

STATEMENT OF DISCIPLINARY ACTION

A. The Disciplinary Action

1. Pursuant to section 37CA of the Accounting and Financial Reporting Council Ordinance (Cap. 588) (**AFRCO**), the Accounting and Financial Reporting Council (**AFRC**) has:
 - 1.1. publicly reprimanded PricewaterhouseCoopers (**PwC**)¹ and imposed a pecuniary penalty of **HK\$800,000**;
 - 1.2. publicly reprimanded Mr Cheng Kwong On (**Cheng**)² and imposed a pecuniary penalty of **HK\$600,000**; and
 - 1.3. publicly reprimanded Mr Kong Ling Yin, Raymond (**Kong**)³ and imposed a pecuniary penalty of **HK\$200,000**.
2. The disciplinary action was taken in relation to the audits of the financial statements of Dynasty Fine Wines Group Limited (**Company**) and its subsidiaries (together, **Group**) by PwC for the years ended 31 December 2010 (**2010 Financial Statements**) and 31 December 2011 (**2011 Financial Statements**) (together, **Relevant Financial Statements**).
3. Cheng was the engagement partner for both audits (respectively, **2010 Audit** and **2011 Audit**). Collectively, PwC and Cheng are referred to as the **Auditor**.
4. Kong was the engagement quality control reviewer for both the 2010 and 2011 Audits.
5. As explained in the “**Summary of Findings**” section below, the AFRC found audit deficiencies in the work of PwC, Cheng and Kong in the area of revenue recognition, which constituted failures to observe, maintain or otherwise apply the PAO professional standards (as defined under section 2 of the AFRCO). Those deficiencies therefore constitute professional irregularities pursuant to section 3B(1)(c) of the AFRCO, and in turn, constitute CPA misconduct pursuant

¹ PwC is and was at all material times a CPA firm (firm registration number: 0034) registered with the Hong Kong Institute of Certified Public Accountants (**HKICPA**) and also registered as a PIE auditor in Hong Kong since 1 October 2019.

² Cheng is and was at all material times a fellow member of the HKICPA (membership number: F04037) and practising certificate holder (practising certificate number: P04726). He has also been registered as an engagement partner and engagement quality control reviewer in relation to a registered PIE auditor since 1 October 2019.

³ Kong is and was at all material times a member of the HKICPA (membership number: A06486). He was also a practising certificate holder (practising certificate number: P03167) at the material time. He was also registered as an engagement partner and engagement quality control reviewer in relation to a registered PIE auditor between 1 October 2019 and 1 July 2024.

to section 37AA(1)(a) of the AFRCO.⁴

6. The PAO professional standards which the regulatees failed to observe, maintain or otherwise apply were as follows:

6.1. The Auditor failed to observe, maintain or otherwise apply:

6.1.1. HKSA 200 (*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*);

6.1.2. HKSA 240 (*The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*);

6.1.3. HKSA 315 (*Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*);

6.1.4. HKSA 330 (*The Auditor's Responses to Assessed Risks*);

6.1.5. HKSA 500 (*Audit Evidence*);

6.1.6. HKSA 505 (*External Confirmations*);

6.1.7. HKSA 520 (*Analytical Procedures*); and

6.1.8. HKSA 700 (*Forming an Opinion and Reporting on Financial Statements*).⁵

6.2. In addition to the above, Cheng failed to observe, maintain or otherwise apply:

6.2.1. HKSA 220 (*Quality Control for an Audit of Financial Statements*); and

6.2.2. the Code of Ethics for Professional Accountants (**Code of Ethics**).

6.3. Kong failed to observe, maintain or otherwise apply:

6.3.1. HKSA 220; and

6.3.2. the Code of Ethics.

⁴ This disciplinary matter was handled in accordance with section 71 of the Accounting and Financial Reporting Council (Transitional and Saving Provisions and Consequential Amendments) Regulation (Cap. 588B). PwC, Cheng and Kong were treated as if they were professional persons under the AFRCO.

⁵ All references to accounting and auditing standards in this Statement of Disciplinary Action are references to the versions applicable at the time of the relevant audits.

