

IN THE MATTER OF

A Complaint made under section 34(1A) of the Professional Accountants Ordinance (Cap. 50) (the “**PAO**”)

BETWEEN

The Registrar of the Hong Kong Institute  
of Certified Public Accountants

COMPLAINANT

AND

Mr. Lin Ching Yee, Daniel (A07204)  
Mr. Kwong Kam Wing, Kelvin (A19664)

1<sup>st</sup> RESPONDENT  
2<sup>nd</sup> RESPONDENT

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

Members: Ms. Koo Kar Chun, Anna (Chairman)  
Mr. Raymond Chan  
Mr. Chung Kwok Fai  
Ms. Chua Suk Lin, Ivy  
Mr. Tang Kwai Chang

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**ORDER AND REASONS FOR DECISION**

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1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants (the “**Institute**”) as Complainant against Mr. Lin Ching Yee, Daniel and Mr. Kwong Kam Wing, Kelvin, both practicing certified public accountants (the “**Respondents**”). The Institute complains that the Respondents failed or neglected to observe, maintain or otherwise apply professional standards under section 34(1)(a) of the Professional Accountants Ordinance (Cap. 50) (the “**PAO**”).

2. The Registrar of the Institute brought the complaint against the Respondents by a letter to the Council of the Institute dated 9 October 2018 and 4 April 2019.

## THE PROCEEDINGS

3. On 26 March 2021, the parties made a joint application to the Disciplinary Committee to dispose of the proceedings summarily by adopting the Carecraft procedure.
4. The Carecraft procedure has its origins in the case of *Re Carecraft Construction Co Ltd* [1994] 1 WLR 172. It essentially limits the facts, by way of a statement of agreed facts, on which the Disciplinary Committee may decide whether the complaint referred to it has been proved and, if so, determine the sanction that ought to be imposed.
5. The Disciplinary Committee understands this is the first time that the Carecraft procedure is invoked in disciplinary proceedings under the PAO. It directed the parties to make written submissions on adopting this summary procedure in the present context and in the present case. The parties provided their respective submissions on 31 March 2021.
6. The Disciplinary Committee agreed to the parties' joint application to dispense with the proceedings by adopting the Carecraft procedure, in light of the parties' submissions, the Disciplinary Committee's discretion to dispense with or vary any procedural requirements as and when appropriate under rule 11 of the *Disciplinary Committee Proceedings Rules*, and the principle of procedural fairness under paragraph 2 of the *Guidelines for the Chairman and the Committee on Administering the Disciplinary Committee Proceedings Rules*.
7. The Disciplinary Committee directed the parties to submit an agreed statement of facts (the "**Carecraft Statement**"), which also includes agreed proposed orders as to sanctions and costs. The parties filed the Carecraft Statement on 7 April 2021.

8. The Disciplinary Committee further directed that hearing dates be vacated; that the parties respond to the Disciplinary Committee's questions and comments on the Carecraft Statement; and that the Complainant file its statement of costs.
9. On 28 April 2021, the parties provided their respective submissions on the Disciplinary Committee's questions and comments on the Carecraft Statement. On even date, the Complainant filed its statement of costs.
10. On 29 April 2021, the Respondents sought leave to make submissions on the Complainant's costs. The Disciplinary Committee granted leave. The Respondents provided their submissions on 7 May 2021.
11. On 26 May 2021, the Disciplinary Committee directed the Complainant to provide a reply to the Respondents' submissions on the Complainant's costs. The Complainant submitted its reply on 8 June 2021.

#### **THE COMPLAINTS, AND SUPPORTING FACTS AND CIRCUMSTANCES**

12. For want of clarity and in light of the parties' agreement (as stated in paragraph 6 of the Carecraft Statement), the Carecraft Statement is annexed to this order.
13. There were two complaints against the 1<sup>st</sup> Respondent, and two against the 2<sup>nd</sup> Respondent. These complaints were set out in paragraph 4 of the Carecraft Statement.
14. The admitted facts and circumstances in support of these complaints were set out from paragraphs 8 to 91 of the Carecraft Statement.

#### **DISCUSSION AND DECISION**

15. The complaints were all found proven on the basis of the admission made by the Respondents.

16. The only outstanding matter is the question of sanctions and costs which ought to be imposed upon the Respondents.
17. The parties' agreed mitigating factors and agreed proposed orders were set out from paragraphs 92 to 94 of the Carecraft Statement respectively.
18. 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, the Respondents' personal circumstances, the parties' submissions, and the conduct of the Complainant and the Respondents throughout the proceedings.
19. In terms of costs, the Disciplinary Committee considers that the sum incurred by the Complainant, the Disciplinary Committee and the Financial Reporting Council was reasonable and ought to be borne by the Respondents. It was only 21 days before the hearing that the parties agreed to adopt the Carecraft procedure. By then, costs were already incurred for the preparation of a three-day hearing with four witnesses to be presented by the Respondents. As mentioned above, the parties needed to assist the Disciplinary Committee to consider the suitability to adopt the Carecraft procedure, and make further submissions regarding the Carecraft Statement.

## **SANCTIONS AND COSTS**

20. The Disciplinary Committee orders that:-
  - (1) the Respondents be reprimanded under section 35(1)(b) of the PAO;
  - (2) the 1<sup>st</sup> Respondent pay a penalty of HK\$200,000.00 pursuant to section 35(1)(c) of the PAO;
  - (3) the 2<sup>nd</sup> Respondent pay a penalty of HK\$100,000.00 pursuant to section 35(1)(c) of the PAO;

(4) the Respondents pay jointly and severally the total costs of HK\$3,635,673.70 made up as follows:

- (i) HK\$3,002,910.50 in relation to the costs of the Complainant under section 35(1)(iii) of the PAO;
- (ii) HK\$39,120.00 in relation to the costs and expenses of the Disciplinary Committee under section 35(1)(iii) of the PAO; and
- (iii) HK\$593,643.20 in relation to the costs and expenses of the Financial Reporting Council under section 35(1)(d) of the PAO.

The above shall take effect on the 42<sup>nd</sup> day from the date of this Order.

Dated the 31<sup>st</sup> day of August 2021.

