

## STATEMENT OF DISCIPLINARY ACTION

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### A. The Disciplinary Action

1. Pursuant to sections 37CA and 37I(1A) of the Accounting and Financial Reporting Council Ordinance (Cap. 588) (**AFRCO**), the Accounting and Financial Reporting Council (**AFRC**) has:
  - 1.1. publicly reprimanded each of BDO Limited (**BDO**), Lo Ngai Hang (**Lo**) and Lam Hung Yun Andrew (**Lam**);
  - 1.2. imposed a pecuniary penalty of **HK\$840,000** against BDO;
  - 1.3. imposed a pecuniary penalty of **HK\$196,000** against Lo;
  - 1.4. imposed a pecuniary penalty of **HK\$420,000** against Lam; and
  - 1.5. directed each of Lo and Lam to:
    - 1.5.1 undertake 30 verifiable continuing professional development (**CPD**) hours<sup>1</sup> on specified areas<sup>2</sup> within 12 months from the date of the issuance of the Decision Notices to Lo and Lam respectively; and
    - 1.5.2 provide the AFRC with evidence of compliance with paragraph 1.5.1 above within three months upon the expiry of the 12 months' period,

(collectively, **Disciplinary Action**).

2. The Disciplinary Action was taken in relation to the audits of the consolidated financial statements of China Water Affairs Group Limited (**Company**) (stock code: 00855) and its subsidiaries (collectively, the **Group**) for the years ended 31 March 2011 to 31 March 2016 (**2011 to 2016 Financial Statements** respectively).

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<sup>1</sup> The 30 verifiable CPD hours shall be in addition to any requirements applicable to each of Lo and Lam in connection with any professional licence (including those as set out in Statement 1.500 (*Continuing Professional Development*) issued by the Hong Kong Institute of Certified Public Accountants (**HKICPA**)).

<sup>2</sup> More specifically, (a) 15 verifiable CPD hours shall focus on professional judgment and professional skepticism under Hong Kong Standard on Auditing (**HKSA**) 200 (*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*), and (b) 15 verifiable CPD hours shall focus on audit procedures, audit evidence and the use of work of a management's expert under HKSA 500 (*Audit Evidence*).

3. BDO<sup>3</sup> conducted the audits of the 2011 to 2016 Financial Statements (**2011 to 2016 Audits** respectively). Lo<sup>4</sup> was the engagement partner for the 2011 and 2012 Audits, and Lam<sup>5</sup> was the engagement partner for the 2013 to 2016 Audits. Unless otherwise stated, **Auditor** refers to (a) BDO and Lo for the 2011 and 2012 Audits, and (b) BDO and Lam for the 2013 to 2016 Audits.
4. The AFRC found multiple audit deficiencies in the 2011 to 2016 Audits regarding the Auditor's assessment of whether or not certain water supply arrangements of the Group fell within the scope of the Hong Kong (IFRIC) Interpretation 12 (*Service Concession Arrangements*) (**HK(IFRIC)-Int 12**) (and therefore whether or not the relevant water supply infrastructure should be accounted for as property, plant and equipment or other intangible assets in the 2011 to 2016 Financial Statements). Most significantly, the Auditor:
  - 4.1. failed to perform adequate audit procedures and obtain sufficient appropriate audit evidence in evaluating the accounting of the relevant water supply arrangements, such as failing to obtain a sufficient understanding of the relevant documents including various agreements and the rules and regulations of the People's Republic of China (**PRC**) applicable to water supply business at the time, critically evaluate the terms therein and consider whether paragraph 5(b) of HK(IFRIC)-Int 12 (**Relevant Condition**) was fulfilled or not;
  - 4.2. failed to critically assess and challenge the management's assessment and judgments with professional skepticism notwithstanding the apparent inconsistencies between the management's view and other audit evidence, failed to seek further clarifications with the management and/or the Company's legal advisers, and consequently failed to properly evaluate the management's judgments in applying the applicable financial reporting framework and whether sufficient appropriate audit evidence had been obtained;
  - 4.3. failed to exercise appropriate professional judgment in evaluating the appropriateness of the accounting of the relevant water supply arrangements; and
  - 4.4. failed to critically evaluate whether the accounting of the water supply arrangements for some of the Group's subsidiaries was in compliance with HK(IFRIC)-Int 12 in forming the unmodified auditor's opinions.

