

Press Release

23 September 2015

Completed investigation

On 10 September 2015, the FRC adopted the investigation report on the audits of the consolidated financial statements of a listed entity for the years ended 31 December 2008 (**the 2008 Financial Statements**) and 31 December 2009 (**the 2009 Financial Statements**).

The Audit Investigation Board (**the AIB**) found that the auditor failed or neglected to observe, maintain or otherwise apply certain professional standards in the audits of the acquisition of subsidiaries, impairment of goodwill, customer loyalty programme, leasehold improvements, and provisions for social insurance and contingent rental in the 2008 Financial Statements and/or the 2009 Financial Statements.

The AIB also found that there was no evidence to support the appointment of an engagement quality control reviewer and to support the performance of an engagement quality control review of the audits. The AIB also concluded that the two senior engagement team members who were responsible for the audits of the 2008 Financial Statements and the 2009 Financial Statements failed to maintain professional knowledge and skill at the level required and act diligently in the audits of the 2008 Financial Statements and the 2009 Financial Statements in respect of the identified auditing irregularities.

The investigation report has been referred to the Hong Kong Institute of Certified Public Accountants (**the HKICPA**) to determine if any disciplinary actions are warranted.

On 22 March 2013, the FRC directed the Audit Investigation Board (**the AIB**) to conduct an investigation on the audits of the 2008 Financial Statements and the 2009 Financial Statements.

As a result of the investigation, the AIB found the following auditing irregularities:

(a) Acquisition of subsidiaries in the 2008 Financial Statements

The auditor failed to perform audit procedures to obtain sufficient appropriate audit evidence, other than reliance on a draft valuation report, to (i) separately recognize the trademark-use-right from the goodwill arising from the acquisition of subsidiaries in accordance with HKFRS 3 and HKAS 38; and (ii) measure the loan receivable of the acquired subsidiaries at the acquisition-date fair value in accordance with HKFRS 3 and HKAS 39. There were non-compliances with paragraph 2 of HKSA 500, and paragraphs 2, 12 to 15 of HKSA 620.

As the relevant impacts were material, the auditor failed to express an appropriate audit opinion on the 2008 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700.

The auditor also failed to prepare sufficient and appropriate documentation in relation to their discussions with the management of the listed entity and the valuer in relation to the acquisition of subsidiaries in accordance with paragraph 9 of HKSA 230.

(b) Impairment of goodwill in the 2008 Financial Statements

The auditor failed to perform audit procedures to obtain sufficient appropriate audit evidence, other than reliance on a draft valuation report, to (i) ensure that the valuer's work provided reliable audit evidence; and (ii) test the source data, inputs and assumptions used in the valuation. The auditor also failed to identify that the impairment test of goodwill did not comply with paragraphs 92 and 93 of HKAS 36. There were non-compliances with paragraph 2 of HKSA 620 and paragraph 2 of HKSA 500.

(c) Customer loyalty programme in the 2009 Financial Statements

The auditor failed to perform audit procedures to assess the source data and assumptions used for measuring the value of the outstanding award credits under the customer loyalty programme in accordance with paragraph 2 of HKSA 500, paragraphs 8 and 10 of HKSA 540, and paragraphs 37 and 50 of HKSA 545.

(d) Leasehold improvements in the 2009 Financial Statements

The auditor had quantified the misstatements in relation to the depreciation of leasehold improvements and included them as the uncorrected misstatements in the management representation letter. However, these accumulated uncorrected misstatements were in aggregate material to the 2009 Financial Statements, and

would also continue to accumulate and have an increasing carryover effect in subsequent years. In this regard, the auditor failed to assess whether the aggregate uncorrected misstatements should be adjusted in accordance with paragraphs 12 to 14 of HKSA 320.

(e) *Provision for social insurance in the 2008 Financial Statements and the 2009 Financial Statements*

The auditor failed to develop expectations in their substantive analytical procedures performed, which were sufficiently precise to identify a material misstatement at the desired level of assurance. Therefore, the auditor did not comply with paragraph 2 of HKSA 500, and paragraphs 12 and 12e of HKSA 520.

(f) *Provision for contingent rentals in the 2009 Financial Statements*

The auditor failed to obtain sufficient appropriate audit evidence to assess the provision of contingent rentals in accordance with paragraph 2 of HKSA 500.

(g) *Engagement quality control reviews for the audits of the 2008 Financial Statements and the 2009 Financial Statements*

There was no evidence to support the appointment of an engagement quality control reviewer and to support the performance of an engagement quality control review in accordance with HKAS 220 for the audits. The roles of the two senior engagement team members in the audits were unclear as the information obtained by the AIB was inconsistent and contradictory. As they were both heavily involved, the AIB concluded that the two senior engagement team members were responsible for the audits of the 2008 Financial Statements and the 2009 Financial Statements and failed to maintain professional knowledge and skill at the level required and failed to act diligently in accordance with section 130.1 of the Code of Ethics for Professional Accountants.

On 10 September 2015, the FRC adopted the investigation report prepared by the AIB, which summarized the findings of the investigation. The investigation report has been referred to the HKICPA to determine if any disciplinary actions are warranted. Names of the relevant parties are withheld pending the conclusion of such disciplinary proceedings, if any.

The AIB is chaired by the Chief Executive Officer and its members are full-time staff of the FRC.

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Note to editors

About the FRC

The FRC is a statutory body established in December 2006 under the Financial Reporting Council Ordinance. The FRC is entrusted with the statutory responsibilities to conduct independent investigations into possible auditing or reporting irregularities in relation to listed entities and to enquire into possible non-compliance with accounting requirements on the part of listed entities. The FRC has 11 members with a variety of professional backgrounds and the majority of whom, including the Chairman, are lay persons. For more information, please visit www.frc.org.hk.