B. Summary of Facts

7. The Company was incorporated in the Cayman Islands and listed on the Main Board of The Stock Exchange of Hong Kong Limited.⁶ The Group was primarily engaged in the business of manufacturing and sale of wine products.
8. PwC was the auditor of the Relevant Financial Statements and issued an unmodified opinion in each of the 2010 and 2011 Audits.
9. According to the Relevant Financial Statements, the total amounts of revenue arising from the manufacturing and sale of wine products recognised by the Group in 2010 and 2011 were HK\$1.61 billion and HK\$1.45 billion respectively.
10. In late 2012, PwC received anonymous allegations that the Group's revenue had been inflated and a substantial amount of sales was fictitious. As a result, the Company engaged Ernst & Young Advisory Services Limited to conduct an internal investigation (**Internal Investigation**), which revealed that a significant portion of revenue recognised by the Group was for goods yet to be delivered to its customers.
11. Among other things, the Internal Investigation found that in respect of the sales of RMB350 million recognised in 2010, only approximately RMB1 million of the corresponding wine products were in fact delivered to the Group's designated distributors in 2010.
12. In light of the Internal Investigation findings, the Company made prior year adjustments to correct misstated revenue in the Relevant Financial Statements, which resulted in the Group's reported net profit for 2011 dropping by approximately HK\$8.3 million, from a net profit of HK\$2.2 million to a net loss of HK\$6.1 million.⁷ The prior year adjustments also led to a substantial decrease in the Group's retained earnings by HK\$224.7 million and HK\$262 million in 2010 and 2011 respectively.
13. By reason of the Internal Investigation and the consequent delay in publishing the 2012 financial statements, trading in the shares of the Company was suspended for more than six years from 22 March 2013 to 28 July 2019.

C. Summary of Findings

14. The key responsibility of an auditor is to assess the risks of material misstatement in the financial statements, and carry out audit procedures to reduce those risks to an acceptably low level, so as to provide reasonable assurance that the financial statements as a whole are free from material misstatement.
15. Revenue recognition is an area with particular risks of material misstatement, as revenue is a key performance indicator and can be susceptible to

⁶ The Company's stock code is 00828.

⁷ The restatement made to 2010 net profit is unclear, as the Group's 2012 financial statements only set out the Group's restated net profit for 2011.

manipulation by management. As a result, the auditing standards provide that there is a presumed risk of fraud in respect of revenue recognition.

16. Pursuant to the Group's accounting policy at all material times, and in line with HKAS 18 (*Revenue*), the Group was permitted to recognise revenue from the sales of goods only when the following criteria were met:
 - 16.1. the Group had delivered the products to the customers (i.e. distributors of the Group's wine products);
 - 16.2. the customer had accepted the products; and
 - 16.3. collectability of the related receivables was reasonably assured.
17. However, the Group's controls were fundamentally ineffective in ensuring the correct recognition of revenue, because those controls did not keep track of when the first two criteria had been met – i.e. they did not keep track of when the Group's wine products had been delivered to and accepted by customers. While the Group did generate sales orders and goods delivery notes (**GDNs**) as part of the sales process, those did not provide evidence of delivery / acceptance, because:
 - 17.1. both the sales orders and GDNs were generated internally by the Group; and
 - 17.2. in the case of the GDNs specifically – while GDNs might ordinarily provide evidence of delivery / acceptance if they were signed by customers to acknowledge receipt of the goods, the Group did not in fact request its customers to do so. As a result, the GDNs only demonstrated that the goods had purportedly been transferred out of the Group's warehouses, and did not provide any evidence of delivery / acceptance.
18. As a result:
 - 18.1. the Group was effectively unable to identify when revenue should be recognised in respect of each sales transaction; and
 - 18.2. the Auditor was similarly unable to identify when revenue should be recognised in respect of those sales transactions, based on the Group's books and records alone.
19. The Auditor ought to have recognised the above in the course of obtaining an understanding of the Group's revenue cycle and internal controls at the outset of the audit (see further at Section C.1 below). In particular, the Auditor ought to have identified that the Group's sales orders and GDNs were not evidence of the delivery / acceptance of goods.
20. However, the Auditor failed to do so. This was a significant failure which triggered a range of other audit deficiencies throughout multiple stages of the

2010 and 2011 Audits, as follows:

- 20.1. Firstly, the Auditor inappropriately relied on internal controls relating to sales orders and GDNs (amongst other things) to conclude that there was no significant or elevated risk of misstatement in respect of the occurrence and accuracy of the Group's recorded sales. This was inappropriate, given that such controls were fundamentally ineffective in ensuring the correct recognition of revenue (as set out at paragraph 17 above). See further at Section C.1 below.
 - 20.2. Secondly, while the Auditor was apparently aware of the risks of misstatement due to fraud in relation to revenue recognition, it inappropriately placed reliance on internal controls in designing its audit procedures to respond to those risks. Again, this was inappropriate given that such controls were fundamentally ineffective in ensuring the correct recognition of revenue. See further at Section C.2 below.
 - 20.3. Thirdly, the Auditor performed tests of controls, but failed to recognise that the results of such tests provided little assurance that revenue had been correctly recognised, because the controls tested were fundamentally ineffective in this regard. See further at Section C.3 below.
 - 20.4. Fourthly, the Auditor performed tests of details involving the GDNs to determine whether revenue had been correctly recognised. However, the GDNs were not evidence of the delivery / acceptance of goods (see paragraph 17.2 above). As a result, those tests provided little assurance as to whether revenue had been correctly recognised. See further at Section C.4 below.
21. The Auditor also performed a range of other audit procedures in order to obtain audit evidence to support the Group's recorded revenues for 2010 and 2011. However, those procedures were inadequate for this purpose, because:
- 21.1. the audit evidence obtained did not demonstrate delivery / acceptance of goods, and therefore could not support a conclusion that revenue had been correctly recognised; and
 - 21.2. the audit procedures suffered from a range of other deficiencies, as set out in Section C.5 below. Most significantly, in lieu of actual evidence of delivery / acceptance of goods, the Auditor's sales cutoff tests heavily depended upon arbitrary assumptions regarding when delivery / acceptance of goods occurred, and therefore provided little assurance as to whether revenue had been correctly recognised (see paragraphs 35 to 38 below).
22. Ultimately, as a result of the audit deficiencies in the 2010 and 2011 Audits, the audit evidence obtained by the Auditor did not amount to sufficient appropriate audit evidence of the Group's recorded revenues for 2010 and 2011. See further at Section C.6 below.

C.1 Failure to understand revenue cycle and controls (2010 and 2011 Audits)

23. At the outset of the 2010 and 2011 Audits, the Auditor was obliged to obtain an understanding of the Group's revenue cycle and internal controls. In the course of doing so, the Auditor ought to have identified the matters set out at paragraphs 17 to 19 above, in particular, that the sales orders and GDNs did not provide evidence of delivery / acceptance. However, based on the available evidence, the Auditor failed to do so.
24. As a result, the Auditor erroneously relied on controls relating to sales orders and GDNs (amongst other things) to conclude that there was no significant or elevated risk of misstatement in respect of the occurrence and accuracy of the Group's recorded sales. This constituted a breach of HKSA 315.25 and 26.
25. To the extent that the Auditor now claims to have relied on other controls to reach this conclusion, the AFRC finds that: (a) the Auditor's reliance was inappropriate, in that the Auditor's knowledge of those controls was based solely on management's representations; and/or (b) such controls were not in fact relied upon by the Auditor at the time of the audits.

C.2 Failure to properly assess and respond to the risks of material misstatement due to fraud (2010 and 2011 Audits)

26. In both the 2010 and 2011 Audits, the Auditor's recorded assessment of the risks of misstatement due to fraud (in relation to revenue recognition) appeared inconsistent, or was at best unclear.
27. The audit working papers suggest, at least in part, that the Auditor placed some reliance on the Group's internal controls in designing its audit procedures to respond to those risks. However, this reliance was inappropriate, as the Group's internal controls did not adequately address such risks, particularly in light of the fact that such controls did not keep track of the delivery / acceptance of goods. This constituted a failure to:
 - 27.1. obtain a proper understanding of the Group's controls relevant to the risks of fraud in revenue recognition in its fraud risk assessment, in breach of HKSA 240.27;
 - 27.2. properly evaluate the design of the Group's controls and their implementation, in breach of HKSA 315.13;
 - 27.3. properly determine the overall responses to address the fraud risks in revenue recognition, in breach of HKSA 240.28; and
 - 27.4. adequately design and perform further audit procedures which were responsive to fraud risks at the assertion level, in breach of HKSA 240.30.

C.3 Failure to properly design tests of controls (2010 and 2011 Audits)

28. In both the 2010 and 2011 Audits, the Auditor tested a range of controls in the sales process. This included checking samples of sales invoices against the sales orders or GDNs. The Auditor concluded that there were no deviations from controls.
29. However, those controls did not keep track of when goods had been delivered to and accepted by customers. As a result, even if the controls were operating as designed, they were fundamentally ineffective in ensuring that revenue had been correctly recognised.
30. The Auditor therefore failed to properly design tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of the relevant controls, in breach of HKSA 330.8.

