

IN THE MATTER OF

A Complaint made under Section 34(1)(a) and 34(1A) 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

Mr. Lam Chi Ming Francis 1ST
Membership No. F05359 RESPONDENT

Ms. Lee Ho Yee 2ND
Membership No. A13337 RESPONDENT

KL CPA Limited 3RD
Corporate Practice No. M233 RESPONDENT

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

Members: Ms. Queenie Fiona Lau (Chairman)
Ms. Lam Tsoi Maisie
Ms. Law Wing Yee Wendy
Mr. Chan Kin Man Eddie
Mr. Cheung Yat Ming Brian

ORDER & REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the “**Institute**”) against Mr. LAM Chi Ming Francis as the 1st Respondent, Ms. LEE Ho Yee as the 2nd Respondent, both certified public accountants (practising), and KL CPA Limited as the 3rd 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 28 May 2014 (the “**Complaint**”) from the Registrar to the Council of the Institute for consideration of referring the Complaint to the Disciplinary Panels, and which the Respondents have confirmed that they do not dispute (see the letters from each of the Respondents all dated 18 July 2014), are as follows:-

BACKGROUND

*Initial practice review in January 2010 ("**Initial Practice Review**")*

- (1) In January 2010, a practice review was carried out on KL CPA. Amongst the audit clients whose audit files were selected during the review was Code Agriculture (Holdings) Limited (formerly known as China Chief Cable TV Group Limited) ("**Code**") which is incorporated in Bermuda and has its shares listed on the Growth Enterprise Market (stock code 08153) of the Stock Exchange of Hong Kong Limited.
- (2) The Initial Practice Review in its report identified deficiencies in KL CPA's system of quality control and its audit of Code. As a result, the Practice Review Committee ("**PRC**") issued a letter dated 26 March 2010 requiring KL CPA to implement necessary improvement measures ("**Decision Letter**"), which KL CPA undertook to carry out.

*Second review visit in February 2011 and extended follow up visit in August 2011 (together the "**1st Follow Up Visit**")*

- (3) On 21 February 2011, KL CPA was subject to a second review visit to confirm that the remedial actions had been implemented.
- (4) The reviewer reviewed the working papers for KL CPA's audit of the consolidated financial statements for Code and its subsidiaries (the "**Group**") for the year ended 31 March 2010 (the "**2010 Financial Statements**"). The 2010 Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards ("**HKFRS**").
- (5) The auditor report, signed and dated 24 June 2010, stated that the audit was conducted in accordance with the Hong Kong Standards on Auditing ("**HKSA**"). Lam and Lee were the engagement partner and engagement quality control reviewer ("**EQCR**"), respectively.
- (6) The consolidated loss and the consolidated net assets of the Group stated in the 2010 Financial Statements were HK\$290.3 million and HK\$910.2 million, respectively. KL CPA had expressed an unmodified audit opinion on the 2010 Financial Statements.
- (7) In carrying out the review, the reviewer identified repeated and new audit deficiencies that were significant departures from the professional standards. These were contained in the reviewer's report of the 1st Follow Up visit dated 16 June 2011. Despite an extended Follow Up Visit in August 2011 and an opportunity to provide subsequent explanations, the reviewer's conclusion on the audit deficiencies, as contained in a supplemental report dated 9 February 2012, remained unchanged.

Referral to Financial Reporting Council

- (8) Pursuant to its statutory obligations, the Institute referred its concerns over the audit of the 2010 Financial Statements to the Financial Reporting Council ("**FRC**") which directed the Audit Investigation Board ("**AIB**"), in accordance with section 23(3)(b) of the FRC Ordinance, Cap 588, to investigate possible auditing irregularities in relation to KL CPA's audit of the 2010 Financial Statements.
- (9) On 10 December 2012, the AIB sent its draft investigation report to the Respondents for their comments. The Respondents' responses were recorded in the AIB's investigation report (the "**Investigation Report**") which was adopted by the FRC on 28 May 2013.
- (10) The AIB, in its Investigation Report, had concluded that KL CPA had failed or neglected to observe or maintain or otherwise apply professional standards under section 34(1)(a)(vi) of the PAO.
- (11) On 30 May 2013, the FRC referred the Investigation Report together with annexures to the Institute pursuant to section 9(f) of the FRC Ordinance.