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<sup>3</sup> BDO is registered as a corporate practice and a public interest entity auditor with the AFRC (registration number M0200).

<sup>4</sup> Lo is a member of the HKICPA (number A11991) and currently holds a practising certificate (number P04743). He is currently a practising director, a registered engagement partner and a registered engagement quality control reviewer of BDO.

<sup>5</sup> Lam is a member of the HKICPA (number F03338) and currently holds a practising certificate (number P04092). He is currently a practising director, a registered engagement partner, a registered engagement quality control reviewer and a registered quality control system responsible person of BDO.

5. The AFRC further found that each of BDO and Lam failed to critically assess whether various PRC legal opinions obtained for the 2015 and 2016 Audits were relevant and/or sufficient in evaluating and determining whether the Relevant Condition was fulfilled and failed to seek further clarification with the Company's legal advisers.
6. The AFRC further found that in light of the deficiencies of Lo and Lam, each of them also failed or neglected to observe, maintain or otherwise apply the fundamental principle of professional competence and due care in the 2011 to 2016 Audits.
7. As a result, the AFRC found that the Auditor failed or neglected to observe, maintain or otherwise apply the PAO professional standards<sup>6</sup> below in the relevant years of audits:
  - 7.1. for BDO (in each of the 2011 to 2016 Audits), Lo (in each of the 2011 and 2012 Audits) and Lam (in each of the 2013 to 2016 Audits):
    - 7.1.1 paragraphs 15, 16 and A26<sup>7</sup> of the applicable versions of HKSA 200 (*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*) (**HKSA 200**);
    - 7.1.2 paragraph 6 of the applicable versions of HKSA 500 (*Audit Evidence*) (**HKSA 500**); and
    - 7.1.3 paragraphs 10 and 13 of the applicable versions of HKSA 700 (*Forming an Opinion and Reporting on Financial Statements*) (**HKSA 700**);
  - 7.2. for BDO and Lam (in each of the 2015 and 2016 Audits): paragraphs 8 and A48 of HKSA 500; and
  - 7.3. for Lo (in each of the 2011 and 2012 Audits) and Lam (in each of the 2013 to 2016 Audits): sections 100.5(c) and 130.1 of the applicable versions of the Code of Ethics for Professional Accountants (**COE**).
8. By failing or neglecting to observe, maintain or otherwise apply the above PAO professional standards in the relevant years of audits, each of BDO, Lo and Lam is guilty of CPA misconduct pursuant to section 71 of the Accounting and Financial Reporting Council (Transitional and Saving Provisions and Consequential Amendments) Regulation (Cap. 588B) (**Transitional Regulation**).

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<sup>6</sup> As defined in section 2 of the AFRCO.

<sup>7</sup> Equivalent to the current version of HKSA 200.A29.

