

SFC commences legal proceedings against Ernst & Young over access to accounting records

27 Aug 2012

The Securities and Futures Commission (SFC) has commenced proceedings in the Court of First Instance against Ernst & Young Hong Kong (Ernst & Young) for failing to produce to the SFC specified accounting records.

The records relate to its work as the reporting accountant and auditor for Standard Water Limited (Standard Water) (Note 1).

The SFC issued a formal notice to Ernst & Young seeking the audit working papers and underlying accounting documents relating to Standard Water. Ernst & Young did not comply with this request and claimed that it did not have the relevant records which were held in the Mainland by its joint venture partner in the Mainland, Ernst & Young Hua Ming (EY Hua Ming), whose staff were the ones involved in the engagement.

On following up the non-compliance, Ernst & Young then claimed the documents could not be produced because of restrictions under PRC law (Note 2).

The SFC then sought the assistance of the relevant authority in the Mainland using its standing arrangements for mutual assistance in investigatory matters. However, EY Hua Ming also failed to produce the records to the relevant Mainland authority as requested.

Given Ernst & Young was the reporting accountant and EY Hua Ming was Ernst & Young's agent, the failure to produce these records to the relevant Mainland authority on the SFC's request is a matter of serious concern.

Accounting and audit working papers relating to private companies applying for listing in Hong Kong must be capable of being produced either directly to the SFC or via the relevant Mainland authority under the standing arrangements for cooperation, especially where the SFC is investigating suspected misconduct.

The SFC is invoking section 185 of the Securities and Futures Ordinance which empowers the Court of First Instance to inquire into the circumstances of Ernst & Young's non-compliance with the SFC's request for these records. The Court can order Ernst & Young to comply with the SFC's request if it is satisfied that Ernst & Young does not have any reasonable excuse for not complying.

The SFC has brought this proceeding after consulting the relevant Mainland authority about access to these records and the SFC and the relevant Mainland authority are continuing to work closely together in relation to this issue.

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Notes:

1. Standard Water applied for listing to the Stock Exchange of Hong Kong (SEHK) on 9 November 2009. In March 2010, Ernst & Young suddenly informed the SEHK of its resignation as reporting accountants and auditors of Standard Water upon discovery of certain inconsistencies in documentation provided by the company. Shortly afterwards, Standard Water also withdrew its listing application.
2. As a result of a joint statement issued by PRC authorities on 20 October 2009, accounting records, including audit working papers, may be the subject of claims of state secrecy under PRC law and that all Hong Kong accountants are required to obtain the consent of the relevant Mainland authorities before handing over any accounting records to regulators like the SFC even if the records are kept in Hong Kong.