CPA
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 a certified public accountant (practising)

(HONG KONG, 4 December 2020) A Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants reprimanded Mr. Ng Ka Hong, certified public accountant (practising) (F07043) on 27 October 2020 for his failure or neglect to observe, maintain or otherwise apply professional standards issued by the Institute. In addition, Ng was ordered to pay a penalty of HK$120,000 and costs of disciplinary proceedings of HK$39,004.

In April 2019, the Institute completed a practice review on McMillan Woods SG CPA Limited, a corporate practice that is now de-registered. The review covered the practice's audit of the 2017 consolidated financial statements of a Hong Kong listed company and its subsidiaries. Ng was the engagement quality control reviewer of the audit.

The practice review found significant audit deficiencies relating to the valuations of an investment in an associate acquired and convertible notes issued as consideration for the acquisition. Ng failed to adequately evaluate the audit team's judgements and conclusions in those areas and review selected audit documentation, as required under Hong Kong Standard on Auditing 220 *Quality Control for an Audit of Financial Statements*.

After considering the information available, the Institute lodged a complaint against Ng under section 34(1)(a)(vi) of the Professional Accountants Ordinance (Cap. 50) ("PAO").

Ng admitted the complaint against him.The Disciplinary Committee found that Ng failed to maintain professional knowledge and skill at the level required and act diligently, in accordance with applicable technical and professional standards. Therefore, he was in breach of the fundamental principle of professional competence and due care in sections 100.5(c) and 130.1 of the *Code of Ethics for Professional Accountants*.

Having taken into account the circumstances of the case and Ng's past regulatory record, the Disciplinary Committee made the above order against Ng under section 35(1) of the PAO.

<u>About HKICPA Disciplinary Process</u>

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 over 46,000 members and 18,000 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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Hong Kong Institute of
Certified Public Accountants
香港會計師公會

香港會計師公會對一名執業會計師作出紀律處分

（香港，二零二零年十二月四日）香港會計師公會轄下一紀律委員會，於二零二零年十月二十七日就執業會計師吳家康先生（會員編號：F07043）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，對他予以譴責。此外，吳先生須繳付罰款 120,000 港元及紀律程序費用 39,004 港元。

在二零一九年四月，公會完成對長青暉勝會計師事務所有限公司的執業審核，該事務所現已撤銷註冊。審核涵蓋該事務所對一間香港上市公司及其附屬公司的二零一七年度綜合財務報表的審計。吳先生是審計項目的質量控制覆核人。

執業審核發現該事務所在審計該公司收購聯營公司的一項投資及作為收購代價而發行的可換股票據兩方面的估值時，有嚴重缺失。吳先生沒有按 Hong Kong Standard on Auditing 220「Quality Control for an Audit of Financial Statements」充分評估審計團隊在以上兩方面的判斷及結論，以及審閱選定的審計紀錄。

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)條對吳先生作出投訴。

吳先生承認投訴中的指控屬實。紀律委員會裁定吳先生未能維持應有的專業知識及技能水平，且沒有盡職遵守適用的技術及專業準則，因此違反了 Code of Ethics for Professional Accountants 第 100.5(c)及第 130.1 條有關「Professional Competence and Due Care」的基本原則。

經考慮有關情況及吳先生過往的監管紀錄，紀律委員會根據《專業會計師條例》第 35(1)條向吳先生作出上述命令。

<u>香港會計師公會的紀律處分程序</u>

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。公會會員逾 46,000 名，學生人數逾 18,000。

公會開辦專業資格課程，確保會計師的入職質素，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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Proceedings No. D-19-1520C

IN THE MATTER OF

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	
Ng Ka Hong (F07043)	RESPONDENT

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

Members: Mr. Malcolm Lim (Chairman)
Ms. Chan Lai Yee
Ms. Chang See Mun Lily
Ms. Tang Yuen Yee Loren Gertrud
Ms. Woo King Wa

ORDER AND REASONS FOR DECISION

1. This is a complaint made by the Registrar of the Hong Kong Institute of Certified Public Accountants against Ng Ka Hong, CPA (Practising) (the "Respondent").

