



Hong Kong Institute of  
Certified Public Accountants  
香港會計師公會

## **Hong Kong Institute of Certified Public Accountants takes disciplinary action against two certified public accountants (practising) and a corporate practice**

(HONG KONG, 2 August 2018) A Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants reprimanded Mr. Andrew David Ross (A01858), Mr. Fok Wai Ming (A14447) and Baker Tilly Hong Kong Limited (M0154) on 20 June 2018 for their failure or neglect to observe, maintain or otherwise apply professional standards issued by the Institute. The Committee further ordered Ross, Fok and Baker Tilly to pay penalties of HK\$100,000, HK\$100,000 and HK\$250,000 respectively. In addition, the three respondents were ordered to pay jointly and severally costs and expenses of disciplinary proceedings of the Institute and the costs of the Financial Reporting Council (FRC) in the total of HK\$117,372.20.

Baker Tilly was a newly appointed auditor who audited the consolidated financial statements of Code Agriculture (Holdings) Limited, a company listed in Hong Kong, and its subsidiaries for the year ended 31 March 2012 (2012 Financial Statements) and expressed an unmodified auditor's opinion. Ross was a director of Baker Tilly who issued the auditor's report on behalf of the corporate practice. Fok was a director of Baker Tilly substantially involved in the audit.

The Institute received a referral from the FRC about auditing irregularities in relation to the audit of the 2012 Financial Statements. The group's financial statements in the previous years included errors in the accounting treatment of a substantial acquisition. Those errors affected the opening and year-end balances and comparative information in the 2012 Financial Statements which pertained to the acquisition. Deficiencies were found in the audit procedures conducted by the respondents on the balances pertaining to the acquisition. Furthermore, Baker Tilly did not have adequate policies and procedures to ensure clear designation of an engagement director and appointment of an engagement quality control reviewer (EQCR) in the audit of the 2012 Financial Statements.

After considering the information available, the Institute lodged complaints under section 34(1)(a)(vi) of the Professional Accountants Ordinance (Cap 50).

The Disciplinary Committee found that:

- (i) Baker Tilly was in breach of Hong Kong Standard on Auditing (HKSA) 200, HKSA 230, HKSA 500 and HKSA 510;
- (ii) Ross and Fok were in breach of section 100.5(c), as elaborated in section 130.1, of the Code of Ethics for Professional Accountants for their failure to act diligently in the audit;

- (iii) Ross, whom Baker Tilly asserted to be an EQCR in the audit, was in breach of HKSA 220 for his failure to objectively evaluate the significant judgements and conclusions of the audit team; and
- (iv) Baker Tilly was in breach of Hong Kong Standard on Quality Control 1 for its failure to maintain adequate policies and procedures to ensure clear assignment of responsibility to an engagement director and appointment of an EQCR.

Having taken into account the circumstances of the case, the Disciplinary Committee made the above order against the respondents under section 35(1) of the ordinance. The Committee noted from evidence presented in the disciplinary proceedings that the breaches identified were a **manifestation of a systemic problem in the respondents' audits, which included audits of listed companies that could have adversely affected public investors' interests.**

#### About HKICPA Disciplinary Process

The Hong Kong Institute of Certified Public Accountants (HKICPA) enforces the highest professional and ethical standards in the accounting profession. Governed by the Professional Accountants Ordinance (Cap. 50) and the Disciplinary Committee Proceedings Rules, an independent Disciplinary Committee is convened to deal with a complaint referred by Council. If the charges against a member, member practice or registered student are proven, the Committee will make disciplinary orders setting out the sanctions it considers appropriate. Subject to any appeal by the respondent, the order and findings of the Disciplinary Committee will be published.

For more information, please see:

<http://www.hkicpa.org.hk/en/standards-and-regulations/compliance/disciplinary/>

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#### **About HKICPA**

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the statutory body established by the Professional Accountants Ordinance responsible for the professional training, development and regulation of certified public accountants in Hong Kong. The Institute has more than 42,000 members and 16,000 registered students.

Our qualification programme assures the quality of entry into the profession, and we promulgate financial reporting, auditing and ethical standards that safeguard Hong Kong's leadership as an international financial centre.

The CPA designation is a top qualification recognised globally. The Institute is a member of and actively contributes to the work of the Global Accounting Alliance and International Federation of Accountants.

