Proceedings No.: D-10-0492C

IN THE MATTER OF

A Complaint 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	
The Respondent	RESPONDENT

Before a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants ("**the Institute**")

Members:

Date of Hearing: 29 November 2011

REASONS FOR DECISION

The complaint

1. The complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants against the Respondent, a certified public accountant, is as follows:-

   Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he had failed or neglected to observe, maintain or otherwise apply a professional standard namely the Fundamental Principles set out in the then Statement 1.200 "Professional Ethics – Explanatory Foreword" by conniving in a scheme to provide false and misleading information to the Securities and Futures Commission ("**SFC**") on the level of liquid capital maintained by [Company S] and [Company Y].

2. Statement 1.200 "Professional Ethics – Explanatory Foreword", as then in force, was as follows:-

"The following are the Fundamental Principles on which the ethical guidance of the Hong Kong Society of Accountants is based:-

...

4. A member should follow the ethical guidance of the Society and in circumstances not provided for by that guidance should conduct himself in a manner consistent with the good reputation of the profession and the Society."

The factual background

3. The complaint arises following the decision of the Securities and Futures Appeals Tribunal ("**SFAT**") to uphold the SFC's suspension of the Respondent, together with [Mr. C] and [Mr. K], for the Respondent's involvement in an accounting scheme which resulted in inflated amounts of liquid capital of [Company S] and [Company Y] in their financial returns submitted to the SFC.

4. In 1995, [Company S] was registered with the SFC as a dealer. In about October 2000, [Company Y] was registered with the SFC as a securities margin financier. At the material times, both [Company S] and [Company Y] were under a statutory duty to provide the SFC with monthly returns that would include, inter alia, information regarding their liquid capital.

5. [Company S], [Company Y] and [Company F] belonged to a group of companies under the control of their holding company, [Company U]. [Company F] was a licensed money lender.

6. [Mr. C] was the group financial controller of [Company U] and its subsidiaries including [Company S] and [Company Y]. The Respondent was a director of [Company S] and [Company U], and was in charge of compliance matters of [Company S] and [Company Y].

7. In 2000, [Mr. C] obtained the approval of [Company S] and [Company Y] to regularly transfer funds from [Company S] to [Company Y] and [Company F], and from [Company Y] to [Company F], to provide funding for [Company F]. The transfer-out from [Company S] and [Company Y] were recorded in their respective books as inter-group company loans. Cheques were drawn on the accounts of [Company F] and [Company Y] for the benefit of [Company S] and [Company Y] as repayment of loans.

8. However, [Company S] and [Company Y], under the supervision and control of [Mr. C], did not present those cheques when they were received, although [Mr. C] caused certain entries to be made on their respective books to the effect the cheques had already been deposited into their respective bank accounts. The bank accounts balances of [Company S] and [Company Y] were taken into account in their report of their amounts of liquid capital to the SFC. When those cheques were eventually deposited a few days later, [Mr. C]

caused [Company S] and [Company Y] to make another round of transfers-out in almost the same amounts as those deposited as new inter-group company loans.

9. The accounting treatment of the cheques is hereinafter referred to as the "**Accounting Treatment**" and the whole arrangement is hereinafter referred to as the "**Arrangement**".

10. The amounts of liquid capital reported by [Company S] as at 30 April 2002, 15 May 2002 and 30 June 2002 were $17,827,000.00, $22,425,000.00 and $26,502,000.00 respectively, while the amounts of liquid capital that [Company S] actually had at these dates were $3,827,000.00, $7,425,000.00 and $4,202,000.00 respectively. As for [Company Y], the amounts of liquid capital reported as at 30 November 2002, 31 December 2002 and 2 January 2003 were $16,149,000.00, $15,267,000.00 and $7,086,000.00 respectively, whereas the amounts of liquid capital that [Company Y] actually had at these dates were $6,149,000.00, $1,067,000.00 and a negative balance of $7,114,000.00 respectively.

11. Further, on 31 December 2002 and 2 January 2003, [Company Y] did not have sufficient liquid capital as required by the Financial Resources Rules as was then in force ("**FRR**"). Section 6 of the FRR required [Company S] and [Company Y] to maintain liquid capital of no less than $3,000,000.00. However, [Company Y] only reported to the SFC its shortfall in liquid capital by letter dated 14 March 2003.