2. The particulars of the complaint letter of the Registrar dated 9 April 2020 are set out below.

BACKGROUND

3. A Reviewer's Report on McMillan Woods SG CPA Limited (corporate practice no. S0327) (the "**Practice**") issued on 22 July 2019 reported inter alia, a number of deficiencies in relation to the audit of the consolidated financial statements of a Hong

Kong listed company, "Client C", and its subsidiaries for the year ended 31 December 2017 (**"2017 Financial Statements"**). The Practice expressed an unmodified opinion on the 2017 Financial Statements on 28 March 2018. The Respondent was the engagement quality control reviewer ("EQCR") of the audit.

4. In respect of the audit, the Practice Review Committee considered the Respondent did not perform an adequate engagement quality control review, in particular, in the areas concerning Client C's investment in an associate and convertible notes ("CNs") issued by Client C in relation to the investment. Having considered the facts, and in view of the public interest involved, the Registrar decided to raise a complaint against the Respondent under section 34(1A) of the *Professional Accountants Ordinance*.

THE COMPLAINT

5. Section 34(1)(a)(vi) of the PAO applies to the Respondent in that he failed or neglected to observe, maintain or otherwise apply a professional standard for his failure to maintain professional knowledge and skill at the level required, and act diligently and in accordance with applicable professional standards, to ensure his client received competent professional services in the audit of Client C's financial statements for the year ended 31 December 2017.

FACTS AND CIRCUMSTANCES IN SUPPORT OF THE COMPLAINT

(a) Investment in an associate

6. An "Investment in an associate" of approximately HK$102 million, representing a 49% equity interest in "Asso-B" in Mainland China, was recorded in the 2017 Financial Statements. The investment represented 50% of the net assets of Client C's group. Asso-B was a start-up retailer engaged in an e-commerce business of selling non-high end watches with a track record of less than one and a half years.

7. Client C acquired the investment in April 2017 by issuing CNs valued at HK$91.6 million at the time of the acquisition. The net assets acquired were valued at approximately HK$6.3 million. After taking into account the contingent consideration receivable of HK$1.7 million, the acquisition resulted in significant goodwill of approximately HK$83.6 million[1] (i.e. 13 times the net assets acquired) at the date of acquisition. Client C accounted for the investment using the equity method, under which the investment was initially recognized at cost, and the carrying amount would be subsequently adjusted to recognize its share of the profit or loss of Asso-B. The entire

[1] The goodwill was estimated to be around HK$83.6 million derived from: Purchase Consideration of HK$91.6 million minus fair value (FV) of net assets acquired of approximately HK$6.3 million (RMB 5.2 million) minus FV of Contingent Consideration of HK$1.7 million

carrying amount including the goodwill arising on acquisition would be tested for impairment.[2]

8. The acquisition was a material business transaction of Client C in 2017 [3] and gave rise to significant goodwill. The auditor failed to perform adequate work to support the year-end investment balance of HK$102 million as recorded in the 2017 Financial Statements. They relied on the year-end valuation of the investment performed by an independent valuer engaged by Client C to obtain reasonable assurance on the investment in the associate. Based on the audit working papers, there was no evidence that the auditor had adequately reviewed / assessed:

   (a) Client C's determination of the recoverable amount in relation to the investment; and

   (b) the assumptions and significant data used in the underlying management forecast adopted in the valuation.

9. With respect to 8(a), the 2017 Financial Statements stated that impairment of Client C's investment in associate would be the excess of the carrying amount over the recoverable amount of the investment[4]. Under HKAS 36 *Impairment of Assets,* the recoverable amount is defined as the higher of an asset's fair value less costs of disposal and its value in use; and it is stated in paragraph 53A of HKAS 36 that "*fair value differs from value in use*".

10. Therefore, in order for Client C to assess impairment of its investment in Asso-B, they needed to determine the investment's fair value (less costs of disposal) and value-in-use in order to establish its recoverable amount.

11. The associated valuation report stated that Client C had instructed a value-in-use valuation to be performed; and the valuer reported a value-in-use of Client C's 49% interest in the investment at 31 December 2017 of HK$102 million. However, the same valuation report was inconsistent in stating the valuation was carried out "based on fair value" in accordance with HKFRS 13 *Fair Value Measurement.* The auditor documented in their working papers that they had reviewed the valuer's method of using the DCF (discounted cash flow) and concluded it "*acceptable as per HKFRS 13*".