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Ms. Koo Kar Chun, Anna  
Chairman  
Disciplinary Panel A

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Mr. Raymond Chan  
Member  
Disciplinary Panel A

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Ms. Chua Suk Lin, Ivy  
Member  
Disciplinary Panel B

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Mr. Chung Kwok Fai  
Member  
Disciplinary Panel A

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Mr. Tang Kwai Chang  
Member  
Disciplinary Panel B

Proceedings No: D-18-1372F and D-18-1407F

A Complaint made under section 34(1A) of the Professional Accountants Ordinance (Cap. 50)

BETWEEN

The Registrar of the Hong Kong Institute  
of Certified Public Accountants

COMPLAINANT

AND

Mr. Lin Ching Yee, Daniel (A07204)

1<sup>st</sup> RESPONDENT

Mr. Kwong Kam Wing, Kelvin (A19664)

2<sup>nd</sup> RESPONDENT

**STATEMENT OF AGREED FACTS FOR CARECRAFT PROCEDURE IN  
RESPECT OF THE 1<sup>ST</sup> AND 2<sup>ND</sup> RESPONDENTS**

**PART 1 – INTRODUCTION**

1. On 9 October 2018 and 4 April 2019, the Complainant submitted two sets of complaints against the Respondents to the Council of the Hong Kong Institute of Certified Public Accountants (the “**Institute**”) pursuant to section 34(1A) of the Professional Accountants Ordinance (Cap. 50) (“**PAO**”) [A/1/1-6; A/4/56-63]. The complaints relate to the Respondents’ alleged failure or neglect to observe, maintain or otherwise apply professional standards in the audits of the consolidated financial statements of E. Bon Holdings Limited (the “**Company**”) for the years ended 31 March 2010 (the “**2010 Financial Statements**”) (the “**2010 Audit**”) and 31 March 2011 (the “**2011 Financial Statements**”) (the “**2011 Audit**”), respectively.
2. Subject to the approval of the Disciplinary Committee, the Complainant and the Respondents agree to dispose of these proceedings by way of the Carecraft procedure (the “**Carecraft Procedure**”) sanctioned by the High Court in England and Wales in the case of Re Carecraft Construction Co Ltd [1994] 1 WLR 172 and clarified by the English Court of Appeal in Secretary of State for Trade and Industry v Rogers [1996] 1 WLR 1569. The Carecraft Procedure was adopted in Hong Kong in a number of cases in respect of proceedings under

section 214 of the Securities and Futures Ordinance (Cap. 571) and section 168H of the former Companies Ordinance (Cap. 32), and by the Competition Tribunal.

3. This Statement of Agreed Facts (“**Statement**”) is submitted by the parties for the purpose of setting out the factual basis upon which the Disciplinary Committee is invited to make the orders sought.
4. For the purpose of resolving these proceedings summarily, and by reference to the facts as set out in Part 2 of this Statement which the Respondents admit and accept, the Respondents admit the complaints against them as follows:

*In relation to the 2010 Audit (Proceedings No. D-18-1372F)*

- (a) Section 34(1)(a)(vi) of the PAO applies to the 1<sup>st</sup> Respondent in that he failed or neglected to observe, maintain or otherwise apply professional standards in auditing the Company’s (i) provision for inventories; and (ii) revenue from sales of goods in the 2010 Audit [A/1/1-6].
- (b) Section 34(1)(a)(vi) of the PAO applies to the 2<sup>nd</sup> Respondent for having failed or neglected to observe, maintain or otherwise apply professional standards when carrying out the engagement quality control review in the 2010 Audit [A/1/1-6].

*In relation to the 2011 Audit (Proceedings No. D-18-1407F)*

- (c) Section 34(1)(a)(vi) of the PAO applies to the 1<sup>st</sup> Respondent in that he failed or neglected to observe, maintain or otherwise apply professional standards in auditing the Company’s (i) provision for inventories; (ii) revenue from sales of goods; (iii) revenue from variations and claims and the relevant expenses in contract work; and (iv) share-based payment expense in the 2011 Audit [A/4/56-63].
- (d) Section 34(1)(a)(vi) of the PAO applies to the 2<sup>nd</sup> Respondent for having failed or neglected to observe, maintain or otherwise apply professional standards when carrying out the engagement quality control review in the 2011 Audit [A/4/56-63].

5. The facts set out in this Statement are not disputed between the Complainant and the Respondents on the basis that these proceedings will be dealt with by the Disciplinary Committee by way of the Carecraft Procedure. If the Disciplinary Committee for any reason is of the view that these proceedings shall not be dealt with by the Carecraft Procedure or that a full hearing is appropriate, no admission or concession by either the Complainant or the Respondents and none of the proposed orders referred to below shall be referred to or relied upon by any of the parties at any subsequent hearing without the prior written consent of the Complainant and the Respondents.
6. In the event that the Disciplinary Committee makes any order sought against the Respondents by reference to this Statement, the Complainant and the Respondents agree that this Statement be annexed to the Disciplinary Committee's decision and will jointly seek a direction to that effect.
7. Furthermore, without prejudice to all of the Complainant's rights, the Complainant specifically reserves the right to (a) disclose this Statement to third parties where it appears proper to do so in the public interest; and (b) refer to this Statement for purposes ancillary to, connected with and/or arising out of these proceedings.

## **PART 2 – AGREED FACTS**

### **A. Background**

8. The Company was incorporated in the Cayman Islands and its shares are listed on the Main Board of The Stock Exchange of Hong Kong Limited. The principal activities of the Company and its subsidiaries (the “Group”) included the trading of builders' hardware, bathroom, kitchen collections and furniture in Hong Kong and overseas. The Group participates in commercial and residential construction projects in Hong Kong, mainland China and Macau (2010) [C/18/326-425] [D/31/723] (2011) [C/19/436, 472] [E/57-61/1179, 1189, 1201, 1213, 1224].
9. The 2010 and 2011 Financial Statements were audited by JBPB & Co. and Grant Thornton, respectively. The 1<sup>st</sup> Respondent was the engagement partner



and the 2<sup>nd</sup> Respondent was the engagement quality control reviewer (“EQCR”) for both audits.

10. The 2010 and 2011 Financial Statements were stated to have been prepared in accordance with the Hong Kong Financial Reporting Standards. The auditor’s reports on the 2010 and 2011 Financial Statements stated that the audits were conducted in accordance with the Hong Kong Standards on Auditing (“HKSA”) [C/18/370] [C/19/472].
11. JBPB & Co. and Grant Thornton expressed an unmodified opinion in the auditor’s reports on the 2010 and 2011 Financial Statements, respectively [C/18/362] [C/19/464].
12. On 11 May 2018 and 17 September 2018, the Financial Reporting Council (the “FRC”) referred two reports of the Audit Investigation Board (the “AIB Reports”) to the Institute pursuant to section 9(f) of the Financial Reporting Council Ordinance (Cap. 588) in respect of the 2010 and 2011 Audits, respectively [A/2/7-50] [A/5/64-188]. This led to the present complaints against the Respondents.
13. This Part 2 deals with the complaints against the Respondents under the following sub-headings:

*As against the 1<sup>st</sup> Respondent*

- (a) 2010 and 2011 Audits – Provision for Inventories;
- (b) 2010 Audit – Revenue from Sales of Goods;
- (c) 2011 Audit – Revenue from Sales of Goods;
- (d) 2011 Audit – Revenue from Variations and Claims, and Relevant Expenses;
- (e) 2011 Audit – Share-Based Payment Expense; and

*As against the 2<sup>nd</sup> Respondent*

(f) 2010 and 2011 Audits – Engagement Quality Control Review.

