No doubt he is acting antagonistically to the directors in the sense that he is appointed by the shareholders to be a check upon them:’ ...”

I do not see how those observations which are not controversial assist Mr Pang’s case.

16. The correctness or otherwise of Mr Pang’s submissions lies in whether the directors and/or the shareholders may dispense with an audit altogether. The consent (express or implied) of the shareholders (acting through the directors) to the multiple roles assumed by the auditor is irrelevant unless it is within their powers to waive any irregularity and/or non-compliance. In other words, if compliance with the provisions of the Companies Ordinance relating to the accounts of a company cannot be achieved without an auditors’ report, the shareholders cannot and may not opt out of the requirement of an audit. If an audit has to be carried out, then the auditor carrying it out must comply with the requisite professional standards.

17. The purpose of the audit is apparent from the auditors’ report itself. The auditors’ report which the firm signed, in pertinent part, read:

“We have audited the financial statements set out ... which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the directors to prepare financial statements which give a true and fair view ...

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgment is made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the companies circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement ...”

18. It is the independent verification by a professional third party that lies at the heart of an audit. That is intended to ensure that the financial information prepared by the directors give a true and fair view of the company’s affairs and to provide shareholders with reliable information as to the company’s financial condition. Whether a conflict of interest situation arises or could be perceived to arise does not turn on either the smallness of the company or the number of transactions.

19. Mr Pang then referred to the Code of Ethics for Professional Accountants issued in December 2005 by the Institute. As it was a codification of existing standards, it was said that the fact that it was not in effect at the material time was nothing to the point. §§290.150-

151 of the Code make it clear that, in general, a partner or an employee of the firm who serves as company secretary is considered to imply a close degree of association with the company and may create self-review and advocacy threats. Normally no safeguard could reduce the threat to an acceptable level,

“unless the duties and functions undertaken are limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns, and are permitted by law.”

§290.152 went on to provide that:

“Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.”

20. Mr Pang also drew attention to §§ 36-38 of the Guidelines:

“ Provision of other services to audit clients

36. There are occasions where objectivity may be threatened or appear to be threatened by the provision to an audit client of services other than the audit.

37. There is no objection in principle to a practice providing to a client services additional to the audit. However, care must be taken not to perform management functions or to make management decisions.

38. In the case of many audit clients it is common to provide a range of accountancy services, which may include participation in the preparation of accounting records.”

It was said that even the Guidelines envisaged that preparation of accounts for audit is common and that there is no objection in principle to it as such.

21. Mr Pang submitted that the Committee failed to take into consideration the role played by Mr Lam as LAPL’s accountant as explained in his letter of 31 August 2008 to the Committee which stated that:

“... most of the transactions were the transfer of money to and from the subsidiaries and some of the general and administrative expenses, the transactions were less than forty for a financial year.”

It was submitted that had it done so, the Committee would have realized that the work performed consisted of routine administrative matters which would not involve any conflict of interest.

22. The Guidelines are intended to give effect to the Statement 1.203 and the principles stated. They must be applied with that in mind and with common sense. Whether or not “objectivity may be threatened or appear to be threatened” is fact-sensitive. While participation in the preparation of accounting records may be acceptable, that would depend on the nature of the ‘participation’. On any view, it could not possibly cover a situation such as the present where the person conducting the audit had himself prepared the financial statements that were the subject matter of the audit. The perceived conflict of interest is all

too obvious to require any elaboration. The respondent was fully cognisant of Mr Lam's tripartite role. In my view the challenge to the Committee's finding is entirely without merit.

The penalty

23. Mr Pang also appealed against the penalty imposed on the ground that it was excessive. The Committee considered the respondent's breach to be "of a very serious nature". As earlier noted, it was the respondent who had asked Mr Lam to prepare LAPL's accounts and perform audit work on behalf of the firm.

24. The penalty imposed by the Committee was within the Guideline to Disciplinary Committees for Determining Disciplinary Order. It is evident from §10 of its Decision on Sanction and Costs that the Committee considered that the upholding of the "core values of independence and professionalism" as set out in the Statement to be of primary importance and that ignorance or lack of understanding of the Statement provides no excuse. The Committee in imposing the penalty made allowance for the respondent's "unblemished professional record" and the steps taken to avoid similar breaches in the future.

25. In those circumstances, it is not for this court to second-guess the profession who was well represented on the Committee as to the professional standards to be expected of members of that profession. For my part, I can see no basis for interfering with the penalty imposed.

Order

26. I would dismiss this appeal. I would also order that there be an order *nisi* of costs in favour of the Registrar of the Institute.

Hon Barma J:

27. I agree.

Hon Le Pichon JA:

28. Accordingly, there will be an order in terms of §26.

(Anthony Rogers)
Vice-President

(Doreen Le Pichon)
Justice of Appeal

(Aarif Barma)
Judge of the

Mr Robert Y H Pang and Ms Pauline Leung, instructed by Messrs Tam & Partners, for the Appellant

Mr Eugene Fung, instructed by Messrs Mayer Brown JSM, for the Respondent