C.4 Failure to properly design and perform sales transactions test (2011 Audit)

31. The Auditor inspected sales invoices and GDNs on a sample basis to assess whether the sales transactions recorded in 2011 had been correctly recognised.
32. However, the GDNs only demonstrated that the goods were purportedly transferred out of the Group's warehouses and did not provide any evidence that the goods were delivered to and accepted by the customers, which were essential criteria for revenue recognition under the Group's accounting policy. Therefore, the Auditor should not have relied on the GDNs as audit evidence to support the occurrence of sales.
33. Further, the samples selected by the Auditor were not representative of the transactions that occurred during the year, in that they were only selected from sales transactions recorded in January 2011 and December 2011.
34. In the circumstances, the Auditor failed to properly design and perform audit procedures to obtain sufficient appropriate audit evidence to support the occurrence of sales recognised in 2011, in breach of HKSA 500.6 and 10.

C.5 Other audit deficiencies relating to revenue

35. **Sales cutoff tests (2010 and 2011 Audits)** – The Auditor was aware of an elevated risk of cutoff errors in the 2010 and 2011 Audits (meaning errors whereby sales recorded close to the year-end cutoff date might be recognised in the wrong financial year). The Auditor therefore conducted sales cutoff tests to determine whether sales had been recognised in the correct financial year.
36. However, in the absence of evidence of delivery / acceptance of goods:
 - 36.1. the Auditor depended heavily upon inappropriate and arbitrary assumptions in both the 2010 and 2011 Audits regarding the time taken for goods to be delivered to customers, despite the existence of audit evidence suggesting that delivery took much longer; and

- 36.2. these assumptions, in turn, affected the Auditor's assessment of whether sales transactions had been correctly recognised before or after the cutoff date and the parameters of the Auditor's sample of transactions for cutoff testing.
37. The Auditor's sales cutoff tests in the 2011 Audit were also deficient in that the Auditor failed to: (a) select several sales transactions for the cutoff test despite those transactions meeting the selection criteria; and (b) obtain GDNs for several transactions sampled as part of the cutoff test, without recording any explanation or obtaining alternative audit evidence.
38. The above deficiencies in the cutoff tests constituted failures to, among other things:
- 38.1. properly design and perform audit procedures which were responsive to the risk of cutoff error, in breach of HKSA 330.6; and
- 38.2. properly design and perform audit procedures to obtain sufficient appropriate audit evidence, in breach of HKSA 500.6.
39. **Preliminary analytical review (2010 and 2011 Audits)** – The Auditor's preliminary analytical review identified significant and unusual fluctuations in revenue. However, the Auditor merely relied on brief management representations to explain such fluctuations, without making appropriate further inquiries. This constituted a failure to adequately exercise professional skepticism and professional judgment, in breach of HKSA 200.15 and 16.
40. **Tests of controls (2010 Audit)** – These tests revealed significant deviations from one significant control in the sales process, being the sales manager's approval of sales orders, indicating that the control was not operating effectively. However, again, the Auditor merely relied on management representations to explain this, without making appropriate further inquiries. This constituted a failure to properly inquire into deviations from controls, in breach of HKSA 330.17.
41. **Sales and gross profit analyses (2010 and 2011 Audits)** – The Auditor performed these tests to identify if recorded sales and gross profit were significantly different from expectations, which would indicate potential misstatement. However, in doing so, the Auditor:
- 41.1. relied on arbitrary and unjustified assumptions to calculate expected annual sales for each year. This constituted a failure to properly determine whether the sales and gross profit analyses were suitable for responding to the assessed risks of material misstatement, in breach of HKSA 520.5(a); and
- 41.2. simply accepted management representations to explain significant fluctuations in sales and significant differences between recorded and expected revenues, without obtaining corroborative evidence. This

failure to investigate further constituted a breach of HKSA 520.7.

42. **Customer confirmations (2010 and 2011 Audits)** – The Auditor circulated confirmation requests to the Group’s customers, but failed to properly investigate instances where the returned confirmations “confirmed” accounts receivable balances which were significantly different from those recorded by the Group. This constituted a failure to properly investigate exceptions indicative of misstatements, in breach of HKSA 505.14.

C.6 Ultimate failure to obtain sufficient appropriate audit evidence (2010 and 2011 Audits)

43. Ultimately, as a result of the audit deficiencies above, the audit evidence obtained by the Auditor did not amount to sufficient appropriate audit evidence of the Group’s recorded revenues.

44. Consequently, the Auditor was not in a position to conclude whether the Relevant Financial Statements complied with HKAS 18, and therefore should not have issued a clean audit opinion.

45. The Auditor therefore failed in each of the 2010 and 2011 Audits to:

45.1. obtain sufficient appropriate audit evidence that the Group had correctly recognised revenue, in breach of HKSA 330.26;

45.2. obtain reasonable assurance that the Relevant Financial Statements were free from material misstatement, in breach of HKSA 700.11; and

45.3. properly evaluate whether the Relevant Financial Statements were prepared, in all material aspects, in accordance with the requirements of the applicable financial reporting framework, in breach of HKSA 700.12.