**B. 2010 and 2011 Audits – Provision for Inventories**

14. As mentioned above, the principal activities of the Group included the trading of builders' hardware, bathroom, kitchen collections and furniture for commercial and residential construction projects in Hong Kong and overseas.

15. In accordance with **Hong Kong Accounting Standard ("HKAS") 2 [H1/187/3603-3625]**, the Group's accounting policy was to measure inventories at the lower of cost and net realizable value ("**NRV**"). Inventory provision is provided based on the aging of inventories at the year-end date, i.e. a specified percentage of provision was made on all inventories in a given age band, as follows [**D/23/685-689; E1/46-50/1135-1144**]:

(a) **For inventories purchased within 9 months:** no provision would be made and the inventories would be stated at cost in the financial statements.

(b) **For inventories purchased for more than 9 months but within 18 months:** the inventories would be stated at cost less 10% for each successive month after the 9<sup>th</sup> month in the financial statements.

(c) **For inventories purchased for more than 18 months:** the inventories would be fully provisioned and their value would be stated as "nil" in the financial statements.

(the "**Provisioning Policy**")

16. The Provisioning Policy sets out a systematic assessment method to calculate impairment by reference to the aging profile of the inventories as the basis to identify slow-moving inventory. The Provisioning Policy had been applied by the Group since it was listed on The Stock Exchange of Hong Kong Limited in April 2000.

17. As at 31 March 2010 and 2011:

- (a) the Group had over 14,000 items of inventories [B/16/303; D/36/817-994] and over 23,000 items of inventories [B/16/311; E3/88/1643-2185], respectively. These included obsolescence / slow-moving surplus inventories from the commercial and residential construction projects the Group had participated in over the years;
  - (b) the carrying amount of inventories was approximately HK\$84.7 million (which represented 36% of the Group's consolidated net assets value) [C/18/364; D/23/685-689] and HK\$90.3 million (which represented 31% of the Group's consolidated net assets value), respectively [C/19/466; E1/46-50/1135-1144]; and
  - (c) general provision for slow-moving inventories of approximately HK\$47.9 million [D/22/684] and HK\$51.0 million [E/45/1134] was made by reference to the aging of inventories, respectively.
18. Upon performing the audit procedures designed by the audit engagement team (outlined below) and obtaining an understanding from the management on the Group's Provisioning Policy for inventory, the audit engagement team was satisfied that the Group's inventories were fairly stated for both financial years.
19. To review the provision for slow-moving inventory estimated by the management and evaluate whether the Group had stated inventories at the lower of cost and NRV, the audit engagement team performed the "inventory valuation test and NRV test" by selecting samples from the Group's stock list and compared their:
- (a) original unit cost before provision (i.e. the cost);
  - (b) net unit cost after provision (i.e. the carrying value in the Group's financial statements); and
  - (c) (if the relevant item was sold after the year-end) the actual unit selling price and quantity after the year-end (i.e. the NRV),
- and assessed whether the items were stated at the lower of cost and NRV in accordance with HKAS 2 and the Group's accounting policy (2010) [D/39/1005;

1011; 1013; 1015; 1017] [D/24/690-694] [D/39/1007-1010; 1019] (2011) [E3/89/2190-2191; 2201; 2226-2227; 2257-2258; 2267-2268] [E1/51-55/1145-1155].

20. In addition to the inventory valuation test and NRV test, according to the Respondents the audit engagement team also relied on the following in respect of the Group's provision for inventories:
- (a) their experience and understanding of the Group's business, based on their previous audits of the Group [A/7/199-200; B/16/311];
  - (b) the enquiries made with the Group's management to understand the basis of the Group's calculation and estimation of the provision for inventories to (i) gain understanding of the consumer demand and management action plan; and (ii) to evaluate the appropriateness of the formulae used by the management in calculation of the provision for slow-moving inventories [B/16/303-304; 311], and the written representations obtained from management during the 2011 Audit [B/16/312] [E2/69/1549-1555];
  - (c) the evaluation of other relevant information, including the aging profile of inventories, inventory turnover days, sales pattern analysis and subsequent utilisation of the inventories to ascertain the continuing appropriateness of the formulae used by the management (2010) [D/36/817-994] [D/37-38/995-1004] [D/40/1020-1092] (2011) [E3/88-89/1643-2185; 2188-2286];
  - (d) audit evidence obtained during the stocktake procedures performed at the Group's facilities to identify slow-moving inventories and test whether the inventory records of the Group were reliable [B/16/304; 311] (2010) [D/43/1103-1129] (2011) [E/91/2292-2319]; and
  - (e) the gross profit analysis as an alternative audit procedure to evaluate the reasonableness of the accounting estimates (2010) [D/41/1093-1097] (2011) [E3/90/2287-2291].
21. For both the 2010 and 2011 Audits, the audit engagement team identified a number of errors in the inventory valuation test and NRV test in which the

actual unit selling price after the year-end was less than the net unit cost after provision (the "**Under-Provision Errors**"). By way of illustration, the following data is extracted from the working papers in respect of one of the Under-Provision Errors for the year ended 31 March 2010 [D/24/690]:

- (a) Original unit cost before provision (i.e. the cost): HK\$38.78.
- (b) Net unit cost after provision (i.e. the carrying value in the Group's Financial Statements): HK\$38.78.
- (c) Actual unit selling price after the year-end (i.e. the NRV): HK\$25.50.

If this inventory were to be stated at the lower of cost (HK\$38.78) and NRV (HK\$25.50), it should have been stated at HK\$25.50. As the value of the inventory was stated as HK\$38.78 per unit in the 2010 Financial Statements, this was a misstatement.

- 22. All of the Under-Provision Errors identified by the audit engagement team were marked "No" under the column "Lower of cost or NRV" in the working papers [D/24/690]. The audit engagement team also documented their evaluation and projection of the Under-Provision Errors. Consequently, an audit adjustment was made and the audit engagement team concluded that the result of the inventory valuation test and NRV test was satisfactory.
- 23. However, there was no indication in the working papers that the audit engagement team had performed further audit procedures on the samples which were subsequently sold at a higher price than the net unit cost after provision (the "**Over-Provision Errors**") [A/2/19-20; A/5/75-76].
- 24. There was also no indication in the working papers that the audit engagement team had considered the nature and cause of the Over-Provision Errors.
- 25. By way of illustration, the following data is extracted from the working papers in respect of one of the Over-Provision Errors for the year ended 31 March 2010 [D/24/690]:
  - (a) Original unit cost before provision (i.e. the cost): HK\$228.20.

- (b) Net unit cost after provision (i.e. the carrying value in the Group's Financial Statements): HK\$68.46.
- (c) Actual unit selling price for sales after the year-end (i.e. the NRV): HK\$185.