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## 香港會計師公會對兩名執業會計師及一間執業法團作出紀律處分

(香港，二零一八年八月二日) 香港會計師公會轄下一紀律委員會，於二零一八年六月二十日就 Andrew David Ross 先生 (會員編號：A01858)、霍偉明先生 (會員編號：A14447) 及天職香港會計師事務所有限公司 (「天職」，執業法團編號：M0154) (統稱為「答辯人」) 沒有或忽略遵守、維持或以其他方式應用公會頒佈的專業準則，對他們作出譴責。紀律委員會同時命令 Ross 先生、霍先生及天職分別須繳付罰款 100,000 港元、100,000 港元及 250,000 港元。此外，三名答辯人須共同及各別繳付公會的紀律程序費用及財務匯報局 (「財匯局」) 的費用合共 117,372.20 港元。

天職曾受聘為新任核數師審計香港上市公司科地農業控股有限公司及其附屬公司截至二零一二年三月三十一日止年度的綜合財務報表 (「二零一二年財務報表」)，並發表了無保留的核數師意見。Ross 先生是天職的董事並替執業法團發出有關的核數師報告。霍先生為天職的董事，深入參與了該審計項目。

公會收到財匯局的轉介，指二零一二年財務報表的審計出現違規。該集團以往年度的財務報表內一宗重大收購項目的會計處理出現錯誤。相關錯誤影響了二零一二年財務報表內與該收購項目有關的期初和年末結餘及比較資訊。答辯人對該收購項目有關的結餘進行的審計程序出現缺失。此外，天職未有具備充足的政策及程序，以確保在審計二零一二年財務報表的過程中清晰指定負責該項目的執業董事及委任項目的質量控制覆核人 (「EQCR」)。

公會經考慮所得資料後，根據香港法例第 50 章《專業會計師條例》第 34(1)(a)(vi)條作出投訴。

紀律委員會裁定：

- (i) 天職違反了 Hong Kong Standard on Auditing (「HKSA」) 200、HKSA 230、HKSA 500 及 HKSA 510；
- (ii) Ross 先生及霍先生因沒有謹慎地進行有關的審計項目，故違反了 Code of Ethics for Professional Accountants 內的第 100.5(c)條及進一步闡述該條文的第 130.1 條；
- (iii) 在天職聲稱 Ross 先生為該審計項目的 EQCR 的情況下，Ross 先生未能客觀地評估審計團隊作出的重要判斷及結論，故違反了 HKSA 220；及
- (iv) 天職因未有具備充足的政策和程序，以確保在審計過程中清晰地分工予負責該項目的執業董事及委任項目的 EQCR，故違反了 Hong Kong Standard on Quality Control 1。

經考慮有關情況後，紀律委員會根據《專業會計師條例》第 35(1)條向答辯人作出上述命令。根據紀律程序中所提呈的證據，紀律委員會注意到答辯人所犯的違規顯示其審計工作存在系統性的問題，其中包括上市公司的審計工作，因此可能損害公眾投資者的利益。

#### 香港會計師公會的紀律處分程序

香港會計師公會致力維持會計界的最高專業和道德標準。公會根據香港法例第 50 章《專業會計師條例》及紀律委員會訴訟程序規則，成立獨立的紀律委員會，處理理事會轉介的投訴個案。委員會一旦證明對公會會員、執業會計師事務所會員或註冊學生的檢控屬實，將會作出適當懲處。若答辯人未有提出上訴，紀律委員會的裁判將會向外公佈。

詳情請參閱：

<http://www.hkicpa.org.hk/en/standards-and-regulations/compliance/disciplinary/>

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#### **關於香港會計師公會**

香港會計師公會是根據《專業會計師條例》成立的法定機構，負責培訓、發展和監管本港的會計專業。公會會員超過 42,000 名，學生人數逾 16,000。

公會開辦專業資格課程，確保會計師的人職質素，同時頒佈財務報告、審計及專業操守的準則，以鞏固香港作為國際金融中心的領導地位。

CPA 會計師是一個獲國際認可的頂尖專業資格。公會是全球會計聯盟及國際會計師聯合會的成員之一，積極推動國際專業發展。

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## BACKGROUND

- (1) Code Agriculture (Holdings) Limited ("**Company**") was incorporated in Bermuda and its shares are listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong (stock code: 08153).
- (2) The financial statements of the Company and its subsidiaries ("**Group**") for the year ended 31 March 2012 ("**2012 Financial Statements**") were stated to have been prepared in accordance with Hong Kong Financial Reporting Standards ("**HKFRS**") issued by the Hong Kong Institute of Certified Public Accountants<sup>1</sup>.
- (3) Baker Tilly Hong Kong Limited ("**BTHK**") was appointed as the new auditor of the Company on 24 May 2012. Mr. Andrew David Ross ("**Ross**") was the director who issued the auditor's report on behalf of BTHK for the 2012 Financial Statements on 21 June 2012. The auditor's report stated that the audit for the year was conducted in accordance with the Hong Kong Standards on Auditing ("**HKSA**") and gave a true and fair view<sup>2</sup> on the 2012 Financial Statements.
- (4) Mr. Fok Wai Ming ("**Fok**") was a director of BTHK at the relevant time. He was substantially involved in the audit of the 2012 Financial Statements ("**2012 Audit**") based on the facts available. Fok resigned from BTHK as a director in August 2013.
- (5) The Group's financial statements for the years ended 31 March 2011<sup>3</sup> and 2012 stated that there were adjustments for accounting errors in previous years, which mainly related to an acquisition in 2010 ("**Acquisition**"). The Acquisition recorded in the 2010 financial statements<sup>3</sup> was earlier the subject matter of an investigation and enquiry of the Financial Reporting Council ("**FRC**") in May 2012 to April 2013. The Company retrospectively corrected the accounting errors in the 2013 financial statements after FRC completed the investigation and enquiry of the 2010 financial statements.
- (6) On the basis of the result of the FRC investigation referred to in the foregoing paragraph, the Institute took regulatory actions against the Company's previous auditor in relation to the audit of the Group's financial statements for the year ended 31 March 2010. A Disciplinary Committee made an order against the previous auditor in January 2015.
- (7) In January 2014, the FRC received a complaint on the 2012 Audit concerning, among others, the audit of the opening balances and comparative information in the 2012 Financial Statements. In July 2014, the FRC directed the Audit Investigation Board ("**AIB**") to investigate possible auditing irregularities in relation to the 2012 Financial Statements.

