Proceedings No.: D-12-0666F

IN THE MATTER OF

A Complaint made under section 34(1) of the Professional Accountants Ordinance (Cap. 50) ("PAO") and referred to the Disciplinary Committee under section 33(3) of the PAO

BETWEEN

Hong Kong Institute of Certified Public Accountants	COMPLAINANT
AND	
1st Respondent	1st RESPONDENT
2nd Respondent	2nd RESPONDENT

Members:

REASONS FOR DECISION

(1) This is a complaint made by the Hong Kong Institute of Certified Public Accountants ("the Institute") as Complainant against the Respondents, who is a certified public accountant (practising) and a firm of certified public accountants respectively. 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 April 2013 ("the Complaint") from Mr. Chris Joy, Executive Director of the Institute to the Council of the Institute for consideration of the Complaint for referral to the Disciplinary Panels were as follows:-

BACKGROUND

1. [Company A] (the "**Company**") was incorporated in the Cayman Islands and its shares are listed on the Main Board (Stock Code: 00[xxx]) of the Stock Exchange of Hong Kong Limited.

2. The financial statements for the Company and its subsidiaries (the "**Group**") for the year ended 31 December 2007 (the "**2007 Financial**

Statements") were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards ("**HKFRS**").

3. [2nd Respondent] ("**[**the Firm**]**") audited the 2007 Financial Statements. [The Firm]'s audit report, signed and dated 25 April 2008, stated that the audits were conducted in accordance with Hong Kong Standards of Auditing. [1st Respondent] was the engagement partner.

4. The consolidated loss and the consolidated net assets of the Group stated in the 2007 Financial Statements were HK$8.4 million and HK$449.1 million respectively.

5. [The Firm] expressed a modified opinion on the 2007 Financial Statements with an emphasis on the outcome of various fund raising activities which might affect the carrying amount of the goodwill and investment in the mining business arising from the Company's acquisition which took place in May 2007 (the "**2007 Acquisition**").

6. The 2007 Acquisition was partly paid by Consideration Shares. Assets acquired included an Exploration and Evaluation Asset which comprised an Exploration Licence.

7. In the financial statements for the year ended 31 December 2009 audited by a different firm of auditors, there was a retrospective restatement of the fair value of the net assets acquired in the 2007 Acquisition.

<u>Report of the Audit Investigation Board</u>

8. The Financial Reporting Council (the "**FRC**") on 19 November 2010, directed the Audit Investigation Board (the "**AIB**") in accordance with section 23(3)(b) of the FRC Ordinance, to investigate the audit of the 2007 Financial Statements for a possible auditing irregularity in respect of the accounting treatment of the 2007 Acquisition.

9. On 6 January 2012, the AIB sent its draft investigation report and the relevant sections of its draft report to [the Firm] for its comments. [the Firm]'s responses contained in its letter to the AIB dated 10 February 2012 was included in the AIB's investigation report (the "**Investigation Report**") that was adopted by the FRC on 23 March 2012.

10. On 26 March 2012, the FRC referred the Investigation Report together with annexures to the Institute pursuant to section 9(f) of the FRC Ordinance.

11. In making the referral, the AIB considered that [the Firm] had failed or neglected to observe, maintain or otherwise apply a professional standard pursuant to section 34(1)(a)(vi) of the Professional Accountants Ordinance, Cap 50 ("**PAO**").

SUMMARY OF PRINCIPAL ISSUES

12. The principal issues relate to the failure by the Company to comply with paragraphs 24, 27, 36 and 37 of Hong Kong Financial Reporting Standard 3 *Business Combinations* ("**HKFRS 3**") in that the published price of the Company's shares at the date of exchange was not used to measure the fair value of the Consideration Shares issued for the 2007 Acquisition, and the intangible asset acquired through the 2007 Acquisition was not measured at its fair value at the acquisition date.

13. [The Firm] should have expressed a modified auditor's opinion on the 2007 Financial Statements regarding this non-compliance with HKFRS 3. Accordingly, there is non-compliance with the professional standards stated in the Complaints below.

14. The principal issues are explained in the AIB Report, which should be referred to for details. The issues and evidence will be further addressed in the Complainant's Case to be filed pursuant to the Disciplinary Committee Proceedings Rules.

RELEVANT PROFESSIONAL STANDARDS

15. Hong Kong Standard on Auditing 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements* ("**HKSA 700**"):

    "11. The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements."

    "13. Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework involves evaluating whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework for particular classes of transactions, account balances and disclosures…. "

16. Hong Kong Standard on Auditing 230 *Audit Documentation* ("**HKSA 230**"):

    "2. The auditor should prepare, on a timely basis, audit documentation that provides:

    (a) A sufficient and appropriate record of the basis for the auditor's report; and

(b) *Evidence that the audit was performed in accordance with HKSAs and applicable legal and regulatory requirements."*

"9. The auditor should prepare the audit documentation so as to enable an experienced auditor, having no previous connection with the audit, to understand:

(a) *The nature, timing, and extent of the audit procedures performed to comply with HKSAs and applicable legal and regulatory requirements;*

(b) *The results of the audit procedures and the audit evidence obtained; and*

(c) *Significant matters arising during the audit and the conclusions reached thereon."*

"18. If the auditor has identified information that contradicts or is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor should document how the auditor addressed the contradiction or inconsistency informing the final conclusion."