If this inventory were to be stated at the lower of cost (HK\$228.20) and NRV (HK\$185), it should have been stated at HK\$185. As the value of the inventory was stated as HK\$68.46 per unit in the 2010 Financial Statements, this was a misstatement.

- 26. Although the Over-Provision Errors were not stated at the lower of cost or NRV, they were nonetheless marked "Yes" under the column "Lower of cost or NRV" in the working papers [D/24/690-694]. The Respondents accept that this was erroneously marked in the working papers.
- 27. The Respondents subsequently explained that:
  - (a) In total, 19 out of 227 samples evaluated by the audit engagement team during the 2010 Audit contained Over-Provision Errors. The amount of overprovision was HK\$19,549 and represented 2.74% of the total sample value [B/16/304-305]. As to the 2011 Audit, 30 out of 326 samples evaluated by the audit engagement team contained Over-Provision Errors. The amount of overprovision was HK\$32,850 and represented 2.51% of the total sample value [B/16/311-312].
  - (b) The low percentage of errors detected in the samples evaluated by the audit engagement team was immaterial as it did not affect the slow-moving nature of the inventories existed as at year-end and did not indicate any change in consumer demand or the Group's operation. The audit engagement team considered such results to have no implications upon the true and fair view of the financial statements of the Group [B/16/305].
  - (c) The Respondents had taken steps to assess the implication of the Over-Provision Errors by projecting their monetary value (i.e. the over-

provision amount value) to the population, and concluded that the Over-Provision Errors were immaterial [B/16/305].

28. However, as noted above and unlike the Under-Provision Errors, there was no documentation of any projection or evaluation performed on the Over-Provision Errors.
29. The other audit works outlined in paragraph 20 above also could not provide sufficient appropriate audit evidence to support the audit engagement team's conclusion that the Group's provision for inventories was reasonable and that the inventories were stated at the lower of cost and NRV. In particular:
  - (a) as to paragraphs 20(a) to 20(c), according to the Respondents the Group's inventory provision policy had been applied consistently over a number of years. Since there had been no significant change of operation or significant fluctuation in the financial performance of the Group (having considered the information referred to in paragraph 20(c) above), there was no justification for the audit engagement team to override management's decision. However, the above matters were not sufficient to address the question of whether the Group's inventory provision policy remained reasonable for the current financial year (particularly given the Under-Provision and Over-Provision Errors), and whether the formulas used by the Group to estimate the provision remained appropriate;
  - (b) as to paragraph 20(d), the stocktake procedure is not audit evidence as to the reasonableness of the Group's provision for inventories; and
  - (c) as to paragraph 20(e), the support which could be derived from the gross profit analysis is limited given that there are many variables which could influence the gross profit margin of the Group.
30. In any event, there was inadequate documentation in the working papers as to the audit work said to have been performed in respect of: (a) the audit engagement team's enquiries with the Group's management and the conclusions reached thereon; (b) the evaluation of the gross profit margin, inventory turnover days, sales pattern analysis and subsequent utilisation of the

inventories in the context of the Group's provision for inventory; and (c) the impact of the Over-Provision Errors on the reasonableness of the Group's inventory provision policy, particularly for the 2011 Audit given that it was the second occasion on which the Over-Provision Errors occurred [A/12/248-251].

31. As the engagement partner for the 2010 and 2011 Audits, the 1<sup>st</sup> Respondent was responsible for ensuring that the audits were conducted in compliance with the HKSAs.

32. In the premises:

*In relation to the 2010 Audit*

- (a) the 1<sup>st</sup> Respondent failed to identify and evaluate the Over-Provision Errors in accordance with **HKSA 530 §§47 and 51 [H1/194/3722-3736]**;
- (b) the 1<sup>st</sup> Respondent failed to perform adequate procedures to obtain sufficient appropriate audit evidence to assess whether the provision for inventories was reasonable and that the inventories were stated at the lower of cost and NRV in accordance with **HKSA 540 §§2, 8 and 10 [H1/195/3737-3742]**;
- (c) the 1<sup>st</sup> Respondent further failed to comply with the applicable documentation requirements in respect of the audit work performed in accordance with **HKSA 230 §§2, 9 and 18 [H1/191/3669-3677]**;

*In relation to the 2011 Audit*

- (d) the 1<sup>st</sup> Respondent failed to identify and evaluate the Over-Provision Errors in accordance with **HKSA 530 §§12 to 14 [H1/206/3874-3888]**;
- (e) the 1<sup>st</sup> Respondent failed to perform adequate procedures to obtain sufficient appropriate audit evidence to assess whether the provision for inventories was reasonable and that the inventories were stated at the lower of cost and NRV in accordance with **HKSA 540 §§13 and 18 [H2/207/3889-3927]**; and



- (f) the 1<sup>st</sup> Respondent further failed to comply with the applicable documentation requirements in respect of the audit work performed in accordance with **HKSA 230 §§2, 7, 8 and 11 [H1/201/3808-3820]** and **HKSA 540 §23 [H2/207/3889-3927]**.

**C. 2010 Audit – Revenue from Sales of Goods**

33. The Company had two subsidiaries which were engaged in retail sales.
34. In accordance with **HKAS 18 [H1/188/3626-3644]**, the Group's accounting policy was to recognize revenue from sales of goods on the transfer of risks and rewards of ownership of the goods to customers [**C/18/383**]. This generally coincides with the time when the goods were delivered to customers and title had passed.
35. Revenue from retail sales amounted to approximately HK\$83 million, representing 19% of the Group's revenue for the year ended 31 March 2010 [**A/1/4**]. The audit engagement team identified accounting treatment on retail sales as one of the significant accounting and audit issues for the 2010 Audit [**D/25/697**].
36. There were two types of retail transactions:
- (a) sales where the goods were delivered to customers at the time the order was placed – in such cases, the customers were required to make full payment for the goods at the same time (the "**Cash Sales**") [**B/16/306**]; and
  - (b) sales where the goods were delivered to customers subsequently – in such cases, the customers would make a deposit (being a portion of the full purchase price) for the goods at the time the order was placed, with the balance (the "**Outstanding Balance**") due upon the delivery of the goods or in accordance with the credit terms granted (the "**Deposit Received Transactions**") [**D/25/697; D/26/710-711**].
37. During the audit, the audit engagement team identified certain issues associated with the Group's recognition of revenue from the Deposit Received

Transactions. Specifically, the working papers recorded that the Group recognized sales on a cash basis. For the Deposit Received Transactions, the Group would only recognize sales to the extent of the deposits received at the time the orders were placed. The Outstanding Balance would not be recorded. This gave rise to a risk of misstatement of sales [D/25/697; D/26/710-711; D/27/712-713].