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<sup>1</sup> BTHK's auditor's report and Note 3.1 to the 2012 Financial Statements (pages 366 to 367 and 379 of Annex 1.1)

<sup>2</sup> BTHK expressed true and fair view on the 2012 Financial Statements.

<sup>3</sup> The 2010 and 2011 financial statements were audited by another practice and were the subject of disciplinary action by the Institute in January 2015.

- (8) In carrying out its investigation into the 2012 Audit, the AIB found that BTHK failed to identify the following accounting errors that were contained in the previous year's financial statements and affected the correctness of balances brought forward to the 2012 Financial Statements:
- (i) deferred tax liability adjustment was not measured at a tax rate applicable to the acquired subsidiaries in mainland China according to paragraph 47 of HKAS 12 *Income Taxes* ("HKAS 12");
  - (ii) "capital reserve" was accounted for as an identifiable liability in the Acquisition;
  - (iii) allocation of goodwill for the purpose of impairment assessment was not compliant with paragraph 80 of HKAS 36 *Impairment of Assets* ("HKAS 36");
  - (iv) convertible bonds issued for the Acquisition were not properly accounted for in accordance with HKAS 32 *Financial Instruments: Presentation* ("HKAS 32") and HKAS 39 *Financial Instruments: Recognition and Measurement* ("HKAS 39"); and
  - (v) recognition and measurement of identifiable assets acquired in the Acquisition was not compliant with HKFRS 3 *Business Combinations* ("HKFRS 3").
- (9) In their representations to the FRC<sup>4</sup>, BTHK asserted that (i) they did not revisit the initial recognition of the Acquisition which took place in the financial year ended 2010, and they were not aware of any errors in the subsequent measurement of assets and liabilities identified and recognized in the initial recognition; (ii) the predecessor auditor and management of the Company both represented to BTHK that no misstatements were identified in previous years; and (iii) they performed all applicable audit procedures on the opening balances and the comparative information.
- (10) BTHK submitted to the FRC that Ross was the Engagement Quality Control Reviewer ("EQCR") for the 2012 Audit and signing director for the audit report on the 2012 Financial Statements, and that Fok took up the role of an engagement director<sup>5</sup> in the 2012 Audit.
- (11) In his representations to the FRC<sup>6</sup>, Fok asserted that (i) after performing audit procedures, he and his subordinate did not find any material misstatement in the opening balances or the comparative information in the 2012 Financial Statements and he sent the relevant documents to Ross for review and approval; (ii) the audit procedures performed by BTHK during the 2012 Audit did not reveal the potential errors as later disclosed by the management of the Company; and (iii) any accounting error relating to the capital reserves would have been dealt with by audit procedures performed on impairment of goodwill.
- (12) On 1 June 2015, the FRC referred a report of the AIB dated 7 May 2015 to the Institute pursuant to section 9(f) of the Financial Reporting Council Ordinance, Cap. 588.
- (13) The balances pertaining to the Acquisition, i.e. goodwill, intangible assets, deferred taxation and convertible bonds, were included in the statement of financial position in

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4 Representations of BTHK and/or Ross were extracted in section 3.1.3 of the AIB report.

5 Section 4.1.2.1 of the AIB report.

6 Section 3.1.4 of the AIB report.



the 2012 Financial Statements. As the AIB report focused on the 2012 opening balances and did not contain information about BTHK's audit work on the balances at the year end, the Institute obtained from BTHK their working papers of the 2012 Audit for review in April 2016.