12. In the end of the Brief Statement of Facts to be Admitted ("**Admitted Facts**") as signed by the Respondent for submission to the SFC, in relation to circumstances as set out in paragraphs 4 to 11 above, it was stated that :-

"*Despite his duties on compliance matters, the Respondent did nothing to stop* ([Mr. C]) *but connived in what he was doing.*"

13. SFC disciplinary proceedings were brought against the Respondent, together with [Mr. C] and [Mr. K], with different periods of suspension imposed on them by the SFC. The three appealed to the SFAT. The SFAT upheld the SFC's decision but reviewed the sanctions imposed on them. The period of suspension imposed on the Respondent was reduced from 4 months to 3 months.

The Financial Resources Rules

14. Section 4(1) of the FRR provided that:-

> "*(1) For the purposes of these Rules, a registered person* (that is, including a dealer and a securities margin financier) *shall calculate all assets and liabilities in accordance with generally accepted accounting principles unless otherwise specified.*"

15. Section 12 of the FRR provided that :-

"The following items shall be included in the liquid assets of a dealer or securities margin financier provided he is the beneficial owner thereof and holds them directly in his own name-
(a) cash in hand;
(b) money which is held on account with an authorized institution or an approved bank formed or established outside Hong Kong, as follows-
(i) demand deposits;
(ii) time deposits which will mature in 6 months or less;
(ii) accrued interest on time deposits maturing in 3 months or less."

The Respondent's case

16. The Respondent's main defence was that he had been acting in line with reasonable standards and due care and diligence of a professional accountant.

17. The Respondent submitted that the SFC seemed to suggest that an undeposited cheque should not be included as liquid assets because it did not fall within section 12 of the FRR. The Respondent submitted that section 12 of the FRR only stated what should be included but it did not state what could not be included.

18. The Respondent argued that as cheques drawn by [Company F] were all within its credit facilities and were deposited into [Company Y] and [Company S] bank accounts with no undue delay, which in most cases deposit was effected from within a few days up to 2 weeks and was never more than one month ("**the deferred deposit period**"), the cheques were far more liquid than immature deposits or accrued interest as referred to in section 12(b)(ii) and (iii) of the FRR.

19. The Respondent further asserted at the hearing before the Disciplinary Committee ("**DC**") that there was bank confirmation that the cheques in question could be cashed at anytime by [Company S] and [Company Y] during the deferred deposit period.

20. It was submitted by the Respondent that the Arrangement was for a real economic benefit of interest saving for the whole group, and that he had been acting in good faith and consistently in applying the defined basis adopted by the relevant companies in discharging his duty as a compliance officer for the relevant companies.

21. Whether the Accounting Treatment and the Arrangement were in accordance with the FRR or otherwise were questions for the SFC and the SFAT. What the DC needs to determine is whether the Respondent had failed or neglected to observe, maintain or otherwise apply a professional standard as set out in the complaint at paragraph 1 above.

22. The Respondent defended his case by asserting that he exercised his professional judgment in a reasonable manner and honestly believed that the Accounting Treatment was in accordance with the market practice at the

material times when the Arrangement was implemented. However, based on the facts before the DC, the level of liquid capital of [Company S] and [Company Y] were overstated and furthermore, there were breaches by [Company Y] of the FRR. Whilst the Respondent had knowledge of the Accounting Treatment and the Arrangement, despite his duty as a compliance officer, he did nothing to stop the Accounting Treatment and the Arrangement.

23. Whilst there could possibly be commercial benefit, that is interest saving, behind the Accounting Treatment, consideration of commercial benefit should not override the Respondent's duty as a compliance officer.

Connivance

24. In respect of the Accounting Treatment and the Arrangement, it was admitted by the Respondent in the Admitted Facts that:-

"[Mr. K] knew what [Mr. C] was doing but he failed to stop [Mr. C]. Despite his duties on compliance matters, the Respondent did nothing to stop [Mr. C] but connived in what he was doing."

25. The Complainant submitted that the word "connived" denoted a participation in a conspiracy to allow an illegal, immoral or harmful act to occur and it could not have been intended to denote an innocent act or mere oversight. The Complainant further pointed out that the Respondent, having been advised by his legal advisor when he signed the Admitted Facts, should understand the meaning of the word and its effect.

26. At the hearing, the parties disputed over the meaning of the word "connived". The Respondent submitted that the word "connived" should not mean participation in a conspiracy to allow an illegal, immoral or harmful act to occur.

