

Exchange of Hong Kong Limited. The trading of the Company's shares was suspended on 12 September 2007. The Company was wound up by a court order in May 2011 and subsequently delisted on 4 January 2012.

- (2) Baker Tilly Hong Kong Limited ("**BTHK**") audited the financial statements of the Company and its subsidiaries (collectively "**Group**") for the years ended 31 May 2006 ("**2006 Financial Statements**") and 31 May 2007 ("**2007 Financial Statements**"). Mr. Au Yiu Kwan ("**Au**") is a former director of BTHK who was substantially involved in the audit of the 2006 Financial Statements¹ based on the totality of facts available (the "**2006 Audit Team**").
- (3) The 2006 and 2007 Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards ("**HKFRS**") issued by the Hong Kong Institute of Certified Public Accountants. The auditor's reports on these financial statements issued by BTHK stated that the audits were conducted in accordance with the Hong Kong Standards on Auditing ("**HKSA**") issued by the Institute.
- (4) BTHK expressed an unmodified opinion in the auditor's report on the 2006 Financial Statements dated 21 September 2006.
- (5) The 2007 Financial Statements were audited by a different team of BTHK (the "**2007 Audit Team**"). In the auditor's report on the 2007 Financial Statements dated 26 October 2007, BTHK did not express an opinion on whether the financial statements gave a true and fair view in accordance with HKFRS. One of the reasons was that BTHK were unable to obtain the necessary information to satisfy themselves that certain sales transactions of the Group's trading operations, their related costs and gross profit, or the appropriate provision made for the associated outstanding balances were fairly stated. Similar sales transactions existed in the 2006 Financial Statements.
- (6) In addition, in the 2007 Financial Statements, the Company recognized significant amounts of impairment losses on intangible assets, available-for-sale financial assets, other receivables and promissory notes.
- (7) On 20 July 2016, the Financial Reporting Council ("**FRC**") referred to the Institute a report of the Audit Investigation Board ("**AIB**") dated 2 June 2016 pursuant to section 9(f) of the FRC Ordinance, Cap.588.
- (8) The AIB found auditing irregularities in relation to BTHK's 2006 audit in respect of certain sales and purchase transactions and the impairment assessment of the following assets:
 - (i) intangible assets;
 - (ii) available-for-sale financial assets;
 - (iii) other receivables; and
 - (iv) promissory notes.

¹ Mr. Chan Cheuk Chi is a former director of BTHK who issued the auditor's report as the engagement director for the 2006 audit. He is currently not a certified public accountant.

- (9) In their representations to both the FRC and the Institute, BTHK asserted that they had carried out their responsibilities to provide an appropriate supervisory framework for audits conducted by its personnel. The actual conduct and quality control of an audit under the relevant auditing standards were the responsibility of the engagement director and the engagement quality control reviewer ("**EQCR**"). BTHK should not be responsible for the audit deficiencies as alleged in the AIB report.
- (10) In addition, BTHK submitted to the FRC that Au undertook the partner's role to review the audit documentation and to supervise the engagement team. It was a practising director, Mr. Chan Cheuk Chi ("**Mr. Chan**"), who undertook the role of EQCR and signed the auditor's report for the 2006 Financial Statements.
- (11) According to Au, he was only responsible for reviewing the audit files prepared by the engagement team before the files were submitted to Mr. Chan for review and sign off as the engagement partner. There was no EQCR in the 2006 audit.

THE COMPLAINTS

First Complaint

- (12) Section 34(1)(a)(vi) of the PAO applies to BTHK in that, as the auditor of the 2006 Financial Statements, they failed or neglected to observe, maintain or otherwise apply the following professional standards in the audit:
- (a) Paragraph 6 of HKSA 200 *"Objectives and General Principles Governing an Audit of Financial Statements"*; and/or
 - (b) Paragraph 24 of HKSA 240 *"The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements"*; and/or
 - (c) Paragraph 2 of HKSA 500 *"Audit Evidence"*; and/or
 - (d) Paragraphs 2, 8, 10 and 19 of HKSA 540 *"Audit of Accounting Estimates"*; and/or
 - (e) Paragraph 3 of HKSA 545 *"Auditing Fair Value Measurements and Disclosures"*; and/or
 - (f) Paragraph 2 of HKSA 550 *"Related Parties"*; and/or
 - (g) Paragraph 12 of HKSA 620 *"Using the Work of an Expert"*.