## **THE COMPLAINTS**

### **First Complaint**

(14) Section 34(1)(a)(vi) of the Professional Accountants Ordinance ("PAO") applies to BTHK in that, in the audit of the 2012 Financial Statements, they failed or neglected to observe, maintain or otherwise apply one or more of the following professional standards:

- (a) Paragraph 6 of HKSA 510 *Initial Audit Engagements - Opening balances*;
- (b) Paragraph 15 of HKSA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*;
- (c) Paragraphs 8 to 10 of HKSA 230 *Audit Documentation*; and
- (d) Paragraph 6 of HKSA 500 *Audit Evidence*.

### **Second Complaint**

(15) Section 34(1)(a)(vi) of the PAO applies to Ross in that, non-compliances with four professional standards in the 2012 Audit indicate that he failed to act diligently in accordance with section 100.5(c) as elaborated in section 130.1 of the Code of Ethics for Professional Accountants ("COE").

### **Third Complaint**

(16) Section 34(1)(a)(vi) of the PAO applies to Fok in that, non-compliances with four professional standards in the 2012 Audit indicate that he failed to act diligently in accordance with section 100.5(c) as elaborated in section 130.1 of the COE.

### **Fourth Complaint**

(17) Section 34(1)(a)(vi) of the PAO applies to Ross in that, in issuing the auditor's report for the 2012 Financial Statements as director responsible for the 2012 Audit, he failed or neglected to observe, maintain or otherwise apply paragraph 19 of HKSA 220 *Quality Control for an Audit of Financial Statements* ("HKSA 220") because he had failed to ensure appointment of an independent EQCR and discuss significant matters with the EQCR for the 2012 Audit.

### **Fifth Complaint (In the Alternative to the Fourth Complaint)**

(18) Alternatively, section 34(1)(a)(vi) of the PAO applies to Ross in that, as EQCR of the 2012 Audit, he failed or neglected to observe, maintain or otherwise apply paragraph 20 of HKSA 220 because he had failed to perform an objective evaluation of the significant judgments made by the engagement team and conclusions reached in formulating the auditor's report.

### **Sixth Complaint**

- (19) Section 34(1)(a)(vi) of the PAO applies to BTHK in that they had failed or neglected to observe, maintain or otherwise apply paragraphs 30, 32, 35 and 42 of 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* ("HKSQC1") because there was inadequate policies and procedures to ensure the clear assignment of responsibility for the audit engagement of the Company to an engagement director and appointment of an EQCR.

### **Facts and circumstances in respect of the First Complaint**

- (20) There were a number of accounting errors in the financial statements for the previous years (2010 and 2011) which were brought forward to the opening balances and comparative information of the 2012 Financial Statements. The Respondents did not obtain sufficient appropriate audit evidence to confirm that the opening balances and comparative information were correct and reflect the application of appropriate accounting policies by performing one or more of the following procedures in accordance with paragraph 6(c) of HKSA 510:
- (a) Reviewing the predecessor auditor's working papers;
  - (b) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances relating to the Acquisition; or
  - (c) Performing specific audit procedures to verify the opening balances relating to the Acquisition.
- (21) The previous years' accounting errors brought forward to the opening balances and comparative information in the 2012 Financial Statements were as follows:

#### *Deferred tax*

- (a) Deferred tax liability in respect of the fair value adjustment of net assets acquired in the Acquisition was determined based on a tax rate of 16.5%. The use of this tax rate was inappropriate as it was not applicable to the acquired subsidiaries in mainland China.

#### **Audit procedures performed by BTHK relating to the balance of deferred tax at 31 March 2012**

The 2012 closing balances revealed that a single tax rate of 16.5% was used in calculating deferred tax liability of the Group. Some of the investee / acquired companies giving rise to deferred taxation were operating in mainland China where profits tax rates were not uniformly 16.5%. There was no documented audit work to verify the components of the deferred tax provision to support the auditor's acceptance of the correctness of calculation, in particular, the use of a single tax rate of 16.5%. (Annexes 2.5 and 2.7)

*Capital reserve*

- (b) "Capital reserve" of HK\$26 million was identified as a liability assumed in the Acquisition. However, the amount was recognized directly in equity rather than as a liability of the Group in the 2010 and 2011 financial statements. The inconsistency was not identified.

*Goodwill acquired*

- (c) Goodwill acquired in the Acquisition was allocated to one single cash-generating unit ("CGU") of "agricultural related machinery operation and fertilizer operation" which in fact comprised two separate operating segments. Impairment assessment was made of the goodwill allocated to the single CGU in the 2011 financial statements. The allocating of goodwill to a CGU larger than one operating segment for impairment assessment was a non-compliance with paragraph 80 of HKAS 36.

Audit procedures performed by BTHK relating to the balance of goodwill at 31 March 2012

The planned audit procedures relating to goodwill focused on the valuation assertion only. BTHK did not consider the existence, completeness and proper allocation assertions as having significant risks. The Group allocated goodwill to a single CGU, i.e. tobacco agricultural operation, notwithstanding that a professional valuation report issued in June 2012 stated that the investee company was "principally engaged in the business of tobacco leave flue-curing, tobacco agricultural machinery and tobacco-specialized fertilizers in China", which suggested that the business comprised more than one CGUs. There was no documentation of audit work done to support the auditor's acceptance of management's allocation of the goodwill to one single CGU.

