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Press Release

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AFRC reprimands Ting Ho Kwan & Chan and three others for serious audit breaches and imposes fines over HK$1.7 million

The Accounting and Financial Reporting Council (**AFRC**) has sanctioned the following PIE audit firm and its then partners for serious deficiencies, involving negligence and multiple breaches of the auditing standards, in relation to the audits of a Hong Kong listed company, REXLot Holdings Limited (**REXLot**) (in liquidation since 20 August 2020), for the years ended 31 December 2013 and 31 December 2014 (**2013 Audit** and **2014 Audit** respectively):

(i) Ting Ho Kwan & Chan (firm registration no. 0631) (**THKC**);

(ii) Mr Chan Shu Kin (also known as **Albert Chan**), engagement partner for both audits (together with THKC, the **Auditor**);

(iii) Ms Chan Kwan Ying (also known as **Amy Chan**), engagement quality control reviewer (**EQCR**) for the 2013 Audit; and

(iv) Mr Wong Kam Chuen (also known as **Tony Wong**), EQCR for the 2014 Audit.

The AFRC has issued a reprimand to each of these regulatees and imposed pecuniary penalties totalling HK$1,755,000, comprising penalties of HK$914,000 for THKC, HK$495,000 for Albert Chan, HK$130,000 for Amy Chan, and HK$216,000 for Tony Wong.

In both years, the Auditor failed to identify material misstatements in relation to the accounting treatment of two major REXLot subsidiaries, which had a significant impact on the REXLot Group's consolidated financial statements.[1]

The AFRC found a multitude of serious deficiencies in the Auditor's assessment of these matters, including multiple failures to obtain sufficient appropriate audit evidence, relying excessively on management representations without appropriate corroborative audit evidence, and an overarching lack of professional scepticism.

Additionally, the Auditor failed to communicate the significant difficulties it encountered during the audits to REXLot's audit committee, including its failure to obtain the Articles

[1] On 16 January 2019, the then Financial Reporting Council ("**FRC**") adopted an enquiry report in relation to the material misstatement of the REXLot Group's interests in these two major subsidiaries in the 2013 Financial Statements and the 2014 Financial Statements. On 21 January 2019, the then FRC required REXLot to remedy the misstatements by retrospectively adjusting the opening balances and the comparative figures in the latest consolidated financial statements to be issued. However, REXLot was subsequently delisted and has not since published any financial statements.

of Association for one of REXLot's key subsidiaries, being an important piece of audit evidence.

Ms Hester Leung, Head of Discipline, said "*Exercising professional scepticism, due care and diligence are fundamental to the performance of a high-quality audit. The AFRC takes the failure to do so very seriously, as reflected in the significant pecuniary penalties imposed in this case. High-quality audits are a prerequisite to Hong Kong's reputation as an international financial centre, and the AFRC will not hesitate to hold audit firms and their partners accountable for any misconduct which risks damaging that reputation.*"

Background

REXLot was incorporated in Bermuda and listed on the Main Board of The Stock Exchange of Hong Kong Limited. The REXLot Group was principally engaged in the business of developing lottery systems and games, and distributing and marketing lottery products, in Mainland China. REXLot was subject to a winding up order by the High Court of Hong Kong on 20 August 2020, and subsequently delisted on 10 May 2021.

During the 2013 and 2014 Audits, REXLot's management made significant decisions regarding whether two major subsidiaries should be consolidated into the REXLot Group, accounted for as associates, or given a different accounting treatment. These subsidiaries were:

(i) People Okooo Limited (**PRC Company**), which operated an online lottery platform in Mainland China. Based on its management accounts, the PRC Company recorded a turnover of HK$20 million in 2013 and HK$432 million in 2014; and

(ii) Winrest International Limited (**Web Subsidiary**), which purportedly conducted a referral business for internet lottery sales (**Referral Business**) commencing in 2014. Based on its 2014 management accounts, the Web Subsidiary recorded a turnover of HK$515 million.

REXLot's accounting treatment of these subsidiaries was incorrect and had a material effect on the REXLot Group's consolidated financial statements, including an overstatement of the Group's profits by at least HK$53.3 million (7%) in 2013, and an overstatement of the Group's losses by HK$67 million (39%) in 2014.

In both audits, the Auditor performed an assessment of management's accounting treatment of these subsidiaries. The multiple deficiencies in those assessments led the Auditor to wrongly concur with management's incorrect accounting treatment. As a result, the Auditor issued an unmodified audit opinion in both years, despite the existence of material misstatements in the consolidated financial statements. The

Auditor did not have sufficient appropriate audit evidence to support those opinions, and in those circumstances should have issued modified opinions instead.