Second Complaint

- (13) Section 34(1)(a)(vi) of the PAO applies to Au for having failed or neglected to observe, maintain or otherwise apply a professional standard namely, section 100.4(c) as elaborated in section 130.1 of the Code of Ethics for Professional Accountants ("**COE**") for failure to diligently carry out the audit of the 2006

Financial Statements, in accordance with the relevant technical and professional standards.

Third Complaint

- (14) Section 34(1)(a)(vi) of the PAO applies to BTHK in that they failed or neglected to observe, maintain or otherwise apply Hong Kong Standard on Quality Control 1 "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements" ("HKSQC 1") because the policies and procedures to ensure an independent EQCR had been appointed and/or an objective engagement quality control review had been performed in the audit of a listed entity were inadequate.

SUMMARY OF PRINCIPAL ISSUES

In respect of First Complaint

- (15) It was found that some of the transactions in the 2006 Financial Statements contain indent sales and purchase transactions ("re-invoicing" transactions) that are similar in nature to those which were the subject matter of qualification by the 2007 Audit Team as stated in their auditor's report on the 2007 Financial Statements.
- (16) The 2006 working papers show that the 2006 Audit Team had failed to exercise sufficient professional skepticism and perform adequate procedures to obtain sufficient appropriate audit evidence to ascertain whether the associated sales recognition was in compliance with HKAS 18 "Revenue".
- (17) The 2007 Financial Statements disclosed that the Group had recognized impairment losses on the following assets:
- (i) intangible assets;
 - (ii) available-for-sale financial assets;
 - (iii) other receivables; and
 - (iv) promissory notes.
- (18) The impairment losses on intangible assets of HK\$215.3 million recognized in the 2007 Financial Statements included the carrying amounts of trademarks, goodwill and know-how in the aggregate amount of HK\$210.7 million as at 31 May 2006.
- (19) The impairment losses on available-for-sale financial assets of HK\$206.4 million recognized in the 2007 Financial Statements included investments with an aggregate carrying amount of HK\$206.4 million as at 31 May 2006.
- (20) The impairment losses on other receivables of HK\$265.7 million recognized in the 2007 Financial Statements included escrow monies paid for a proposed investment amounted to HK\$111.5 million as at 31 May 2006.

- (21) The impairment losses on promissory notes of HK\$736.3 million recognized in the 2007 Financial Statements included promissory notes brought forward from 2006. At 31 May 2006, the carrying amount of the outstanding promissory notes held by the Group amounted to HK\$986.3 million.
- (22) The 2006 audit working papers show that the audit procedures performed on the above assets were inadequate for the purpose of obtaining sufficient appropriate audit evidence to support whether impairment losses should have been recognized in the 2006 Financial Statements.
- (23) Based on the above, the Institute concurred with the AIB report that in its audit of the 2006 Financial Statements, BTHK failed to comply with the following HKSA:
- (a) Paragraph 6 of HKSA 200; and/or
 - (b) Paragraph 24 of HKSA 240; and/or
 - (c) Paragraph 2 of HKSA 500; and/or
 - (d) Paragraphs 2, 8, 10 and 19 of HKSA 540; and/or
 - (e) Paragraph 3 of HKSA 545; and/or
 - (f) Paragraph 2 of HKSA 550; and/or
 - (g) Paragraph 12 of HKSA 620.