Follow up visit in October 2012 (the "2nd Follow Up Visit")

- (12) A follow up visit was conducted on 22 October 2012 and concluded on 9 November 2012, and a report was prepared and sent to KL CPA on 11 November 2013. The report found that there had been little improvement to the KL CPA's system of quality control or its audit of Code.
- (13) In the 2nd Follow Up Visit, the reviewer reviewed the working papers for KL CPA's audit of the consolidated financial statements for the Group for the year ended 31 March 2011 (the "**2011 Financial Statements**"). The 2011 Financial Statements were prepared in accordance with HKFRS. KL CPA conducted the audit in accordance with HKSA and expressed an unmodified audit opinion.

SUMMARY OF PRINCIPAL ISSUES

The Acquisition

- (14) The principal issues concerned the treatment of the Group's acquisition of the entire interest of Kang Yuan Universal Investment Limited ("**Kang Yuan**") and its subsidiary (together "**Kang Yuan Group**") for a consideration of HK\$1,402,544,000 (the "**Acquisition**") in the 2010 Financial Statements and the audit work that was carried out by KL CPA. The total consideration had been satisfied by cash of HK\$304,544,000 and the issue of convertible bonds totalling HK\$1,098,000,000.

The AIB Investigation Report

- (15) The AIB Investigation Report identified significant deficiencies to the audit of the 2010 Financial Statements (the "**Audit**") in the following three areas:

- (i) *Net assets acquired, convertible bonds issued and resulting goodwill acquired in the Acquisition* –
 - a. There had been a failure to plan the Audit with an attitude of professional skepticism as required under HKSA 200.15 and to develop a proper audit plan in accordance with HKSA 300.13/14/22-24;
 - b. There had been a failure to obtain sufficient appropriate audit evidence in accordance with HKSA 500.2 and HKSA 545.3/17 & 63 to support the conclusions reached for the recognition and measurement of the net assets acquired, convertible bonds issued and the resulting goodwill acquired; and for the unmodified audit opinion issued in accordance with HKSA 700.11 & 13; and
 - c. There had been a failure to obtain sufficient appropriate audit evidence in accordance with HKSA 540.2 & 8 in relation to the subsequent measurement of the convertible bonds.
 - (ii) *Impairment assessment of goodwill acquired in the Acquisition and related disclosures* – There had been a failure to obtain sufficient appropriate audit evidence in accordance with HKSA 500.2 and HKSA 545.2 & 8 in relation to the impairment assessment of the goodwill acquired in the Acquisition; and
 - (iii) *Use of the work of an expert* – There had been a failure to obtain sufficient appropriate audit evidence in accordance with HKSA 620.2/8/9/11/12 & 15 when using the work of valuer as audit evidence for the valuation of the convertible bonds issued and of the goodwill acquired.
- (16) The Respondents in their letter dated 18 February 2013 to the FRC denied that their Audit was deficient and sought to rely on additional explanations that were not recorded in the working papers. The AIB considered that such explanations were either unsatisfactory or not supported by any evidence contained in the audit working papers.

The Practice Review Findings

- (17) KL CPA was the subject of three consecutive practice reviews at which, on every occasion, its audit of Code and the Group had been selected for review.
- (18) The deficiencies in the audit of Code and the Group, identified in the AIB Investigation Report, were consistent with those found by the reviewer during the 1st Follow Up Visit. In fact, similar sub standard audit work had been found during the Initial Practice Review and the 2nd Follow Up Visit.
- (19) In its responses to the findings of the practice reviews, KL CPA explained what audit work they had done and/or maintained that adequate audit work had been carried out but had not been documented. However, during its discussions with the reviewer, the audit team had been unable to provide adequate explanations to support a number of their key audit conclusions.

