

STATEMENT OF DISCIPLINARY ACTION

The Disciplinary Action

1. Pursuant to section 37CA of the Accounting and Financial Reporting Council Ordinance (**AFRCO**), the Accounting and Financial Reporting Council (**AFRC**) has:
 - 1.1 publicly reprimanded Centurion ZD CPA Limited (**Centurion**)¹ and imposed a pecuniary penalty of HK\$350,000;
 - 1.2 publicly reprimanded Mr Chan Kam Fuk (**Chan**),² imposed a pecuniary penalty of HK\$250,000, cancelled Chan's practising certificate and ordered that Chan not be issued with a practising certificate for 12 months; and
 - 1.3 publicly reprimanded Mr Ling Chun Kwok (**Ling**)³ and imposed a pecuniary penalty of HK\$100,000.
2. The disciplinary action was taken in relation to the audit (**Audit Engagement**) of the consolidated financial statements of China Infrastructure Investment Limited (**Company**) and its subsidiaries (**Group**) for the year ended 31 December 2016 (**2016 Financial Statements**). Centurion was the auditor for the Audit Engagement, Chan was the engagement partner, and Ling was the engagement quality control reviewer (**EQCR**).
3. The Audit Engagement was a PIE engagement completed before 1 October 2019 and this disciplinary matter was handled in accordance with the transitional arrangements.⁴
4. The AFRC found that in respect of the Audit Engagement:
 - 4.1 Centurion and Chan (together, the **Auditor**) failed to perform sufficient audit procedures to obtain sufficient appropriate evidence in relation to the initial recognition of goodwill arising from the Group's acquisition of a subsidiary, and the impairment assessment of the goodwill as at 31 December 2016; and

¹ At the material time, Centurion was registered as a corporate practice with the Hong Kong Institute of Certified Public Accountants (**HKICPA**). Centurion is currently a registered corporate practice (M0561) with the AFRC but not a registered Public Interest Entity (**PIE**) auditor.

² Chan is currently registered as a member of the HKICPA and holds a practising certificate (P04257) issued by the AFRC.

³ Ling is currently registered as a member of the HKICPA. He does not hold a practising certificate.

⁴ This disciplinary matter was handled in accordance with the Accounting and Financial Reporting Council (Transitional and Saving Provisions and Consequential Amendments) Regulation. Centurion, Chan and Ling were treated as if they were professional persons under the AFRCO.

- 4.2 Ling, as the EQCR of the Audit Engagement, failed to perform an objective evaluation of the significant judgments made by the engagement team in connection with the above matters.
5. More specifically, the AFRC found that:
- 5.1 Centurion and Chan failed to observe, maintain or otherwise apply the following Hong Kong Standard on Auditing (**HKSA**):
- 5.1.1 HKSA 500 *Audit Evidence* (HKSA 500.6, 500.8 and 500.9);
- 5.1.2 HKSA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* (HKSA 540.13 and 540.18);
- 5.1.3 HKSA 620 *Using the Work of an Auditor's Expert* (HKSA 620.9, 620.10 and 620.12); and
- 5.1.4 HKSA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standard on Auditing* (HKSA 200.11 and 200.15);
- 5.2 Ling failed to observe, maintain, or otherwise apply HKSA 220 *Quality Control for an Audit of Financial Statements* (HKSA 220.20); and
- 5.3 Chan and Ling failed to observe, maintain, or otherwise apply the Code of Ethics for Professional Accountants (**COE**) (COE 100.5(c) and 130.1).
6. By failing to observe, maintain or otherwise apply the above PAO professional standards (as defined under section 2 of the AFRCO), each of Centurion, Chan and Ling committed a professional irregularity and are guilty of CPA misconduct pursuant to sections 3B and 37CA of the AFRCO.