38. To ensure that sales were not materially understated, the Group made late adjustments by reference to an "invoice balance schedule" ("2010 IBS") prepared by the Group to correct the errors by recognizing all the Outstanding Balances as sales for the year ending 31 March 2010 [D/26/710-711; D/27/712-713; D/29/716-718]. The 2010 IBS was presented by the Group as showing all the transactions made at the two retail shops, including the invoice amount and the deposit received.
39. However, this gave rise to a risk of overstatement of sales where the Group prematurely recognized the deposit received as sales for goods which were delivered after the year-end [D/26/710-711].
40. In this connection, the audit engagement team selected samples of Deposit Received Transactions with outstanding balance as at the year-end from the 2010 IBS, compared it against the sales ledger, and checked if the relevant goods were delivered before or after the year-end. The audit engagement team identified 2 cut-off errors where the goods were delivered after the year-end (i.e. the sales amounts were overstated) (the "2010 Cut-off Errors"). The audit engagement team extended the test by testing 4 additional samples, and no further cut-off errors were identified. The audit engagement team was satisfied that the 2010 Cut-off Errors were isolated errors and not part of a wider problem [D/27-28/712-715].
41. However, the audit engagement team did not adequately document its identification and assessment of the risk of overstatement, the work it performed to test the accuracy and completeness of the 2010 IBS and the evaluation of the 2010 Cut-off Errors in the working papers.

42. Further, in addition to the work done using the 2010 IBS, the audit engagement team also carried out the following audit procedures in respect of the Group's revenue from sales of goods [A/7/203]:
- (a) making enquiries with the Group's management [B/16/306-307];
  - (b) performing a walkthrough test to test the reliability of the Group's accounting system [A/7/203-204; B/16/307];
  - (c) performing a sequential sampling test to evaluate the sales invoices to confirm the sequential orders [B/16/307];
  - (d) performing a cut-off test on retail shops [A/7/203-204; B/16/307; D/42/1098-1102];
  - (e) performing stocktake procedures at selected warehouses and the two retail shops of the Group to test whether the inventory records of the Group were reliable [A/7/203-204; B/16/307-308; D/43/1103-1129]; and
  - (f) performing sales transactions test to test the existence and accuracy of the sales transactions recorded in the sales ledger [A/7/203-204; B/16/307-308; D/32-33/776-779].
43. There was however inadequate documentation in the working papers as to: (a) the audit engagement team's discussions with the Group's management (including the obtaining of a list from management in respect of the goods delivered after year-end which would require adjustment upon investigation); (b) the walkthrough test; and (c) the work performed on the "stock out list" used for the sales transaction test [A/12/251-253].
44. The working papers also recorded that the Group treated goods as being delivered to customers and recognized as sold even when they were only transferred from the warehouse to the retail stores, as follows [D/26/710-711]:

*"Remark: Goods are treated as being delivered to a customer even when goods are transferred from the warehouse to retail shop according to the customer's instruction"*

45. This appeared to be a departure from HKAS 18. The audit engagement team subsequently clarified that when the goods were transferred from the warehouse to the retail shops, the goods would remain as inventories of the Group until the said goods were sold to end customers [A/9/228]. However, this was not documented in the working papers, and there was no documentation as to how the audit engagement team had addressed the inconsistency.
46. As the engagement partner for the 2010 Audit, the 1<sup>st</sup> Respondent was responsible for ensuring that the audit was conducted in compliance with the HKSA's.
47. In the premises, the 1<sup>st</sup> Respondent failed to comply with the applicable documentation requirements in respect of the audit work performed in accordance with HKSA 230 §§2, 9 and 18 [H1/191/3669-3677] and HKSA 315 §§122-123 [H1/192/3678-3712].

**D. 2011 Audit – Revenue from Sales of Goods**

48. The Group's accounting policy for the recognition of revenue from sales of goods remained the same for the year ended 31 March 2011, i.e. revenue would be recognized on the transfer of risks and rewards of ownership of the goods to customers. This generally coincides with the time when the goods were delivered to customers and title had passed [C/19/486].
49. Revenue from retail sales amounted to approximately HK\$90 million, representing 23% of the Group's revenue [A/4/60]. The audit engagement team identified the accounting treatment of retail sales as one of the significant accounting and audit issues for the 2011 Audit.
50. To address the cut-off errors in respect of the Deposit Received Transactions, the Group implemented a new accounting system whereby the deposit received would be correctly recorded as deposits (instead of sales) [E/56/1161-1162]. However, when the audit engagement team performed standard sales cut-off test, it continued to identify a significant number of cut-off errors, as follows:
  - (a) The audit engagement team selected 20 transactions immediately before and after the year-end date respectively for testing, and checked the date

of delivery of the goods to see if the transaction had been posted in the correct financial year.

- (b) For the 20 transactions entered into before the year-end, the audit engagement team identified a total of 15 cut-off errors where the Group recognized the deposit received as sales in circumstances where the goods had not been delivered by the year-end [E/78/1618-1622; E/84/1632-1634].
51. The audit engagement team investigated into the matter and was informed by the Group's management that the cut-off errors occurred due to the failure of the Group's staff to use the new accounting system properly, and continued to record the deposit received as "sales" [E/56/1161-1162]. The audit engagement team had tested the explanation provided by the Group by logging into the Group's new accounting system [A/7/205]. However, the work performed by the audit engagement team in this respect was not adequately recorded in the working papers.
52. To address the cut-off errors, the Group's management analysed all the Deposit Received Transactions and made adjustments to address both understatement and overstatement of sales, as follows [E/56/1161-1162] [E/74/1609; E/79/1623-1624; E/75/1610; E/80/1625]:
- (a) **Understatement of sales** – where goods had been delivered before the year-end but the remaining balance remained unpaid (or unrecognized as sales), the Group would recognise the remaining balances as "sales" and "trade receivables" by adjustment. The effect of the adjustment was increase in "sales" and "trade receivables" amounts by around HK\$0.7 million.
  - (b) **Overstatement of sales** – where the deposit received was recognized as sales but the goods had not been delivered by the year-end, the Group would make adjustments such that the deposit amount would be moved from the "sales" account to the "deposit received" account. The effect of

the adjustment was decrease in "sales" and increase in "deposit received" by around HK\$12 million.

53. The relevant adjustments were recorded in another "invoice balance schedule" prepared by the Group ("2011 IBS") [E/76/1611-1614; E/81/1626]. The audit engagement team was satisfied that all the cut-off errors had been corrected by adjustment [E/56/1161-1162].
54. However, the audit engagement team did not adequately document the work it performed to test the accuracy and completeness of the 2011 IBS.
55. Further, in addition to the cut-off test and the work done using the 2011 IBS as referred to above, the audit engagement team also carried out the following audit procedures in respect of the Group's revenue from sales of goods:
  - (a) making enquiries with the Group's management [B/16/313] [E/56/1156-1175];
  - (b) performing a walkthrough test to test the reliability of the Group's accounting system [A/7/203-204] [B/16/307; 313];
  - (c) performing a sequential sampling test to evaluate the sales invoices to confirm the sequential orders [B/16/307; 313];
  - (d) performing stocktake procedures at selected warehouses and the two retail shops of the Group to test whether the inventory records of the Group were reliable [A/7/203-204; B/16/307-308; 313; E/91/2292-2319]; and
  - (e) performing sales transactions test to test the existence and accuracy of the sales transactions recorded in the sales ledger [A/7/203-204; B/16/307-308; 313; E/77/1615-1617; E/83/1629-1631].
56. There was however inadequate documentation in the working papers as to the audit engagement team's work on: (a) the walkthrough test; and (b) the work performed on the "stock out list" used for the sales transaction test.