Complaint 1 - KL CPA and the Engagement Director

- (20) As evidenced in the Investigation Report, the non compliances with auditing and accounting standards in KL CPA's audit of the 2010 Financial Statements were so extensive and of such a nature that it called into question if KL CPA and Lam had acted with adequate diligence as required of them under sections 100 and 130 of the Code of Ethics for Professional Accountants ("COE").
- (21) The findings of the two PRC reports prepared for the 1st Follow Up Visit are consistent with and support the findings of the Investigation Report. Further, explanations given by KL CPA during the practice review showed a lack of understanding regarding the audit work that was required.
- (22) In fact, this general lack of understanding regarding the audit work to be carried out was also evident during the Initial Practice Review and subsequently during the 2nd Follow Up visit.
- (23) Alternatively, even if KL CPA and Lam's assertion that they had complied with the necessary audit procedures and obtained sufficient appropriate audit evidence were true (which is disputed), it is clear that they had failed to maintain adequate audit documentation as required under HKSA 230.2. The extent of the missing documentation, by itself, demonstrated a lack of diligence towards HKSA 230.2 such as to amount to a breach of s.130 COE.
- (24) Further, this alleged failure to adequately document audit procedures would have had to occur (if it did occur) despite the clear advice contained in the Initial Practice Review Report:

"The Practice has further explained the audit procedures and assessments performed on some of the findings of selected engagements identified in this practice review and is of the view that those weaknesses are related to insufficient documentation only. During the course of practice review, there was no evidence on file that audit procedures and assessments had been undertaken by the engagement team and how they arrived at certain conclusions. The engagement teams were unable to explain those procedures and assessments persuasively to the practice review team. QAD would like to emphasize that it is crucial for the engagement teams to properly document audit procedures and assessments performed in the work papers in order to evidence that the audit was performed in accordance with professional standards." (Underline added)

- (25) In fact, KL CPA continued to rely on a lack of audit documentation to explain apparent deficiencies in audit work identified during the 2nd Follow Up Visit.

Complaint 2 - The Engagement Quality Control Reviewer

- (26) In the Investigation Report, the AIB recorded that it could not find any evidence in the Audit Working Papers which indicated that Lee as the Engagement Quality Control Reviewer ("EQCR") of KL CPA had performed and completed an engagement quality

control review before KL CPA issued its auditor's report on the 2010 Financial Statements.

- (27) In a written response dated 23 July 2013 to the Institute, Lee (who had been the engagement director for the previous year's audit) confirmed that she was the EQCR of the Audit of the 2010 Financial Statements but denied that she had failed to properly perform her duties in accordance with HKSA 220.38 & 39.
- (28) Lee asserted that she had performed a review of the Audit though there is no documentation in support. In particular, she asserted that she had performed the following:
- (i) Assessing the independence of the practice and the audit team;
 - (ii) Discussing significant matters with the engagement director;
 - (iii) Reviewing the financial statements including the adequacy of disclosures, and whether the proposed audit report was appropriate;
 - (iv) Reviewing the adequacy of planned responses to engagement risks, and the suitability of criteria used for evaluating the subject matter;
 - (v) Reviewing the results of the audit work, the appropriateness of key judgements and in particular, those made in high risk areas, and the appropriateness of consultation on difficult or contentious issues;
 - (vi) Reviewing selected working paper file documentation relating to significant judgements and conclusions made by the audit team; and
 - (vii) Considering whether the documentation reviewed and discussions held support the audit conclusion and the content of the audit report.
- (29) There was no documentation to support Lee's assertions that she had performed these steps. In fact, given the unsatisfactory explanations given by Lam, the engagement director, to the reviewer during the Follow Up visit and Extended Follow Up Visit, it is unclear how she would have been satisfied with her engagement quality control review.

Complaint 3 – Professional misconduct

- (30) Given that the non compliances by KL CPA and Lam with auditing and accounting standards in KL CPA's audit of the 2010 Financial Statements were so extensive and of such a nature and that Lee had been unable to identify and correct the non compliances even though they had been brought to her attention several times, KL CPA, Lam and Lee were all guilty of professional misconduct under the PAO.

RELEVANT PROFESSIONAL STANDARDS AND STATUTORY PROVISION

- (31) COE (effective on 30 June 2006) provides as follows:

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

...

- (c) *Professional Competence and Due Care*
A professional accountant has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or

employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable 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."

(32) COE (effective on 1 January 2011) provides as follows:

"100.5 A professional accountant shall comply with the following fundamental principles:

...