Summary of Facts

7. The Company was primarily engaged in property investment and natural gas businesses. On 9 September 2016 (**Acquisition Date**), the Group acquired 51% equity interest in Tianjin Jun Hua Logistics Company Limited (**Subsidiary**) for RMB60 million in cash (equivalent to HK\$66.7 million) (**Acquisition**). The Acquisition was accounted for under Hong Kong Financial Reporting Standard (**HKFRS**) 3 *Business Combinations* in the 2016 Financial Statements.
8. The Subsidiary's main assets comprised of two industrial buildings (**Buildings**). The Company intended to transform the Buildings into a coal warehouse business (**Coal Warehouse Business**) to provide logistics services, including coal storage, security and transportation services.
9. At Acquisition Date, the fair value of the identifiable net assets of the Subsidiary was assessed by the Group to be HK\$34.1 million, giving rise to

goodwill of HK\$49.3 million (**Goodwill**) and non-controlling interests of HK\$16.7 million.

10. According to a property valuation report dated 27 March 2017 (**Property Valuation Report**) prepared by the Company's valuer (**Company's Valuer**), the fair value of the Buildings as at both the Acquisition Date and 31 December 2016 was RMB55 million (equivalent to HK\$61.1 million).
11. The Company's Valuer also issued a valuation report on 29 March 2017 (**Business Valuation Report**), which assessed the fair value of the 100% equity interest of the Subsidiary as at 31 December 2016 at RMB143.6 million (equivalent to HK\$159.8 million).
12. For the purpose of impairment testing at year-end, the Group determined that the Subsidiary was a cash-generating unit (**CGU**) and allocated the Goodwill of HK\$49.3 million to the CGU. Since the Company's management considered that the recoverable amount of the Subsidiary was higher than the sum of the carrying amounts of the net assets of the Subsidiary and the Goodwill, no impairment of the Goodwill was required. The Auditor agreed with the Company's assessment.
13. On 31 March 2017, Centurion issued its Independent Auditors' Report on the 2016 Financial Statements (**Auditors' Report**), which was qualified based on unrelated matters.
14. The Auditors' Report identified a number of key audit matters which, in the Auditor's professional judgment, were of most significance to the Audit Engagement, including (i) accounting for business combination (i.e. the Acquisition) and (ii) impairment assessment on Goodwill. The materiality level for the Audit Engagement was determined at HK\$3.2 million.
15. The Company fully impaired the Goodwill in the year ended 31 December 2017.

Summary of Findings

A. Audit deficiencies in relation to the initial recognition of the Goodwill as at Acquisition Date

16. HKFRS 3 requires an acquirer in a business combination to:
 - 16.1 measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values;
 - 16.2 compare the fair value of the identifiable net assets acquired against the aggregated total of the acquisition price and any non-controlling interest in the acquiree; and

- 16.3 recognise any excess as goodwill at the acquisition date.
17. At Acquisition Date, the fair value of the identifiable assets acquired and liabilities assumed in the Acquisition was assessed by the Group at HK\$34.1 million, comprising of:
- 17.1 the Buildings, the fair value of which was assessed at RMB55 million (HK\$61.12 million).
- 17.2 land use rights to two pieces of land. The fair value of the land use rights to the piece of land where the Buildings were located was included in the fair value of the Buildings. The fair value of the land use rights to the piece of land unrelated to the Buildings was assessed at HK\$1.89 million.
- 17.3 other assets of HK\$0.51 million and other liabilities of HK\$29.46 million.
18. The AFRC found that, apart from the Buildings and the associated land use rights, the Auditor performed limited or no audit procedures to assess the fair values of the other identifiable assets acquired and liabilities assumed.
19. For example, in assessing the fair value of the land use rights to the piece of land unrelated to the Buildings, the Auditor simply considered that a recent sales transaction for a piece of nearby land which was provided by the Company's management as comparable.
20. However, the Auditor did not properly evaluate the relevance and reliability of the information provided by the Company's management. They failed to identify that the authorised use of that piece of land was for industrial, mining and warehouse uses, whereas the piece of land owned by the Subsidiary was for industrial use only, and that mere reliance on information from one transaction was insufficient.
21. The Acquisition Date fair values of the identifiable assets acquired and liabilities assumed would have a consequential effect on the Acquisition Date measurement of the Goodwill.
22. As a result, the AFRC found that the Auditor failed to perform sufficient audit procedures to obtain sufficient appropriate evidence in relation to the initial recognition of the Goodwill at Acquisition Date in that:
- 22.1 the Auditor failed to evaluate whether the information provided by the Company's management to assess the fair value of the land use rights was sufficiently reliable, in breach of HKSA 500.9; and