Serious Breaches

The AFRC found a range of serious breaches of the auditing standards in the 2013 and 2014 Audits. Most significantly, the Auditor:

(i) Failed to obtain the PRC Company's Articles of Association, which were an important piece of audit evidence for making this assessment, and which the Auditor knew were important at the time. As a result, the Auditor fundamentally failed to understand how power over the PRC Company was divided between REXLot and the PRC Company's minority shareholder and therefore which accounting treatment was appropriate.

(ii) Largely overlooked the basic presumption under HKAS 28 (*Investments in Associates and Joint Ventures*) that an investor holding 20% or more of an investee's voting power is presumed to have significant influence over that investee (indicating they ought to be accounted for as an associate). During the 2014 Audit, the Auditor apparently only considered this presumption once it was brought to their attention by the EQCR on the day before the audit opinion was issued.

(iii) Persistently and inappropriately relied on management representations without obtaining appropriate corroborative audit evidence. For example, in the 2013 Audit, the Auditor relied on an incorrect management representation that REXLot controlled the PRC Company's Board.

(iv) Continued to rely on management's representations even in the face of apparent inconsistencies and clear signs that management had an incentive to make such representations in order to avoid a modified audit opinion.

(v) Ultimately failed to obtain sufficient appropriate audit evidence to support its audit opinion in both audits, as a result of the above.

(vi) Failed to communicate significant difficulties to REXLot's audit committee, including management's omission to provide the PRC Company's Articles of Association despite the audit committee urging management to do so.

The AFRC considers the deficiencies in the Auditor's work to be serious. The Auditor knew that the accounting treatment of the PRC Company and Web Subsidiary were important audit areas, but nonetheless still proceeded to make fundamental and easily avoidable errors in those areas.

The AFRC also found moderately serious deficiencies in the engagement quality control reviews conducted by Amy Chan and Tony Wong. Most significantly, based on the audit documentation reviewed and matters known by them, they ought to have identified that the Auditor lacked sufficient appropriate audit evidence, but failed to do so.

THKC, Albert Chan, Amy Chan and Tony Wong therefore failed to observe, maintain or otherwise apply the Hong Kong Standards on Auditing, and were also negligent in the conduct of their profession.[2]

Sanctions

The AFRC has reprimanded THKC, Albert Chan, Amy Chan and Tony Wong, and imposed pecuniary penalties of HK$914,000, HK$495,000, HK$130,000 and HK$216,000 respectively.[3]

In considering the aggravating and mitigating factors applicable to this case, the AFRC noted that:

(i) THKC's misconduct was significantly aggravated by its failure to comply with the then FRC's statutory requirement for the production of audit work papers. THKC's production was manifestly incomplete and omitted highly relevant audit work papers, which was only discovered six years later when the AFRC sent a further requirement.

(ii) THKC, Albert Chan and Tony Wong have each admitted the alleged misconduct, which the AFRC considers a mitigating factor. The AFRC has reduced their sanctions accordingly. That being said, if they had admitted the misconduct earlier, the AFRC would have reduced the sanctions even further.

(iii) All four regulatees in this case had clean disciplinary records with the HKICPA and AFRC, and there was no finding of intentional, dishonest or deliberate misconduct.

(iv) An EQCR's lack of experience or training is not considered a mitigating factor. If a person does not have the professional competence necessary to perform such a critical role, they should not accept that role in the first place.

The AFRC has also considered claims from THKC, Albert Chan and Tony Wong to the effect that the pecuniary penalties originally proposed by the AFRC would place them in financial jeopardy. The AFRC assessed that Albert Chan's claim of financial jeopardy was sufficiently substantiated by the evidence he provided, and accordingly granted a further reduction to his pecuniary penalty. However, no reduction was

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[2] Sections 3B(1)(c) and (g) of the Accounting and Financial Reporting Council Ordinance.

[3] The 2013 and 2014 Audits were completed before 1 October 2019 and therefore fall within the old disciplinary regime, where the maximum pecuniary penalty for each misconduct is HK$500,000. Had these audits fallen within the new disciplinary regime, the maximum pecuniary penalty for each misconduct would be HK$10 million or three times the profit gained or loss avoided, whichever is higher.

granted to THKC and Tony Wong, as both failed to offer any meaningful evidence to support their claims.

For details of the decision, please refer to the Statement of Disciplinary Action.

End

About the Accounting and Financial Reporting Council

The Accounting and Financial Reporting Council (**AFRC**) is an independent body established under the Accounting and Financial Reporting Council Ordinance. As an independent regulator, the AFRC spearheads and leads the accounting profession to constantly raise the level of quality of professional accountants, and thus protects the public interest and promotes the healthy development of the accounting profession.

For more information about the statutory functions of the AFRC, please visit www.afrc.org.hk.

About the Discipline Department

The Discipline Department takes appropriate and timely disciplinary action by imposing commensurate sanctions for the purposes of deterrence, investor protection, maintaining market confidence in the quality of financial reporting and audits, and upholding the standards of conduct among regulatees.

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