57. As the engagement partner for the 2011 Audit, the 1<sup>st</sup> Respondent was responsible for ensuring that the audit was conducted in compliance with the HKSAAs.

58. In the premises, the 1<sup>st</sup> Respondent failed to comply with the applicable documentation requirements in respect of the audit work performed in accordance with **HKSA 230 §§2, 7 and 8 [H1/201/3808-3820]** and **HKSA 330 §28 [H1/202/3821-3831]**.

**E. 2011 Audit – Revenue from Variations and Claims and the Relevant Expenses in Contract Work**

59. The Group had a subsidiary which was engaged as a sub-contractor in a property development project in Shanghai (the "**SH Project**") under two separate contracts, being **[E/64/1234-1237]**:

(a) contract number NSC-621 for the supply and installation of glass curtain walls, metals and wooden decorations (the "**NSC-621 Contract**"); and

(b) contract number NSC-616 for the supply and installation of signage (the "**NSC-616 Contract**")

(together, the "**Original Contracts**").

60. In addition to the works stipulated under the Original Contracts (the "**Original Contracts Works**"), the Group also performed additional works which were out of the contract terms (the "**Additional Works**"). The audit engagement team's understanding of the background to the Additional Works and their valuation process was as follows **[E/63/1232-1233]**:

(a) the Additional Works arose due to changes made by the customers or their architect (the "**Architect**"), a substantial part of which related to temporary works done to facilitate a soft opening of the development project. The Architect would issue instructions for the Additional Works to the main contractor, which would then sub-contract the work to the Group;

- (b) the Architect was appointed and authorised by the customers to liaise with the contractors and issue site instructions for the SH Project;
  - (c) when the project was completed, the customers' quantity surveyor (the "**Quantity Surveyor**") would check the quality of the work done by the Group, and negotiate the price with the Group;
  - (d) as at the year-end date, all the Additional Works had been completed. However, the quantity survey was still in progress and the Group was still negotiating the price with the Quantity Surveyor. As at the time of the audit, the Quantity Surveyor had checked and approved approximately RMB 5.8 million worth of the Additional Works; and
  - (e) the Group predicted that the final price would not be confirmed until around September 2011 (i.e. after the date of the audit report).
61. According to the working papers, contract revenue was identified as one of the significant accounting and auditing issues for the 2011 Audit [E/56/1158].
62. The Group recognized revenue from both the Original Contract Works and the Additional Works in the 2011 Financial Statements, totalling approximately RMB 33.6 million (representing 10% of the total revenue for the financial year). Of this RMB 33.6 million, the amount of revenue recognized for the Additional Works was approximately RMB 20.6 million, representing 45% of the Original Contracts. As the final revenue amount of the Additional Works had not yet been determined, the amount recognized was based on the Group's estimation [E/63/1232-1233] [A/4/60] [A/5/93] [C/19/495].
63. The working papers recorded the basis of the Group's estimation of revenue from the Additional Works as follows:
- (a) the Group estimated the revenue amount by reference to the prices of past similar projects completed by the Group in Hong Kong, their industry experience and market prices [E/63/1232-1233; E/56/1156-1175; E/69/1553];



(b) in respect of the Additional Works performed in relation to the NSC-621 Contract:

- (i) during the negotiation, the Group had quoted RMB 24.50 million for such Additional Works to the Quantity Surveyor. This amount was much higher than the amount recognized in the books (approximately RMB 15.73 million), as the Group had included a buffer in the quoted price for negotiation purposes [E/56/1156-1175]; and
- (ii) the Group believed that the variance between the estimated revenue for such Additional Works, and the final revenue, would be less than 10% [E/69/1553].

64. The audit engagement team was only informed of the Group's proposed recognition of revenue from the Additional Works and the related expenses in June 2011, which was only shortly before the scheduled announcement of the financial results of the Group was due to be made. As a result, the audit engagement team immediately liaised with the Group to seek further information and during this process became aware that the recognition of revenue from the Additional Works proposed by the management involved estimations over the value of works undertaken as final revenue amount of the Additional Works was still being assessed as at the reporting date. The audit engagement team considered this a significant unusual matter requiring further attention. The audit engagement team sought to escalate the issue internally by discussing the issues with the Respondents and suggesting the need for further information and evidence [B/16/314; B/14/281; B/17/322-323; B/15/291].
65. Upon consulting with the Respondents and the then Head of Audit of Grant Thornton, the audit engagement team carried out various audit work to address the concerns over the sufficiency and adequateness of the audit documentation and evidence presented by the Group. According to the Respondents, these included:

- (a) discussing further with the Group's management to understand the status of the SH Project, the certification status of the Additional Works, the basis of the value of the Additional Works estimated by the management, the expected variance of the Additional Works [A/7/206; B/16/315], and (in respect of the NSC-621 Contract only) obtaining written representations in respect of the specific assertions made regarding the management's judgment, estimation and ability to pursue a negotiation with the customers [B/16/316; E/69/1549-1555];
  - (b) reviewing the Original Contracts [A/7/207] [B/16/316] [E/70-73/1556-1608], the contracts with sub-contractors, the costs analysis prepared by the Group [A/7/207; [B/16/316] [E/66/1522-1529] [E4/93/2328-2348], the relevant site memos issued by the Architect in relation to the Additional Works [A/7/207; B/16/316; E1/65/1238-1521; E4/94/2349-2783], the payment request forms submitted by the Group and the interim certificates issued by the Quantity Surveyor;
  - (c) performing a gross profit ratio analysis by comparing the gross profit ratios of the Additional Works and the Original Contracts Works [A/7/206; B/16/316; E/56/1156-1175; E/63/1232-1233; E/64/1234-1237]; and
  - (d) (in respect of the NSC-621 Contract only) comparing the estimated price for selected samples of Additional Works, and the price for similar works under the Original Contract [A/7/207; B/16/316; E/67/1530].
66. The Respondents also subsequently explained that, based on calculations from figures derived from the audit working papers, their audit work covered 93% of the sales from the SH Project. Specifically, 66% of the sales amount of the NSC-621 Contract and the NSC-616 Contract were the Original Contracts Works and the remaining 34% were the sales from the Additional Works, in which 79% was from the NSC-621 Contract and 21% from the NSC-616 Contract [A/13/268].