22.2 the Auditor merely relied on the Company's representations in relation to the other assets acquired and liabilities assumed in paragraph 17.3 above and failed to perform any audit procedures to obtain sufficient appropriate evidence to assess the fair value of such items, in breach of HKSA 500.6 and 500.9.

B. Audit deficiencies in relation to the impairment testing of the Goodwill as at 31 December 2016

23. Hong Kong Accounting Standard (**HKAS**) 36 *Impairment of Assets* requires a reporting entity to conduct an annual impairment assessment of goodwill. If the carrying amount of the CGU to which the Goodwill has been allocated exceeds the recoverable amount of the CGU, the entity shall recognise an impairment loss.
24. The Auditor agreed with the Company's assessment that no impairment of the Goodwill was required as at 31 December 2016. However, the AFRC found multiple audit deficiencies in relation to the Auditor's work on impairment testing of the Goodwill as at 31 December 2016.

Issue One – Inadequate challenge of the Company's estimates for the new Coal Warehouse Business

25. The measurement of the recoverable amount of the CGU as at 31 December 2016 was based on the fair value of the CGU in the Business Valuation Report. The Company's Valuer adopted the discounted cash flow (**DCF**) model to derive the present value of the cash flows expected to be generated from the Coal Warehouse Business from 2017 to 2032.
26. The AFRC found that the Auditor failed to obtain sufficient appropriate audit evidence to assess the reasonableness of the key assumptions and projections by the Company's management used in the DCF Model.
27. The revenue projection adopted by the Company's management was ambitious, given that the Buildings were partially let for a total monthly rental of RMB69,556.17 as at 31 December 2016, whilst the intended transformation of the Buildings into the Coal Warehouse Business was projected to generate RMB81.3 million in revenue by 2018, which would increase yearly to RMB175 million in 2020 and remain constant thereafter (from 2021 to 2032). The projected growth rates of revenue for the four-year period from 2017 to 2020 were 40% to 52%.
28. In support of the revenue projection, the Company's management relied on six agreements of intent (**Agreements of Intent**) between the Subsidiary and potential customers in relation to the coal warehousing services to be provided by the Subsidiary.

29. However, these agreements did not set out the period of services to be provided nor the final terms of the Coal Warehouse Business, and expressly provided that it would only become effective upon the signing of the formal agreement.
30. There was, therefore, considerable uncertainty as to both the timing and quantum of the future revenue to be generated from the Coal Warehouse Business, as well as the legally binding effect of the Agreements of Intent. Nevertheless, the Auditor concurred with the Company's management approach to rely on these agreements as the basis for revenue projection.
31. For the projected profit margins of the Subsidiary for the four-year period from 2017 to 2020, the Auditor conducted an industry review by comparing the profit margins of two companies, and concluded that the projected profit margins were "*in line with the industry figure*" and hence reasonable.
32. However, there was no evidence that the Auditor had assessed why these two companies were considered as comparable companies given the difference in geographical locations in which these companies operate, and that these companies did not engage in coal warehousing business in the People's Republic of China.
33. For the assumption on capital expenditure of approximately RMB90 million, there was no evidence that the Auditor had carried out any audit procedures to assess the reasonableness of this assumption.
34. Accordingly, the AFRC found that the Auditor failed to:
 - 34.1 design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence to assess the reasonableness of the key assumptions and projections by the Company's management used in the DCF Model, in breach of HKSA 500.6;
 - 34.2 adequately evaluate whether the Agreements of Intent were sufficiently reliable to support the revenue projection for the Coal Warehouse Business for a 16-year period, in breach of HKSA 500.9;
 - 34.3 adequately evaluate the appropriateness of the valuation by the Company's Valuer as audit evidence, in breach of HKSA 500.8;
 - 34.4 adequately evaluate the appropriateness of the method of measurement and the reasonableness of the financial projections and assumptions for the Coal Warehouse Business provided by the Company's management, in breach of HKSA 540.13 and 540.18; and
 - 34.5 exercise sufficient professional skepticism by accepting without adequate challenge the revenue projection made by the Company's

management and how the Agreements of Intent could adequately support the revenue projection, in breach of HKSA 200.15.