*Convertible bonds issued*

- (d) Notes 5(f) and 37 to the 2011 financial statements disclosed the accounting policy and further described the accounting treatment of the convertible bonds issued in the Acquisition. The stated accounting treatment of the convertible bonds was (a) not in accordance with paragraphs 31 and 32 of HKAS 32; and (b) inconsistent with the Company's accounting policies.

The description of the convertible bonds in note 37 to the 2011 financial statements referred to an option to early redeem all or part of the then outstanding principal amount of the convertible bonds. However, the relevant accounting treatment for the embedded call option was not disclosed in the 2011 financial statements.

The effective interest rate for the convertible bonds was approximately 1.6% whereas the bank borrowings' interest rate ranged between 5.31% and 6.91% per annum for loans outstanding as at 31 March 2011 and between 6.56% to 11.56% per annum for loans outstanding as at 31 March 2012. The interest expense was unreasonably low for a five-year convertible bond with a principal amount

HK\$1,098 million and carried a fixed interest rate of 1% per annum. The calculation of the interest expense under the effective interest method was not in accordance with paragraph 9 of HKAS 39.

Audit procedures performed by BTHK relating to the balances of convertible bonds at 31 March 2012

BTHK identified the valuation assertion of the liability component of issued convertible bonds as having a significant risk. Assertions regarding rights and obligations, completeness and correct allocation of liability/equity components of the convertible bonds were not documented as having significant risks. There was no documentation of the auditor assessing whether the bonds' embedded call option, the existence of which was evidenced by early redemption occurring in 2011, was correctly accounted for in accordance with paragraphs 31 and 32 of HKAS 32.

There was no reference in the working papers to the valuation report for the initial recognition of the convertible bonds in 2010. In addition, the valuation report stated the fair value of the redemption option to be HK\$264,153,019 as at 25 March 2010 and HK\$342,297,281 as at 31 March 2010. Those amounts should be included in the liability component under HKAS 32, but they appear not to have been so accounted for, as shown by the working papers.

*Intangible assets included in goodwill*

- (e) Goodwill of HK\$896.6 million was recognized as a result of the Acquisition. This amount represented over 60% of the purchase consideration. The 2011 financial statements did not include any qualitative description of the factors that made up the goodwill as required by HKFRS 3. A professional valuation report issued in June 2012 (see (c) above) identified intangible assets, i.e. "license", "distribution network" and "assembled workforce", and stated the fair value of each of the items. In the 2012 Financial Statements, these intangible assets were apparently included in the opening and closing balances of goodwill instead of separately accounted for as intangible assets.

Audit procedures performed by BTHK relating to the balance of intangible assets at 31 March 2012

- (22) BTHK did not identify any significant risk for "other intangible assets". The working papers showed that intangible assets noted above were all included under "goodwill" and their individual fair values were not stated in the working papers and the financial statements. There was no documented audit work to support the auditor's acceptance that the three intangible assets should properly be accounted for as part of "goodwill" instead of included separately with individual fair values attached under "other intangible assets".
- (23) The associated financial effects of the above non-compliances, taken together, are likely to be material to the 2012 Financial Statements.

- (24) In their responses to the Institute<sup>7</sup>, BTHK asserted that there was no requirement in the professional standards to re-audit matters which took place two financial years before the current audit period, and that they were entitled to rely on assurance provided by the predecessor auditor and client when there was no indication or evidence that they could not do so, and that they were under "multiple deceptions" (by management and the predecessor auditor). For the reasons set out in the following paragraphs, BTHK's assertions could not justify the inadequacy of their procedures performed during the 2012 Audit on the material opening and closing balances pertaining to the Acquisition.
- (25) The 2012 Audit was BTHK's first audit engagement for the Company. BTHK should have properly planned and performed their audit procedures for the opening balances and comparative information to address the inherent risks related to initial audits. HKSA 510 sets out the audit procedures that are required to be performed on opening balances and comparative information.
- (26) Specifically, paragraph 6(b) of HKSA 510 requires an auditor to obtain sufficient appropriate audit evidence for determining whether the opening balances reflect the application of appropriate accounting policies; and paragraph 6(c) of HKSA 510 requires the auditor to perform one or more of the procedures specified in that paragraph<sup>8</sup>. BTHK's working papers (as described in sub-paragraph (30) below) failed to reflect that the required audit procedures were carried out.
- (27) As the 2012 Audit was BTHK's first audit engagement for the Company, they did not have previous experience on the ability and integrity of the management of the Company. In addition, BTHK did not carry out procedures to assess the professional competence and independence of the predecessor auditor. Accordingly, BTHK would not have adequate grounds on which to "rely on assurances" from management and the predecessor auditor without obtaining sufficient appropriate evidence to verify those assurances.
- (28) Further, the disclosure of adjustments for prior period accounting errors in 2011 financial statements and 2012 Financial Statements relating to the Acquisition would reasonably alert BTHK to the need to obtain sufficient appropriate evidence of the correctness of the balances relating to the Acquisition that were included in the 2012 Financial Statements.
- (29) The above observations show that BTHK did not plan and perform their work with adequate professional scepticism in breach of paragraph 15 of HKSA 200.