67. The audit engagement team considered that there was no contradictory evidence or suggestion that the Additional Works, which had already been completed, would not be approved for payment [B/16/315]. Upon considering the documentation and audit evidence available, the audit engagement team did not consider the management's expectation on gross profit margin unreasonable.
68. **HKAS 11 [H1/198/3749-3764]** governs the recognition of revenue for construction contracts. **§11** explains that contract revenue comprises:
- (a) the initial amount of revenue agreed in the contract (i.e. the revenue for the Original Contracts Works); and
  - (b) variations in contract work and claims (i.e. the revenue for the Additional Works).
69. **§§13 and 14** further explain the different nature of variations and claims, and the circumstances in which they may be recognized as revenue. In gist, variations and claims can be recognized as contract revenue when it is probable that the customer will approve / accept the work and the amount of revenue can be reliably measured [H1/198/3749-3764].
70. In the present case, the Group classified the Additional Works as "variations" and recognized revenue for the Additional Works accordingly [E1/63/1232-1233].
71. For the reasons explained above, whilst the audit engagement team undertook a number of steps to test and challenge the Group's proposed recognition of revenue for the Additional Works, the audit procedures performed by the audit engagement team referred to in paragraphs 65(b) to 65(d) above could not provide sufficient reliable independent corroborative evidence to substantiate the Group's proposed recognition of revenue for the Additional Works by ascertaining:
- (a) whether the Additional Works pertain to variations or claims [A/6/192];
  - (b) whether it was probable that the customers would approve / accept the Additional Works [A/6/192]; and

- (c) whether the revenue arising from the Additional Works could be reliably measured [A/6/192].

72. In particular:

- (a) as to paragraph 65(b):
  - (i) the Additional Works were not included in the Original Contracts or the contracts with sub-contractors [A/8/220];
  - (ii) the costs analysis and payment request forms were internal documents generated by the Group, and could not provide corroborative evidence as to whether it was probable that the customers would approve / accept the Additional Works or that the associated revenue amounts could be reliably measured [A/8/220];
  - (iii) the interim certificates related only to the limited amount of Additional Works which had been checked and approved by the Quantity Surveyor (see 60(d) above);
  - (iv) the site memos did not clearly show that the Additional Works performed related only to variations (as opposed to claims). In any event, even if the Additional Works were supported by the site memos this did not mean that the quality of the work performed was such that it would be approved / accepted by the customers [A/5/94]; and
- (b) as to paragraph 65(c), the gross profit ratio analysis and comparison could not provide sufficient appropriate audit evidence as to whether the revenue amount could be reliably measured given that the circumstances leading to the Additional Works were different from the Original Contracts Works [A/8/220].

73. In any event, there was inadequate documentation in the working papers as to the audit work said to have been performed by the audit engagement team in respect of: (a) the audit engagement team's consultation with the Respondents and the then Head of Audit of Grant Thornton; (b) the audit engagement team's

discussions with management; and (c) the written representations, costs analysis and gross profit ratio analysis obtained / performed in respect of the NSC-616 Contract [A/12/254].

74. As the engagement partner for the 2011 Audit, the 1<sup>st</sup> Respondent was responsible for ensuring that the audit was conducted in compliance with the HKSA's.

75. In the premises, despite the substantial works carried out by the audit engagement team on the Group's recognition of revenue from the Additional Works:

(a) the 1<sup>st</sup> Respondent fell short of the requirements under **HKSA 500 §6 [H1/204/3843-3859]** and **HKSA 540 §18 [H2/207/3889-3927]** in that he failed to design and perform sufficient audit procedures for the purpose of obtaining sufficient appropriate audit evidence, and evaluate the reasonableness of the accounting estimates in relation to contract revenue; and

(b) the 1<sup>st</sup> Respondent further failed to comply with the applicable documentation requirements in respect of the audit work performed in accordance with **HKSA 230 §§2, 7, 8 and 10 [H1/201/3808-3820]** and **HKSA 540 §23 [H2/207/3889-3927]**.

**F. 2011 Audit – Share-Based Payment Expense**

76. The Group granted certain share options to its directors and employees on 27 January 2011, which were to be vested one year after the grant date. The entire share-based payment expense of HK\$2,047,000 was recognized in the year ended 31 March 2011 [C/19/522-527]. This represented less than 5% of the total employee benefit expense [C/19/502].

77. This was a misstatement as, under **HKFRS 2 §15 [H2/209/3946-4093]**, the value of the share options should be recognized as expense over the options' vesting period, rather than immediate recognition. Therefore, the portion of the Group's share-based payment expense from 1 April 2011 onwards (i.e. after the year-end) should instead be recognized in the financial statements for the year

ended 31 March 2012. In other words, the share-based payment expense for the year ended 31 March 2011 was overstated by around HK\$1,722,000 [E1/62/1231].

78. The audit engagement team identified that the accounting for share options was one of the significant accounting and audit issues for the 2011 Audit. It concurred with the Group's management that the misstatement was immaterial to the 2011 Financial Statements [E/85/1635].
79. There was no record in the working papers as to any evaluation performed by the audit engagement team in respect of the misstatement. The Respondents subsequently explained that the uncorrected misstatement had no material effect on the 2011 Financial Statements because (a) the misstatement only exceeded the materiality level established by the audit engagement team for the 2011 Audit (at HK\$1,681,000) by around HK\$41,000 [A/7/208; A/9/230; B/16/318]; (b) the overall net effect of all uncorrected misstatements in the Group's income statement was an understatement of profit of around HK\$225,000, which was below the materiality level [B/16/318]; and (c) the misstatement would not affect the true and fair view of the state of affairs of the Group as at 31 March 2011 [A/7/208]. The Respondents also considered that the misstatement was a single uncorrected misstatement in the income statement [A/7/208].
80. However, the misstatement relating to share-based payment expense, which exceeded the materiality level and represented 9.8% of the Group's net profit and 84% of the value of the share options, was in fact material [A/5/112]. There was no justification for the audit engagement team to adopt a higher materiality threshold for share-based payment expense, or to offset the misstatement relating to share-based payment expense with misstatements relating to other account balances or classes of transactions in the income statement [A/6/195].
81. As the engagement partner for the 2011 Audit, the 1<sup>st</sup> Respondent was responsible for ensuring that the 2011 Audit was conducted in compliance with the HKSAs.
82. In the premises:

- (a) the 1<sup>st</sup> Respondent failed to properly evaluate the effect of the uncorrected misstatement arising from incorrect recognition of share-based payment expense, in accordance with HKSA 450 §11 [H1/203/3832-3842]; and
- (b) the 1<sup>st</sup> Respondent further failed to comply with the applicable documentation requirements in respect of the audit work performed in accordance with HKSA 230 §§2, 7 and 8 [H1/201/3808-3820] and HKSA 450 §15 and A25 [H1/203/3832-3842].