12. The auditor clearly failed to identify the inconsistencies evident in Client C's determination of the recoverable amount of the investment. Based on this, it was unclear whether the valuer had in reality reported the investment's value-in-use or its fair value less costs of disposal (which are clearly distinguished as two different amounts and subject to different measurement requirements in HKAS 36), and whether, in assessing

[2] Note 4 to 2017 Financial Statements
[3] The overall materiality set by the auditor was HK$3 million
[4] Note 4 to 2017 Financial Statements

impairment of the investment, the recoverable amount of HK$102 million was determined to be value-in-use or fair value less costs of disposal.

13. Moreover, with respect to 8(b) above, the auditor failed to address the apparent unreasonableness of a critical element in the management forecast – the sales growth rate. Management used a growth rate of 28% for 2018, 39% in 2019, 77% in 2020, 30% in 2021, 16% in 2022 and 10% in 2023. The unsupported, unduly optimistic management projection significantly impacted the valuation; and yet, there was no evidence of the auditor questioning management or the valuer about the reasonableness of the sales growth rates used.

14. Further, there was no evidence that the auditor had performed adequate procedures to assess other key elements of the forecast including the gross profit margin, total expenses, changes in net working capital, and capital expenditures.

15. In addition, the auditor filed in the working papers a "Discount Rate" table which listed data for eight comparable companies, as well as cost of debt, cost of equity and the weighted cost of capital. However, there was no evidence of any procedures performed by the auditor on the relevance or accuracy of these information in assessing the appropriateness of the discount rate adopted by the valuer.

(b) CNs in relation to the acquisition of Asso-B

16. As consideration for acquisition of the 49% interest in Asso-B, Client C issued CNs with an aggregate principal amount of HK$91.6 million on 25 April 2017. Client C engaged the same valuer to perform a valuation of the CNs and determined the fair value of the CNs to be the same as their principal amount at the date of acquisition. Based on the valuation, the CNs were recorded in the 2017 Financial Statements with the following breakdown: a net liability component of HK$32.1 million (after deducting the call option of HK$37.7 million)[5] and an equity component of HK$59.5 million. It is also disclosed in the financial statements that the fair value of the liability component was calculated using binomial tree models based on a discount rate of 9.46%.[6]

17. The audit working papers included inter alia, the valuation report and three tables which showed the binomial calculations. There was no evidence to show the auditor had reviewed or assessed the:

(a) Client C's accounting treatment of the CNs;

(b) fair value of a call option in the CNs (HK$37.7 million), which represented 54% of the debt component and effectively reduced the liability component by more than half; and

[5] Debt component of HK$69.8 million minus call option of HK$37.7 million = HK$32.1 million
[6] Note 28 to 2017 Financial Statements

(c) appropriateness of the discount rate (9.46%) used in the valuation.

18. In respect of 17(a) above, the auditor failed to perform an adequate assessment to support his concurrence with Client C's accounting treatment of the CNs. This deficiency was demonstrated by the lack of evidence to support the auditor's consideration of specific terms and conditions of the CNs, which would be a prerequisite for such an assessment. For example, the auditor did not make any reference to the adjustment clauses which would affect the conversion price of the CNs. In other words, there was no evidence that the auditor had assessed or adequately assessed whether the fixed-for-fixed condition under paragraph 11 of HKAS 32 *Financial Instruments: Presentation* had been met to allow the recognition of an equity component; or whether the entire CNs should be accounted for as a financial liability.

19. There was also no evidence to support that the auditor had properly reviewed and assessed Client C's valuation of the call option (15(b) above). In this area, it was simply stated in the working paper that the call option was "calculated by reference to the conversion price and stock price". There was no other information to show how the auditor had audited this material amount.

20. With respect to 17(c) above, there was no evidence to support how the auditor had assessed the appropriateness of the discount rate used by the valuer.