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7 Letter from BTHK dated 7 October 2016 (Annex 2.8).

8 Paragraph 6 of HKSA 510 provides that:

"The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by: ...

(c) Performing one or more of the following: (Ref: Para. A3-A7)

- (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;
- (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Performing specific audit procedures to obtain evidence regarding the opening balances."

- (30) The audit documentation on the audit procedures carried out on the opening balances and comparative information was limited as follows:
- (a) There was a 3-page "Summary of audit work on opening balance" but there was no documentation on the results, findings, conclusions of the specific audit procedures performed or any cross-referencing to specific working papers in respect of the audit procedures performed;
  - (b) the "Audit Planning Memorandum" did not contain any plan for audit work on opening balances and comparative information;
  - (c) the "Significant matters for partner's attention" did not contain any highlight of work done on opening balances and comparative information and the results thereon; and
  - (d) the submissions on the accounting issues identified by the AIB cannot be found in the working papers provided by BTHK to the FRC.
- (31) There was also a lack of audit evidence and documentation on the audit of the 2012 closing balances (see sub-paragraph (21) above). Accordingly, BTHK was in breach of paragraphs 8 to 10 of HKSA 230 and paragraph 6 of HKSA 500 in the 2012 Audit.
- (32) In summary, in carrying out the 2012 Audit, Ross, Fok and BTHK failed to comply with the following HKSAs:
- (a) Paragraph 6 of HKSA 510;
  - (b) Paragraph 15 of HKSA 200;
  - (c) Paragraphs 8 to 10 of HKSA 230; and
  - (d) Paragraph 6 of HKSA 500.

**Facts and circumstances in respect of the Second Complaint**

- (33) BTHK denied that Ross was the engagement director of the 2012 Audit. BTHK asserted that according to their company policy for signing the auditor report for a listed client, Ross acted as the EQCR and the signing director for the engagement. They asserted that Fok was the engagement director<sup>9</sup>.
- (34) BTHK's above assertions are inconsistent with the working papers, which documented that Ross was designated as one of the engagement directors in the audit planning memorandum for the 2012 Audit<sup>10</sup>. The memorandum was approved by Ross<sup>11</sup>, and Ross signed as the "Director-in-charge" in the relevant engagement letter entered

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<sup>9</sup> Section 4.1.2.1 of the AIB report.

<sup>10</sup> Section 5.4.4 of the AIB report; and Annex 2E (page 750 of Annex 1.1) to the AIB report.

<sup>11</sup> Annex 2E (page 737 of Annex 1.1) to the AIB report.

between BTHK and the client dated 31 May 2012<sup>12</sup>. In addition, Ross signed the auditor's report on the 2012 Financial Statements<sup>13</sup> as the director responsible.

- (35) With regard to the signing of auditor's reports, footnote 20d of HKSA 700 *Forming an Opinion and Reporting on Financial Statements* states that, "*The auditor's report also identifies the director responsible for the performance of the audit engagement contemplated by such report, and states his/her full name as appearing in his/her practising certificate and the practising certificate number*". The auditor's report for the 2012 Financial Statements stated the full name and the practising certificate number of Ross.
- (36) There is no evidence to support BTHK's suggestion that Ross had been appointed as and acted as the EQCR of the engagement. The working paper titled "Engagement Quality Control Review Checklist – Final" did not record who the EQCR was, and the document was not signed off by anyone<sup>14</sup>. The audit planning memorandum did not record the name of the EQCR<sup>15</sup>. If Ross was not the engagement director, he should not have signed the auditor's report as that would amount to a breach of Rule 8 of the Corporate Practices (Registration) Rules.
- (37) The available evidence shows that Ross played a substantive role in the engagement.
- (38) In light of the audit deficiencies identified in the First Complaint, there is a case against Ross for his failure to act diligently in the 2012 Audit. As a result, he was in breach of the Fundamental Principle of Due Care in section 100.5(c) as elaborated in section 130.1 of the COE.