In respect of Second Complaint

- (24) Au denied that he was the engagement partner responsible for the audit of the 2006 Financial Statements. Au claimed that he worked under the supervision of Mr. Chan who signed the auditor's report.
- (25) Notwithstanding, Au admitted that he was also responsible for reviewing the audit files prepared by the engagement team and the working papers show evidence of his reviews.
- (26) There is no evidence of any review by Mr. Chan in the working papers and in the "Audit Planning Memorandum". By contrast, Mr. Au had signed on the "Audit Planning Memorandum" to indicate his approval and his initial could also be found in the working papers. In BTHK's submission to the FRC, they confirmed that Au undertook the partner's role to review the audit documentation and to supervise the 2006 Audit Team.
- (27) As a senior member of the 2006 Audit Team who played a substantial role in the audit of the 2006 Financial Statements, Au failed to ensure that sufficient appropriate audit procedures had been carried out and sufficient evidence had been obtained in accordance with the aforementioned HKSAs. Consequently, Au failed to act diligently in accordance with section 100.4(c) as elaborated in section 130.1 of the COE.

In respect of Third Complaint

- (28) Paragraph 3 of HKSQC 1 requires a practice to have a system of quality control designed to provide it with reasonable assurance that the practice and its personnel comply with professional standards, and that reports issued by the practice or engagement partners/directors are appropriate in the circumstances.
- (29) Paragraph 60 of HKSQC 1 further states that a practice should establish policies and procedures requiring an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures should require an engagement quality control review for all audits of financial statements of listed entities.
- (30) The working papers do not show any documentation in relation to the work performed by the EQCR for the 2006 audit. According to BTHK, the engagement partner who signed the auditor's report for the 2006 Financial Statements undertook the role of EQCR for the 2006 audit. If the roles of engagement partner and the EQCR were performed by the same individual as indicated by BTHK, it raised doubts as to whether the EQCR could provide an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in the auditor's report. However, as opposed to BTHK, Au claimed that there was no EQCR being appointed in the 2006 audit.
- (31) In view of the contradictory claims between BTHK and Au, it also raised serious doubt as to whether BTHK's system of quality control could have provided any reasonable assurance that the practice and its personnel would comply with professional standards or that the auditor's reports issued would be appropriate. The lack of documentary evidence regarding the work of EQCR indicated that BTHK failed to establish an effective policy to ensure an engagement quality control review on the Company had been performed.
- (32) Based on the above, it is considered that BTHK failed to comply with paragraphs 3 and 60 of HKSQC 1.

The Proceedings

3. By letters dated 7 December 2017, the First Respondent admitted the First and Third Complaints against it and the Second Respondent admitted the Second Complaint against him. The Parties agreed that the steps set out in Rules 17 to 30 of the Disciplinary Committee Proceedings Rules ("DCPR") be dispensed with.
4. By letter from the Clerk to the Disciplinary Committee (under the direction of the Disciplinary Committee) to the parties dated 27 December 2017, the parties were informed that the Disciplinary Committee had approved their joint

application to dispense with the steps set out in Rules 17 to 30 of the DCPR in light of the admission made by the Respondents and directed the parties to make written submissions on sanctions and costs by 24 January 2018.

5. The Complainant provided his written submissions on sanctions and costs on 24 January 2018 while the Respondents provided their written submissions on sanctions and costs on 7 February 2018 after the Disciplinary Committee acceded to their request for a two-week time extension.
6. Mr. Wan Chuck Fan, David stepped down as a member of the Disciplinary Committee upon expiry of his appointment to the Disciplinary Panel A on 31 January 2018. Accordingly, Mr. Wan ceased to be a member of the Disciplinary Committee with effect from 1 February 2018. On 29 January 2018, the parties were asked if they had any objection to the disciplinary proceedings being dealt with in the absence of one member of the Disciplinary Committee. The Complainant and the Respondents confirmed in reply correspondence that they had no objection for the disciplinary proceedings to be dealt with by the remaining four members of the Disciplinary Committee.
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 Complaints and the Respondents' conduct throughout the proceedings, and the respective written submissions of the Complainant and the Respondents. This Committee has taken note of the following:

(i) In so far as the First Respondent is concerned:

- a) The First Complaint. The First Respondent admitted this Complaint, which concerns its failure or neglect, as auditor of the 2006 Financial Statements, to observe, maintain or otherwise apply seven auditing standards which are listed in paragraphs 2 (15) – (23) above. We agree with the Complainant's submissions that the failures arose from inadequate audit procedures performed in five audit areas which were material to the 2006 Financial Statements, and that there was also a failure to exercise sufficient professional skepticism in the audit of sales, which not only is material in amount, but has a pervasive effect in the overall 2006 Financial Statements. It is clear that insufficient appropriate audit evidence was obtained to support the First Respondent's unmodified opinion on the 2006 Financial Statements.
- b) The Third Complaint. The First Respondent admitted this Complaint, which concerns its failure or neglect to observe, maintain or otherwise apply HKSQC 1. We agree with the the Complainant's submissions that there was no evidence that an independent engagement quality control review was carried out in the 2006 Financial Statements, as required under HKSQC 1.

- c) In general, we accept the Complainant's submissions that in view of the multiple audit deficiencies and the public interest involved (which we would like to emphasize, given the Company was then a publicly listed company), the breaches by the First Respondent in this case are serious. On the other hand, we note, and have taken into account, that subsequently, the First Respondent has taken steps to improve its system of quality control, specifically by developing and installing a new electronic audit platform and control system with a view to prevent such issues from arising again.

(ii) In so far as the Second Respondent is concerned:

- a) The Second Complaint. The Second Respondent admitted this Complaint, which concerns a failure or neglect to observe, maintain or otherwise apply the auditing standards mentioned in the First Complaint when carrying out the audit of the 2006 Financial Statements.
- b) We note that while the Second Respondent denied that he was the engagement director or the EQCR for the 2006 audit, there is no dispute that (i) he was then a director of the First Respondent and (ii) he played a substantial role in the 2006 audit in that he was responsible for reviewing the audit documentation and supervising the audit team. We agree with the Complainant's submissions that the multiple breaches of auditing standards in this case demonstrate that the level of supervision and work performed by the Second Respondent fell below the level of competency and due care as expected of a CPA who was a senior member of the audit team.

8. In light of the above matters, having considered sanctions that are commensurate with the deficiencies identified in the Complaints, the Respondents' early admission and cooperation in these proceedings, the seriousness of the case, the objective of maintaining the public reputation of the profession, the culpability of each Respondent, and the submissions respectively made by the Complainant and the Respondents, the Disciplinary Committee ORDERS that:-

- (a) the Respondents be reprimanded under Section 35(1)(b) of the PAO;
- (b) the First Respondent pay a penalty of HK\$250,000 under Section 35(1)(c) of the PAO;
- (c) the Second Respondent pay a penalty of HK\$100,000 under Section 35(1)(c) of the PAO;

- (d) the Respondents do pay jointly and severally:
- (i) the costs and expenses of and incidental to the proceedings of the Complainant and the Clerk to the Disciplinary Committee in the total sum of HK\$62,045 (being the total of (a) the Complainant's costs of HK\$56,897 and (b) the Clerk to the Disciplinary Committee's costs of HK\$5,148) under Section 35(1)(iii) of the PAO; and
 - (ii) the costs and expenses in relation to the investigation incurred by the Financial Reporting Council in the sum of HK\$94,624.90 under Section 35(1)(d)(ii) of the PAO.

Dated 24 May 2018

Mr. WONG Wing Yan, Kenneth
(Chairman)
Disciplinary Panel A

Miss LEE Wai Fun
Disciplinary Panel A

Mr. ESPINA Anthony Joseph
Disciplinary Panel B

Ms. LEUNG Chi Ying
Disciplinary Panel B