(c) Professional Competence and Due Care - to maintain professional knowledge and skill at a level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

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

(33) HKSA 220 (effective for audits of historical financial information for periods beginning on or after 15 June 2005) provides as follows:

"38. An engagement quality control review should include an objective evaluation of:

(a) The significant judgments made by the engagement team; and

(b) The conclusions reached in formulating the auditor's report.

39. An engagement quality control review ordinarily involves discussion with the engagement partner, a review of the financial information and the auditor's report, and, in particular, consideration of whether the auditor's report is appropriate. It also involves a review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions they reached. The extent of the review depends on the complexity of the audit engagement and the risk that the auditor's report might not be appropriate in

the circumstances. The review does not reduce the responsibilities of the engagement partner.

40. *An engagement quality control review for audits of financial statements of listed entities includes considering the following:*
- *The engagement team's evaluation of the firm's independence in relation to the specific audit engagement.*
 - *Significant risks identified during the engagement (in accordance with HKSA 315, "Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement"), and the responses to those risks (in accordance with HKSA 330, "Auditor's Procedures in Response to Assessed Risks"), including the engagement team's assessment of, and response to, the risk of fraud.*
 - *Judgments made, particularly with respect to materiality and significant risks.*
 - *Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.*
 - *The significance and disposition of corrected and uncorrected misstatements identified during the audit.*
 - *The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.*
 - *Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.*
 - *The appropriateness of the auditor's report to be issued.*

Engagement quality control reviews for audits of historical financial information other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations."

(34) Section 34 of PAO provides that:

"(1) A complaint that-
(a) a certified public accountant-
...
(viii) has been guilty of professional misconduct;
...
shall be made to the Registrar who shall submit the complaint to the Council which may, in its discretion but subject to section 32D(7), refer the complaint to the Disciplinary Panels."

THE COMPLAINTS

1st Complaint

- (35) Section 34(1)(a)(vi) of the PAO applies to KL CPA and Lam in that they had failed or neglected to observe, maintain or otherwise apply a professional standard namely sections 100.4 and 130.1 of the COE in performing the Audit.

2nd Complaint

- (36) Section 34(1)(a)(vi) of the PAO applies to Lee in that she failed to or neglected to observe, maintain or otherwise apply a professional standard namely HKSA 220.38/39/40 when she performed an engagement quality control review of the Audit.

3rd Complaint

- (37) Section 34(1)(a)(viii) of the PAO applies to KL CPA, Lam and Lee in that they had been guilty of professional misconduct when KL CPA and Lam performed the Audit, and when Lee performed the engagement quality control review of the Audit.

THE PROCEEDINGS

3. On 21 July 2014, the Respondents admitted the complaints against them. They did not dispute the facts as set out in the complaints. The parties agreed that the steps set out in paragraphs 17 to 30 of the Disciplinary Committee Proceedings Rules be dispensed with.
4. On 9 October 2014, the Disciplinary Committee informed the parties that they should make written submissions on sanctions and costs.
5. By letters dated 29 October 2014 from each of: (1) the Complainant; (2) the 1st Respondent; and (3) the 2nd and 3rd Respondents, the parties have made submissions on sanctions and costs.

THE SANCTIONS

6. In arriving at the proper sanctions to be imposed on the Respondents, the Disciplinary Committee has had regard to the following facts and matters specific to this case:
 - (i) The Complaint concerns an audit company which is listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited. Whilst the Disciplinary Committee is not aware of anyone coming forward with a claim for damages as a result of the Respondents' transgressions, the Disciplinary Committee does not lose sight of the need to safeguard the public interest which is often unmeasured in monetary terms.
 - (ii) In its responses to the findings of the practice reviews, the 3rd Respondent had, *inter alia*, maintained that adequate audit work had been carried out though not documented, and had sought to rely on a lack of audit documentation to explain apparent deficiencies in audit work identified. Further, explanations given by the 3rd Respondent during the Initial Practice Review and during the 2nd Follow Up evidence showed a lack of understanding regarding the audit work that was required.