#### **Facts and circumstances in respect of the Third Complaint**

- (39) Fok was the senior audit team member for the 2012 Audit.
- (40) Despite Fok's assertion that he was "not sure" if he was the engagement director of the 2012 Audit, it is clear from the available evidence that he played a significant role and had substantial involvement in the 2012 Audit. The relevant evidence<sup>16</sup> was that (a) he signed off the "New Client Checklist" as "contact partner", (b) he signed off the "Audit tendering checklist" as "reporting director", (c) the "Audit Planning Memorandum" recorded that "Andrew D. Ross / Henri Fok" were the engagement directors, and (d) an initial "HF" which appears to denote Henri Fok was marked on the front page of the working paper "Significant matters for partner's attention". Fok

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<sup>12</sup> Annex 2D (pages 731 to 736 of Annex 1.1) to the AIB report.

<sup>13</sup> Rule 8 of the Corporate Practices (Registration) Rules (CPRR) states that the auditor's report shall identify the director responsible for the performance of the audit engagement.

<sup>14</sup> Annex 3C (page 847 of Annex 1.1) to the AIB report

<sup>15</sup> Annex 2E (page 750 of Annex 1.1) to the AIB report.

<sup>16</sup> Section 5.4 of AIB report.

submitted that he was working under the direction and supervision of Ross who was the engagement partner and director responsible for the 2012 Audit<sup>17</sup>.

- (41) In light of the audit deficiencies identified in the First Complaint, there is a case against Fok for his failure to act diligently in the 2012 Audit. As a result, he was in breach of the Fundamental Principle of Due Care in section 100.5(c) as elaborated in section 130.1 of the COE.

#### **Facts and circumstances in respect of the Fourth Complaint**

- (42) Paragraph 19 of HKAS 220 requires the engagement partner (director) for audits of listed companies to ensure appointment of an EQCR, discuss significant audit matters with the EQCR; and date the auditor's report after the completion of the engagement quality control review.
- (43) Ross asserted that he acted as the EQCR, but BTHK's working papers for the 2012 Audit did not support this assertion (see sub-paragraph (36) above). On the other hand, the available evidence (see sub-paragraph (34) above) indicated that Ross was more likely the engagement director. In that capacity, he would have failed to comply with the requirements of paragraph 19 of HKSA 220 noted above.

#### **Facts and circumstances in respect of the Fifth Complaint (In the Alternative to the Fourth Complaint)**

- (44) If Ross was the EQCR as asserted, he would have failed to comply with paragraph 20 of HKSA 220 since an EQCR is required to carry out an objective evaluation of significant judgments made by the engagement team and conclusions reached in formulating the auditor's report. From the working paper titled "Engagement Quality Control Review Checklist – Final", it is not sure how those steps contained in it could have satisfactorily discharged the EQCR's responsibilities under paragraph 20 of HKSA 220.

#### **Facts and circumstances in respect of the Sixth Complaint**

- (45) Paragraphs 30, 32, 35 and 42 of HKSQC1 require 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. Accordingly, the practice should clearly assign responsibility for each engagement to an engagement partner/director and require for appropriate engagement an engagement quality control review be conducted.
- (46) Based on the denials of both Fok and Ross that they were the engagement director, there would be no individual assuming the responsibility as the director responsible for the auditor's report for the 2012 Financial Statements. The absence of a clearly

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<sup>17</sup> Section 5.4.1 of the AIB report, and letters from Fok dated 11 August 2015 and 30 August 2016.



designated engagement director raises 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 Proceedings**

3. The Notice of Commencement of Proceedings was issued to the parties on 3 November 2017.
4. On 1 December 2017, RPC, on behalf of BTHK and Ross, wrote to the Disciplinary Committee and stated that BTHK admits the First Complaint and the Sixth Complaint and Ross admits the Second Complaint and the 5<sup>th</sup> Complaint.
5. On 5 December 2017, the Disciplinary Committee directed the Complainant to provide his representations on the admissions made by BTHK and Ross and to make application to the Disciplinary Committee if he required additional time to prepare the case against Fok. On 7 December 2017, the Complainant replied that Fok had indicated that he required further time for confirmation from his insurers.
6. On 5 January 2018, Mayer Brown JSM, on behalf of Fok, informed the Disciplinary Committee that Fok was prepared to admit the Third Complaint.
7. On 30 January 2018, the Disciplinary Committee informed the parties that Mr. Wan Chuck Fan David, one of the members of the Disciplinary Committee dealing with these proceedings would step down from the Disciplinary Panel A on 31 January 2018. The Chairman of the Disciplinary Committee directed the parties to state if they had any objection that the proceedings be dealt with by the remaining four members of the Committee. All the parties replied by letters that they had no objection.
8. The Disciplinary Committee received the formal admission documents signed by BTHK and Ross on 6 December 2017, and by Fok on 20 February 2017 respectively. On 23 February 2018, the Chairman of the Disciplinary Committee directed that as all the Respondents have admitted the complaints against them, the directions made pursuant to Rules 17 to 30 of the Disciplinary Committee Proceedings Rules (the "Rules") be waived and the substantive oral hearing of the complaint originally scheduled be vacated. The parties were also directed to make written submissions on sanctions and costs, which they have done so in April 2018.