**G. 2010 and 2011 Audit – Engagement Quality Control Review**

83. The 2<sup>nd</sup> Respondent was the EQCR for the 2010 and 2011 Audits. Based on discussions with the audit engagement team and the evidence reviewed, the 2<sup>nd</sup> Respondent was satisfied that the 2010 and 2011 Audits had been performed in accordance with professional standards and agreed with the issuance of the audit reports (2010) [D/35/782-816] (2011) [E/86/1636].

*In relation to the 2010 Audit*

84. The provision for inventories and revenue from sales of goods were significant matters arising during the 2010 Audit [A/3/55] [D/25/696-697]. The 2<sup>nd</sup> Respondent subsequently explained that, as the EQCR, he:
- (a) discussed the issues and the management representation concerning the Provisioning Policy for inventory to understand what constitutes slow-moving conditions and the Group's accounting policy in respect of the revenue recognition for sales of goods with the audit engagement team [A/7/209; B/15/289; 290];
  - (b) reviewed and evaluated the audit work performed by the audit engagement team during the planning, execution, and reporting phase, including their analysis of the subsequent sales of the inventories and the supporting documents obtained [A/7/209; B/15/289]; and
  - (c) carried out assessment on the conclusions made by the audit engagement team [A/7/209; B/15/290].

85. Notwithstanding the matters referred to at paragraph 84 above, the 2<sup>nd</sup> Respondent did not consider the above audit areas (other than the cut-off errors identified at the planning phase) to involve significant judgments made by the audit engagement team, and did not perform an adequate review on these audit areas (which, as explained in the AIB Reports, would have involved significant judgments made by the audit engagement team) to enable him to be satisfied with the audit evidence obtained and procedures performed by the audit engagement team [A/7/209; B/15/290]. In light of the inadequateness of the audit documentation, the 2<sup>nd</sup> Respondent also could not have performed an adequate review on these audit areas.
86. As a consequence, the 2<sup>nd</sup> Respondent failed to identify and address the multiple audit deficiencies identified in Sections B and C above in his review.
87. In the premises, the 2<sup>nd</sup> Respondent failed to perform an adequate engagement quality control review to evaluate the significant judgments made and conclusions reached by the audit engagement team in accordance with **HKSA 220 §§38 and 39 [H1/190/3658-3668]**.

*In relation to the 2011 Audit*

88. The provision for inventories, revenue from sales of goods, revenue from variations and claims and the related expenses in contract work, and share-based payment expense were significant matters arising during the 2011 Audit [A/6/195] [E/56/1158-1162]. The 2<sup>nd</sup> Respondent subsequently explained that, as the EQCR, he:
- (a) discussed the issues and the management representation concerning the Provisioning Policy for inventory, the revenue recognition in respect of the Additional Works (including the level of details of the additional procedures performed), the revenue from sales of goods and cut-off errors, and the uncorrected misstatement relating to share-based payment expenses with the audit engagement team / the 1<sup>st</sup> Respondent [A/7/209-210; A/9/231; B/15/289; 291-292];



- (b) reviewed and evaluated the audit work performed by the audit engagement team during the planning, execution, and reporting phase, including their analysis of the subsequent sales of the inventories and the supporting documents obtained [A/7/210; B/15/289;292]; and
  - (c) challenged the documentation and carried out assessment on the conclusions made by the audit engagement team, including consulting with the then Head of Audit of Grant Thornton (as an additional audit procedure) in respect of the revenue from variations and claims and the related expenses in contract work [A/7/210; A/9/231; B/15/292].
89. Notwithstanding the matters referred to at paragraph 88 above, the 2<sup>nd</sup> Respondent did not consider the above audit areas (other than the cut-off errors identified and revenue from variations and claims and the related expenses in contract work) to involve significant judgments made by the audit engagement team, and did not perform an adequate review on the above audit areas (which, as explained in the AIB Reports, would have involved significant judgments made by the audit engagement team) to enable him to be satisfied with the audit evidence obtained and procedures performed by the audit engagement team [A/7/210; B/15/293]. In light of the inadequateness of the audit documentation, the 2<sup>nd</sup> Respondent also could not have performed an adequate review on these audit areas.
90. As a consequence, the 2<sup>nd</sup> Respondent failed to identify and address the multiple audit deficiencies identified in Sections B, D, E and F above in his review.
91. In the premises, the 2<sup>nd</sup> Respondent failed to perform an adequate engagement quality control review to evaluate the significant judgements made and conclusions reached by the audit engagement team in accordance with **HKSA 220 §20 [H1/200/3791-3807]**.

### **PART 3 – AGREED MITIGATING FACTORS**

92. The Complainant and the Respondents agree to the following mitigating factors:
- (a) Although the Respondents' audit work in respect of the 2010 and 2011 Audits was inadequate in the areas set out above, they subsequently were

able to provide explanations of the audit procedures designed and carried out which are set out above, on which basis they genuinely believed that they complied with the professional standards - this is not a case where the Respondents blatantly or recklessly disregarded the relevant regulatory requirements or principles;

- (b) The Respondents did not gain any benefit from the breach;
- (c) The Respondents have adopted a reasonable course of action to conclude these proceedings by way of the Carecraft Procedure, which saves the time and costs of the Complainant and the Disciplinary Committee;
- (d) The Respondents have a good compliance history with a clean disciplinary record; and
- (e) There have not been any civil claims against the Respondents in respect of the 2010 and 2011 Audits, or any suggestion that any person has suffered loss as a result of the non-compliance with professional standards.

#### **PART 4 – AGREED PROPOSED ORDERS**

- 93. On the basis of the agreed facts set out in Part 2 above, the Complainant and the Respondents agree that the Disciplinary Committee should find the complaints against the Respondents (as set out in paragraphs 4(a) to (d) above) proved.
- 94. On the basis of the agreed facts set out in Part 2 above and taking into account the agreed mitigating factors in Part 3 above, the Complainant and the Respondents further agree that it would be appropriate for the Disciplinary Committee to make the following sanctions:
  - (a) the Respondents be reprimanded under section 35(1)(b) of the PAO;
  - (b) the 1<sup>st</sup> Respondent do pay a penalty of HK\$200,000 under section 35(1)(c) of the PAO;
  - (c) the 2<sup>nd</sup> Respondent do pay a penalty of HK\$100,000 under section 35(1)(c) of the PAO; and

- (d) the Respondents shall jointly and severally pay:
  - (i) the costs and expenses of the Complainant, in a sum to be assessed, under section 35(1)(iii) of the PAO;
  - (ii) the costs and expenses of the Disciplinary Committee, in a sum to be assessed, under section 35(1)(iii) of the PAO;
  - (iii) the costs and expenses of the FRC in the sum of HK\$593,643.2 under section 35(1)(d) of the PAO.

Dated the 7th day of April 2021.