(c) Professional competence and due care

21. Sections (a) and (b) above demonstrate the auditor had failed to perform adequate procedures in the audit of the investment in Asso-B and the related CNs, both of which were material accounts in the 2017 Financial Statements, and required significant judgements made by the auditor. Under the requirements of paragraphs 20 and 21 of HKSA 220, the EQCR was required to perform an objective evaluation of the significant judgments made and conclusions reached by the auditor in these areas, including a review of selected audit documentation.

22. The Respondent asserted that he had reviewed the relevant areas and was satisfied with the audit work performed by the auditor. However, available audit documentation only showed that the Respondent had signed off certain checklists. There was no evidence of which working papers were actually reviewed as none of the working papers of the concerned areas shows the Respondent's sign-off. There was also no evidence that any of the issues as identified above was discussed between the Respondent and the engagement team.

23. The fact that the Respondent failed to identify any of the irregularities as stated in sections (a) and (b) above demonstrated his review as EQCR was highly inadequate, and

that he did not perform an effective, objective evaluation of the significant judgments and conclusions made by the auditor as required under HKSA 220.

24. Therefore, as EQCR of the relevant audit, the Respondent failed to comply with the fundamental principle of professional competence and due care in that he failed to maintain professional knowledge and skill at the level required and act diligently and in accordance with applicable technical and professional standards, and thereby breached sections 100.5(c) and 130.1 of the *Code of Ethics for Professional Accountants*.

25. As the Code is a professional standard referred to in the PAO, section 34(1)(a)(vi) of the PAO also applies to the Respondent.

THE PROCEEDINGS

26. By a letter dated 8 May 2020, the parties jointly informed the Committee that the Respondent had admitted the complaint against him. They also suggested that it is no longer necessary for the parties to follow the steps set out in paragraphs 17 to 20 of the Disciplinary Committee Proceedings Rules.

27. The Notice of Commencement of Proceedings was issued on 20 July 2020. Having considered the parties aforementioned joint letter and the Respondent's admission of the complaint, the Committee approved the parties' proposal and directed that they made submissions on sanctions by 17 August 2020.

28. The Complainant and Respondent provided their written submissions on sanctions and costs on 17 and 18 August 2020 respectively.

RESPONDENTS' DISCIPLINARY RECORD

29. The Respondent has a recent regulatory record. That complaint against him was resolved through resolution by agreement. In January 2020 in respect of C-19-1513F, he was the EQCR for a listed audit and there were breaches of HKSA 220 in 2 areas – the valuation of biological assets and prepaid land lease payments, and impairment assessment of intangible assets. For the former, the engagement team did not perform adequate audit procedures to evaluate the relevance and reasonableness of key assumptions and data used in the valuation, and assess the competence, capabilities and objectivity of the consultant and research company who provided certain data. For the intangible assets, the engagement team did not perform audit procedures to assess the relevance and reasonableness of the valuation method, key input data and assumptions used in the valuation.

CONSIDERATIONS

30. The Committee has considered the facts of the case and have taken into account that the complaint concerned a public listed company and the nature of the failures involved the possibility of misleading the public. It is important that public confidence in the accounting profession be maintained and any sanctions imposed by the Committee should aim to ensure that high standards of the profession are maintained.

31. The Committee has also carefully considered the submissions advanced by the parties. It is noted that the Respondent admitted the complaint thereby obviating the need for a full hearing which acknowledges his responsibility for the failures. However the Committee has to also consider that the Respondent has a recent regulatory record in January 2020 notwithstanding that it was resolved through resolution by agreement.

SANCTIONS

32. The Disciplinary Committee orders that:-

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

(b) the Respondent pay a penalty of HK$120,000.00 under Section 35(1)(c) of the PAO;

COSTS

(c) the Respondent pay the costs and expenses of and incidental to the proceedings of the Complainant and of the Clerk totalling HK$39,004 under Section 35(1)(iii) of the PAO.

The above shall take effect on the 40th day from the date of this Order.

Dated: 27 October 2020

Mr. Malcolm Lim
Chairman
Disciplinary Panel A

Ms. Chan Lai Yee
Member
Disciplinary Panel A

Ms. Tang Yuen Yee Loren Gertrud
Member
Disciplinary Panel B

Ms. Chang See Mun Lily
Member
Disciplinary Panel A

Ms. Woo King Wa
Member
Disciplinary Panel B