### **Discussion and Order**

9. In considering the proper order to be made in this case, the Disciplinary Committee has had regard to all the aforesaid matters, which include the particulars in support of the Complaints, the Respondents' conduct throughout the proceedings, and the respective written submissions of the Complainant and the Respondents. In particular, this Committee note the following:

(1) In so far as BTHK (the Third Respondent) is concerned:

- (a) The First Complaint. The Third Respondent admitted this Complaint. The various audit deficiencies identified in this Complaint demonstrated that the Third Respondent did not properly plan and perform their audit procedures for the opening balances and comparative information to address the inherent risks related to initial audits and did not carry out procedures to assess the professional competence and independence of the predecessor auditor. Instead, they relied on assurances from management and the predecessor auditor without obtaining sufficient appropriate evidence to verify those assurances. The Third Respondent clearly did not plan and carry out their work with sufficient professional scepticism.
- (b) The Sixth Complaint. The Third Respondent admitted this Complaint. It was very unsatisfactory that (given both the First Respondent and the Second Respondent denied that they were the engagement director) the Third Respondent had no director assuming the responsibility for the subject auditor's report. As such, the Third Respondent's system of quality control could not provide any reasonable assurance that the professional standards would be complied with or that the auditor's reports issued would be appropriate.

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

- (a) The Second Complaint. The First Respondent admitted this Complaint. Given the substantive role he played in the engagement, he has failed to act diligently in relation to the audit deficiencies identified in the First Complaint.
- (b) The Fifth Complaint. The First Respondent admitted this Complaint. Assuming the First Respondent was the EQCR as asserted, he did not carry out an objective evaluation of significant judgments made by the engagement team and conclusions reached in formulating the auditor's report – a duty which he had not satisfactorily discharged.

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

- (a) The Third Complaint. The Second Respondent admitted this Complaint. As the senior audit team member for the work, he had failed to act diligently given the audit deficiencies identified in the First Complaint.

(4) Generally, we accept the Complainant's submissions that the breaches identified in the present Complaint was not a one-off manifestation. This is a systemic problem that continued for a number of years. We have been referred to the Disciplinary Committee's decision in case D-15-1096F which concerns the same Respondents in the present proceedings and their audit of the 2008 and 2009 Financial Statements of another listed company. Our attention has also been drawn to the fact that both complaints involved listed companies. Therefore, public investors' interests could have been adversely affected because of the Respondents' audit deficiencies.

- (5) Among other things mentioned in the First and Third Respondents' written submissions, the Third Respondent have subsequently installed further updates to their electronic audit platform and control system which, according to them, were designed to prevent similar issues from arising in future audits, and which requires strict compliance with its sequenced processes which are in accordance of HKSA. In other words, if this updated system works effectively, the systemic problem mentioned in sub-paragraph (4) above should be capable to be avoided in future.
- (6) Lastly, we see no reason why the Respondents should not be ordered to pay the Institute's costs and expenses of and incidental to the investigation and the disciplinary proceedings, the costs incurred by the Financial Reporting Council as well as the costs of the Disciplinary Committee.
10. In light of the above matters, having considered sanctions that are commensurate with the deficiencies identified in the Complaint, 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) all the Respondents be reprimanded under Section 35(1)(b) of the PAO;
  - (b) the Third Respondent do pay a penalty of HK\$250,000 under Section 35(1)(c) of the PAO;
  - (c) the First Respondent do pay a penalty of HK\$100,000 under Section 35(1)(c) of the PAO;
  - (d) the Second Respondent do pay a penalty of HK\$100,000 under Section 35(1)(c) of the PAO;
  - (e) the Respondents do pay jointly and severally the Complainant's costs and expenses of and incidental to the investigation and the disciplinary proceedings, the costs incurred by the Financial Reporting Council and the costs of the Disciplinary Committee in the sum of HK\$117,372.20 under Section 35(1)(iii) of the PAO.
11. Lastly, the Complainant submits that since the First Respondent has admitted the Fifth Complaint, which is an alternative to the Fourth Complaint, the Complainant asks for an order that the Fourth Complaint be kept on the Institute's record and is not to be proceeded with unless the First Respondent at any time withdraws his admission in respect of the Fifth Complaint or an order is issued from the court to do so. We

consider this request to be a reasonable way to dispose of the Fourth Complaint, and order accordingly.

Dated 20 June 2018

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Mr. Wong Wing Yan Kenneth  
Chairman

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Mr. Lee Tsung Wah Jonathan  
Disciplinary Panel A

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Ms. Leung Chi Ying Kathy  
Disciplinary Panel B

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Mr. Espina Anthony Joseph  
Disciplinary Panel B