- (iii) The 2nd Respondent had in her written response dated 23 July 2013 to the Institute denied that she had failed to properly perform her duties in accordance with HKSA 220.38 and 39, and had asserted that she had performed a review of the Audit although there was no documentation in support.
 - (iv) The Respondents failed to address the audit deficiencies after the Practice Review. As stated above, during the 1st Follow Up Visit (which was in February and August 2011 respectively), the reviewer identified repeated and new audit deficiencies that were significant departures from the professional standards. Further, during the 2nd Follow Up Visit on 22 October 2012, over a year after the 1st Follow Up Visit, the reviewer found that there had been little improvement to the KL CPA's system of quality control or its audit of Code.
 - (v) All three Respondents have admitted the Complaint at an early stage. They have also ceased to perform audits for listed companies.
 - (vi) There is no evidence showing that in carrying out the audit work that is the subject of the Complaint, the Respondents were dishonest.
7. In considering the proper order to be made in this case, the Disciplinary Committee has had regard to all the aforesaid matters, including the particulars in support of the Complaint, the Respondents' personal circumstances, the parties' submissions, the 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.
 8. In respect of the 1st and 2nd Respondents, we are of the view that the following sentence and sanctions are appropriate:
 - (1) the practising certificates issued to the 1st and 2nd Respondents (if any) be cancelled 40 days from the date of this order under Section 35(1)(da) of the PAO;
 - (2) a practising certificate shall not be issued to each of the 1st and 2nd Respondents for a period of 24 months from the date of this order, or the date of expiry of the 1st and 2nd Respondents' presently held practising certificates (if earlier than the period of 40 days referred to in sub-paragraph (1) above), or the date that the 1st and 2nd Respondents' practising certificates are cancelled under sub-paragraph (1) above, whichever is later, under section 35(1)(db) of the PAO;
 9. We are of the view that the 3rd Respondent ought to be reprimanded under Section 35(1)(b) of the PAO.
 10. As to the quantum of costs, the Complainant has provided a Statement of Costs dated 29 October 2014 totalling HK\$247,074.60. Of the costs set out in the aforesaid Statement of Costs, the sum of HK\$226,234.60 are the costs incurred by the Financial Reporting Council.

11. The Disciplinary Committee bears in mind the following extracts from paragraph 70 of the Guidelines for the Chairman and the Committee Administering the Disciplinary Committee Proceedings Rules:

"(1) Save where there is good reason to do otherwise, the Committee should award costs to the successful party in the proceedings.

...

(3) The starting point in any award of costs should be the actual costs (i.e. indemnity costs) incurred by the successful party, subject to the Committee being satisfied that the actual costs were reasonably and necessarily incurred. The Committee may reduce the amount awarded to the extent it considers costs to have been incurred unnecessarily or extravagantly. In deciding what reduction is reasonable, the Committee may consider being guided by the practices of the courts in civil proceedings..."

12. Pursuant to Section 35(1)(d)(ii) of the PAO, *"where the disciplinary proceedings were instituted as a result of an investigation under the Financial Reporting Council Ordinance (Cap 588), pay to the FRC the sum the Disciplinary Committee considers appropriate for the costs and expenses in relation or incidental to the investigation reasonably incurred by the FRC"*.

13. Having considered the Statement of Costs dated 29 October 2014, the Disciplinary Committee is of the view that the sum of HK\$247,074.60 incurred was reasonably and necessarily incurred.

14. The Disciplinary Committee orders that:-

- (1) the practising certificates issued to the 1st and 2nd Respondents (if any) be cancelled 40 days from the date of this order under Section 35(1)(da) of the PAO;
- (2) a practising certificate shall not be issued to each of the 1st and 2nd Respondents for a period of 24 months from the date of this order, or the date of expiry of the 1st and 2nd Respondents' presently held practising certificates (if earlier than the period of 40 days referred to in sub-paragraph (1) above), or the date that the 1st and 2nd Respondents' practising certificates are cancelled under sub-paragraph (1) above, whichever is later, under section 35(1)(db) of the PAO;
- (3) the 3rd Respondent be reprimanded under Section 35(1)(b) of the PAO;
- (4) the Respondents are jointly and severally liable to pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK\$247,074.60 under Section 35(1)(iii) of the PAO.

Dated the 8th day of January 2015