17. HKFRS 3:

"24. The acquirer shall measure the cost of a business combination as the aggregate of

(a) *the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus*

(b) *any costs directly attributable to the business combination. "*

"27. The published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and shall be used, except in rare circumstances. Other evidence and valuation methods shall be considered only in the rare circumstances when *the acquirer can demonstrate that the published price at the date of exchange is an unreliable indicator of fair value, and that the other evidence and valuation methods provide a more reliable measure of the equity instrument's fair value. The published price at the date of exchange is an unreliable indicator only when it has been affected by the thinness of the market…."*

"36. The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at that date ...."

"37. The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date: ... (c) in the case of an intangible asset or a contingent liability, its fair value can be measured reliably. "

THE COMPLAINTS

First Complaint

18. Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they have failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 11 and 13 of HKSA 700 for their failure to express a modified auditor's opinion in respect of the valuation of the Exploration Licence and the Consideration Shares on the 2007 Financial Statements.

Second Complaint (in the alternative to the First Complaint)

19. Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they have failed or neglected to observe, maintain or otherwise apply a professional standard namely HKFRS 3 for their failure to measure the Exploration Licence at fair value at the date of Acquisition and/or for not using the published price at the date of Exchange to measure the fair value of the Consideration Shares issued for the purpose of the Acquisition.

Third Complaint (in the alternative to the First or Second Complaint)

20. Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they have failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 2 and/or 9 and/or 18 of HKSA 230 in that they have failed to prepare audit documentation that provides a sufficient and appropriate record of the objective analysis undertaken to support the basis of their concurrence with the Company's accounting treatment of the Exploration License and Consideration Shares.

21. For the reasons as explained in the Investigation Report, the Respondents have not complied with professional standards in the audit of the 2007 Financial Statements. In the circumstances, section 34(1)(a)(vi) of the PAO applies to the Respondents in that they have failed to observe, maintain or otherwise apply HKSA 700 or HKFRS 3 or HKSA 230.

(3) The Respondents admitted the Third Complaint against them. They did not dispute the facts as set out in the Complaint. They agreed that the steps set

out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.

(4) By letters dated 24 July 2013 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) In considering the proper order to be made in this case, the DC has had regard to all the aforesaid matters, including the particulars in support of the Complaint, the Respondents' personal circumstances, and the conduct of the Complainant and the Respondents throughout the proceedings.

(6) The DC orders that:-

1) Both the 1st and 2nd Respondents be reprimanded under section 35(1)(b) of the PAO;

2) The Respondents do pay a penalty of HK$35,000 under section 35(1)(c) of the PAO. The penalty shall be shared by the Respondents equally; and

3) The Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant and the Financial Reporting Council in the total sum of HK$ 43,718 and HK$201,268.60 under Section 35(1)(iii) and Section 35(1)(d)(ii) respectively of the PAO. The costs and expenses shall be shared equally by the Respondents.

Dated the 28th day of October 2013

Proceedings No.: D-12-0666F

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BETWEEN

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 [1st Respondent] and [2nd Respondent], being a certified public accountant (practising) and a firm of certified public accountants respectively, as set out in a letter from an Executive Director of the Institute ("the Complainant") dated 11 April 2013, the written submission of the Complainant dated 14 August 2013, the written submission of the Respondents dated 27 August 2013, and other relevant documents, the Disciplinary Committee is satisfied by the admission of the Respondents and the evidence adduced before it that the following complaint is proved:

> Section 34(1)(a)(vi) of the PAO applies to the Respondents in that they have failed or neglected to observe, maintain or otherwise apply a professional standard namely paragraphs 2 and/or 9 and/or 18 of HKSA 230 in that they have failed to prepare audit documentation that provides a sufficient and appropriate record of the objective analysis undertaken to support the basis of their concurrence with the Company's accounting treatment of the Exploration License and Consideration Shares.

IT IS ORDERED that:-

1. Both the 1st and 2nd Respondents be reprimanded under section 35(1)(b) of the PAO;

2. The Respondents do pay a penalty of HK$35,000 under section 35(1)(c) of the PAO. The penalty shall be shared by the Respondents equally; and

3. The Respondents do pay the costs and expenses of and incidental to the proceedings of the Complainant and the Financial Reporting Council in the total sum of HK$ 43,718 and HK$201,268.60 under Section 35(1)(iii) and Section 35(1)(d)(ii) respectively of the PAO. The costs and expenses shall be shared equally by the Respondents.

Dated the 28th day of October 2013