Issue Two – Incorrect treatment of the Buildings

35. The Company's Valuer treated the Buildings as non-operating assets and included the fair value of the entirety of the Buildings of RMB55 million as at 31 December 2016 to derive the fair value of the Subsidiary.
36. Given that the Buildings were predominantly intended for use to conduct the Coal Warehouse Business, they should not be treated as non-operating assets. Consequently, the Group overstated the fair value of the Subsidiary as it included both the fair value of the Buildings (as non-operating assets) and the projected cash flows from continuous use of the Buildings (for the Coal Warehouse Business).
37. The Auditor asserted that the Company's Valuer considered the Buildings as a separate business unit from the Coal Warehouse Business, that the Company's management represented that the DCF projection included rental expenses paid to the investment properties unit, and therefore the fair value of the Buildings should be added back to the Subsidiary's valuation. However, the Auditor failed to perform any audit procedures to obtain sufficient appropriate evidence to corroborate such representations.
38. Accordingly, the AFRC found that the Auditor failed to:
 - 38.1 evaluate the appropriateness of the treatment by the Company's Valuer of the entire Buildings as non-operating assets in circumstances where the Buildings were to be used predominantly as income-generating asset for the Coal Warehouse Business, in breach of HKSA 500.8;
 - 38.2 obtain sufficient appropriate evidence to corroborate the representations by the Company and the Company's Valuer in paragraph 37 above, in breach of HKSA 500.6; and
 - 38.3 exercise sufficient professional skepticism in accepting, without adequate challenge, the approach by Company's Valuer in treating the entire Buildings as non-operating assets of the Subsidiary, in breach of HKSA 200.15.

Issue Three – Insufficient evaluation and challenge of the work of the Second Valuer

39. The Auditor relied on a second opinion (**Second Valuation Report**) from another valuer (**Second Valuer**) who concluded that the valuation methodology adopted by the Company's Valuer in the Business Valuation

Report was reasonable, and the key valuation parameters adopted by the Company's Valuer were within reasonable range.

40. However, there is no evidence that the Auditor had evaluated the Second Valuer's necessary competence, capabilities and objectivity, or that the Auditor had obtained a sufficient understanding of the field of expertise of the Second Valuer which would enable it to evaluate the adequacy of the Second Valuer's work.
41. In addition, there was no written agreement for the Second Valuer's review and the scope of the Second Valuation Report was limited, which focused on a list of valuation parameters, but did not specifically address key issues such as the appropriateness of treating the Buildings as non-operating assets of the CGU.
42. Accordingly, the AFRC found that the Auditor failed to:
 - 42.1 evaluate the competence, capabilities and objectivity of the Second Valuer, and to understand the Second Valuer's field of expertise to enable the Auditor to evaluate the adequacy of the Second Valuer's work, in breach of HKSA 620.9 and 620.10; and
 - 42.2 evaluate the adequacy of the Second Valuer's work, in breach of HKSA 620.12.

Issue Four – Inaccuracies or inconsistencies in respect of measurements relating to the CGU's carrying value

43. For the purpose of the impairment testing of the Goodwill, the Company's management failed to follow the requirement in HKAS 36.C4 to include the goodwill attributable to the non-controlling interests (HK\$47.4 million) in the carrying value of the Goodwill.
44. The Auditor failed to properly evaluate the information provided by the Company and identify this omission. Consequently, the carrying value of the Goodwill for the purpose of the impairment testing was understated by HK\$47.4 million, which would have made a difference when assessing whether an impairment loss should be recognised.
45. The Auditor also failed to perform any audit procedures to reconcile a material difference of RMB8.2 million (equivalent to HK\$9.1 million) between (i) the value of the Subsidiary's net assets in the audit working papers in relation to the impairment testing of the Goodwill and (ii) the value of the Subsidiary's total equity as stated in the Business Valuation Report.