27. We take the view that the Respondent, as a professional accountant and had the benefit of legal advice before signing the Admitted Facts, should well understand the meaning of the word and its effect. Furthermore, even if the interpretation of the word "connived" as submitted by the Complainant is not to be accepted, when we consider the whole circumstances of the complaint rather than a single word, what matters is the knowledge of the Respondent of the Accounting Treatment and the Arrangement, and with such knowledge he did not do anything to stop such Accounting Treatment and Arrangement.

Conclusion

28. There is no dispute that, on the facts, false and misleading information were supplied to the SFC on the level of liquid capital maintained by [Company S] and [Company Y]. The FRR returns submitted by [Company S] and [Company Y] had grossly overstated the liquid capital positions and that in the case of [Company Y], there had been 2 instances of breaches of the FRR. The Respondent was responsible for the submission of those returns by virtue of his position as a director of [Company S] and as compliance officer for [Company S] and [Company Y]. The Respondent, despite his compliance duties and his knowledge of the Arrangement, did nothing to stop the Arrangement.

29. Having carefully considered all the submissions and papers, including all oral submissions and papers at the hearing, by the Complainant and the Respondent and by reason of all the aforesaid, the DC unanimously found that the Respondent had failed or neglected to observe, maintain or otherwise apply a professional standard namely the Fundamental Principles set out in the then Statement 1.200 "Professional Ethics – Explanatory Foreword".

Costs

30. Turning to the issue on costs, the Respondent had objected to the total costs of HK$97,643.00 of the Complainant, as set out in the Statement of Costs of the Complainant, on the grounds that:-

    (a) The actual hearing time is less than the estimated time in the said Statement of Costs; and

    (b) The Respondent noticed one person, presumably [a Deputy Director], assisting the Complainant's representative [the Legal Counsel] during the hearing and as such, the Respondent questioned the Complainant's charging of [an Associate Director]'s time in attending the hearing.

31. In response, the Complainant submitted by letter dated 19 December 2011 a revised total of the Statement of Costs of HK$85,643.00 (inclusive of the cost for the time by [the Associate Director] in attending the hearing), taking into account the actual hearing time of 5 hours. The Complainant also confirmed that [the Associate Director] was the case handler of this complaint and she attended the full duration of the hearing, which was of 5 hours at the hourly rate of HK$1,200.00 adding up to the total sum of HK$6,000.00.

32. In the DC's view, the charging of the time at the hearing by both [the Legal Counsel] and [the Deputy Director] on behalf of the Complainant was reasonably and necessarily incurred, and was sufficient for the purpose of the hearing of this complaint. Even though [the Associate Director] attended the hearing, the DC has decided not to award to the Complainant the cost of [the Associate Director]'s time in attending the hearing. The DC accordingly reduces the Complainant's costs from HK$85,643.00 to HK$79,643.00, a reduction of HK$6,000.00 in respect of [the Associate Director]'s time in the hearing.

Sanction and Order

33. 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, and the conduct of the Complainant and the Respondent throughout the proceedings.

34. The DC orders that:-

    1) The Respondent be reprimanded under Section 35(1)(b) of the PAO;

    2) The Respondent do pay a penalty of HK$70,000.00 under Section 35(1)(c) of the PAO; and

    3) The Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK$79,643.00 under Section 35(1)(iii) of the PAO.

Dated the 17th day of January 2012

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BETWEEN

The Registrar of the Hong Kong Institute of Certified Public Accountants — COMPLAINANT

AND

The Respondent — RESPONDENT

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

Members:

Date of Hearing: 29 November 2011

ORDER

UPON reading all the submissions and papers, including all submissions and papers presented at the hearing, by the Complainant and the Respondent

AND UPON hearing the representative of the Complainant and the Respondent appearing in person

AND UPON reading the Statement of Costs of the Complainant dated 29 November 2011, the Respondent's submissions on costs by letter dated 12 December 2011 and the Complainant's further submissions on costs by letter dated 19 December 2011

IT IS ORDERED that:-

1. the Respondent be reprimanded under Section 35(1)(b) of the PAO;

2. the Respondent do pay a penalty of HK$70,000.00 under Section 35(1)(c) of the PAO;

3. the Respondent do pay the costs and expenses of and incidental to the proceedings of the Complainant in the sum of HK$79,643.00 under Section 35(1)(iii) of the PAO.

Dated the 17th day of January 2012