C.7 Relevant breaches by the engagement partner

46. In view of the numerous and pervasive audit deficiencies identified, Cheng failed to properly discharge his duties as the engagement partner in the 2010 and 2011 Audits, in breach of HKSA 220.8, 15 and 17, as well as paragraphs 100.5(c) and 130.1 of the Code of Ethics.

C.8 Relevant breaches by the engagement quality control reviewer

47. Kong should have, but failed to, identify that the Auditor’s response to the unusual fluctuations in sales and difference between recorded and expected revenue noted in the substantive analytical procedures was inadequate (see paragraph 41 above), even though these matters were obvious red flags that could be indicative of increased fraud risks and should have prompted further investigation.

48. In the circumstances, Kong failed to properly perform the engagement quality

control review in each of the 2010 and 2011 Audits. In particular, he failed to:

- 48.1. properly evaluate the engagement team's significant judgments made and conclusions reached in formulating the auditor's reports, and consider whether the audit documentation reviewed supported the conclusions reached and whether it was appropriate for the engagement team to form an unmodified audit opinion on the Relevant Financial Statements, in breach of HKSA 220.20 and 21 (as explained in HKSA 220.A28); and
- 48.2. exercise professional competence and due care in carrying out his duties as the engagement quality control reviewer, in breach of paragraphs 100.5(c) and 130.1 of the Code of Ethics.

D. Conclusion

49. Having considered all relevant circumstances, the AFRC is of the view that each of PwC, Cheng and Kong failed to observe, maintain or otherwise apply the PAO professional standards (as defined by section 2 of the AFRCO). Each of them has therefore committed a professional irregularity under section 3B(1)(c) of the AFRCO, and is guilty of CPA misconduct pursuant to section 37AA(1)(a) of the AFRCO.
50. 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 the following.

D.1 The nature and seriousness of the conduct involved

51. The misconduct committed by the Auditor is serious, in that there were multiple deficiencies identified in each of the 2010 and 2011 Audits, which were pervasive in nature and concerned fundamental areas of the audits, from audit planning and risk assessment to tests of controls, and the design and performance of substantive audit procedures.
52. In both the 2010 and 2011 Audits, the Auditor failed to exercise an adequate level of professional skepticism. There were multiple instances where the Auditor failed to resolve inconsistencies identified in the audit evidence or investigate unusual fluctuations, and seek corroboration for management representations where appropriate.
53. Accordingly, the Auditor's work fell short of what was reasonably expected of it, and the Auditor failed in its overall objective, namely to provide reasonable assurance that the Relevant Financial Statements were free from material misstatement.
54. As for Kong, he should have properly evaluated the significant judgments made and conclusions reached by the Auditor during the engagement quality control

review and identified that the Auditor lacked sufficient appropriate audit evidence to support its conclusions in the critical area of revenue recognition. Kong's failure to do so contributed to the Auditor's incorrect issuance of an unmodified audit opinion.

55. The AFRC considers Kong's misconduct to be moderately serious when compared against the Auditor's misconduct.
56. That being said, there was no finding of intentional, dishonest or deliberate misconduct by any of the regulatees.

D.2 Frequency and duration of the misconduct

57. The breaches by the regulatees lasted for two audit years, and were neither isolated incidents nor the result of one-off oversight.

D.3 Impact of the misconduct

58. The regulatees' misconduct significantly increased the risk that any misstatement of the Group's revenue would remain undetected across multiple years. Given that revenue is a key performance measure for a retail group such as the Group, such misstatements could significantly affect the decisions of users of the financial statements (including the Group's shareholders and creditors) and be prejudicial to the interests of the investing public.
59. In this case, the Company itself subsequently considered that revenues had been misstated. Following the Internal Investigation, the Group made prior year adjustments in the 2012 financial statements to rectify the misstatements in relation to, among other things, the revenue reported in the Relevant Financial Statements. This resulted in the Group's reported net profit for 2011 dropping by approximately HK\$8.3 million, from a net profit of HK\$2.2 million to a net loss of HK\$6.1 million. The prior year adjustments also led to a substantial decrease in the retained earnings of the Group as at 31 December 2011 and 1 January 2011.

D.4 Mitigating factor

60. Both Cheng and Kong have a clean disciplinary record with the AFRC and the HKICPA. This has been taken into account as a mitigating factor.