46. Accordingly, the AFRC found that the Auditor failed to:
- 46.1 design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence to assess the carrying value of the Goodwill and the Subsidiary's net assets for the purpose of impairment testing, in breach of HKSA 500.6; and
 - 46.2 adequately evaluate whether the information produced by the Company in relation to the carrying value of the Goodwill and the Subsidiary's net assets was sufficiently reliable, accurate and complete, in breach of HKSA 500.9.
- C. Failure to obtain reasonable assurance to support the audit opinion on the 2016 Financial Statements
47. The amount of Goodwill in the 2016 Financial Statements was HK\$49.3 million, which was more than 15 times the materiality level for the Audit Engagement.
48. In light of the issues identified above in relation to the initial recognition and the impairment testing of the Goodwill, the AFRC found that the Auditor failed to obtain reasonable assurance on whether the 2016 Financial Statements as a whole were free from material misstatement, in breach of HKSA 200.11.
- D. Failure by the EQCR to perform an objective evaluation of the engagement
49. There was no evidence that Ling had performed an objective evaluation of the engagement team's significant judgments and conclusions reached in relation to the initial recognition of the Goodwill as at Acquisition Date and the impairment testing of the Goodwill as at 31 December 2016.
50. There was also no evidence that Ling had challenged the engagement team's decisions on the extent and nature of work performed, and the evidence obtained and the conclusion reached by the engagement team on this matter.
51. Accordingly, the AFRC found that Ling was in breach of HKSA 220.20.
- E. Failure to comply with the requirements under the COE
52. As the engagement partner of the Audit Engagement, Chan was responsible for the overall quality of the Audit Engagement. He was required to act diligently to ensure that sufficient appropriate audit evidence had been obtained to support the conclusions reached by the engagement team.
53. However, for reasons stated at paragraphs 16 to 48 above, the Auditor failed to properly interpret or apply the applicable financial reporting standards, and exercise appropriate professional skepticism in evaluating the information provided by the Company's management in the measurement and impairment

assessment of the Goodwill arising from the Acquisition.

54. As the EQCR, Ling had failed to act diligently by failing to critically review the audit work relating to the significant judgments made by the engagement team and the conclusions reached.
55. In light of the above, the AFRC found that Chan and Ling failed to observe, maintain or otherwise apply the fundamental principle of professional competence and due care in respect of the Audit Engagement, in breach of COE 100.5(c) and 130.1.

Conclusion

56. Having considered all the circumstances, the AFRC is of the view that Centurion, Chan and Ling are guilty of CPA misconduct.
57. In deciding the disciplinary sanctions set out in paragraph 1 above, the AFRC has had regard to its *Sanctions Policy for Professional Persons* and *Guidelines for Exercising the Power to Impose a Pecuniary Penalty for Professional Persons*, and has taken into account all relevant circumstances, including:
 - 57.1 the nature and seriousness of the conduct involved serious breaches of auditing standards in respect of key audit matters of business combination and impairment testing of the Goodwill of a listed company;
 - 57.2 the multiple audit deficiencies which could impact on the investing public's understanding as to the true financial position of the Company;
 - 57.3 there is no evidence of intentional, dishonest or deliberate misconduct;
 - 57.4 the audit deficiencies relate to one audit year only;
 - 57.5 the risk of material misstatement in the 2016 Financial Statements; and
 - 57.6 Centurion and Chan's past disciplinary records with the HKICPA.⁵ Ling has no disciplinary record with the HKICPA.

⁵ Centurion has one disciplinary record in 2017 with the HKICPA, and Chan has three recent disciplinary records in 2016, 2019, and 2021 respectively with the HKICPA.