## **B. Summary of Facts**

9. The Company is and was at all material times listed on the Main Board of The Stock Exchange of Hong Kong Limited.
10. The water supply business was the core operation of the Group and was significant to the 2011 to 2016 Financial Statements. For the years ended 31 March 2011 to 31 March 2016, there were 23 to 53 principal subsidiaries of the Group engaged in water supply or water supply operation business.<sup>8</sup>
11. The Group entered into water supply arrangements with certain public sector entities and/or government authorities in the PRC (as grantors), which generally involved the Group (as operators) (i) constructing water supply infrastructure, and (ii) operating and maintaining the water supply infrastructure on behalf of the grantors at a specified level of serviceability for specified periods and at prices stipulated through a pricing mechanism.
12. In preparing the 2011 to 2016 Financial Statements, the Company's management considered that most of the water supply arrangements did not fall within the scope of HK(IFRIC)-Int 12.<sup>9</sup> Accordingly, those water supply arrangements were not accounted for in accordance with HK(IFRIC)-Int 12 and the relevant water supply infrastructure was recognised as property, plant and equipment in the 2011 to 2016 Financial Statements.
13. The Auditor conducted the 2011 to 2016 Audits in accordance with HKSAs and concurred with the management's accounting of the relevant water supply arrangements, and expressed an unmodified auditor's opinion on each of the 2011 to 2016 Financial Statements.
14. On 21 December 2016, the Company announced the interim condensed consolidated financial statements of the Group for the six months ended 30 September 2016. In preparing the same, the Company's management reassessed the accounting of the water supply arrangements and considered that many of the water supply arrangements previously determined to be outside the scope of HK(IFRIC)-Int 12 actually fulfilled the conditions in paragraph 5 of HK(IFRIC)-Int 12, and should have been accounted for in accordance with HK(IFRIC)-Int 12.
15. As a result, prior year adjustments were made to (a) reclassify the relevant water supply infrastructure previously classified as property, plant and equipment to other intangible assets, and (b) recognise the relevant revenue and costs relating to construction or upgrade services in connection with the relevant water supply infrastructure. Amongst others:

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<sup>8</sup> 2011: 23 subsidiaries; 2012: 25 subsidiaries; 2013: 25 subsidiaries; 2014: 30 subsidiaries; 2015: 35 subsidiaries; 2016: 53 subsidiaries.

<sup>9</sup> For the years ended 31 March 2011 to 31 March 2015, only one water supply arrangement was accounted for under HK(IFRIC)-Int 12. For the year ended 31 March 2016, only five water supply arrangements were accounted for under HK(IFRIC)-Int 12.

- 15.1. the amount of property, plant and equipment was restated and significantly reduced (i) from HK\$6,716 million to HK\$590 million as at 31 March 2016, and (ii) from HK\$5,995 million to HK\$618 million as at 31 March 2015;
- 15.2. the amount of other intangible assets was restated and significantly increased (i) from HK\$764 million to HK\$8,041 million as at 31 March 2016, and (ii) from HK\$176 million to HK\$6,526 million as at 31 March 2015;
- 15.3. the amount of revenue was restated and increased (i) from HK\$4,033 million to HK\$4,740 million for the year ended 31 March 2016, and (ii) from HK\$2,859 million to HK\$3,622 million for the year ended 31 March 2015;
- 15.4. the amount of profit for the year was restated and increased (i) from HK\$1,003 million to HK\$1,100 million for the year ended 31 March 2016, and (ii) from HK\$704 million to HK\$896 million for the year ended 31 March 2015; and
- 15.5. the amount of cost of sales was restated and increased from HK\$2,132 million to HK\$2,642 million for the year ended 31 March 2016, and (ii) from HK\$1,506 million to HK\$2,049 million for the year ended 31 March 2015.

### **C. Summary of Findings**

16. The audit work conducted in respect of the accounting treatment of the water supply arrangements in the 2011 to 2016 Financial Statements was the subject of an investigation conducted by the Audit Investigation Board (**AIB**) pursuant to section 23(3) of the then Financial Reporting Council Ordinance (Cap. 588).
17. In the investigation, the AIB selected for detailed review eight water supply arrangements of eight subsidiaries of the Group (**Subsidiaries A to H** respectively) which were previously determined to be outside the scope of HK(IFRIC)-Int 12 in the 2011 to 2016 Financial Statements.
18. The water supply infrastructure of the arrangements of Subsidiaries A to H was recognised as property, plant and equipment with the most significant carrying amounts, representing 66.3% to 79.5% of the consolidated property, plant and equipment and 57.6% to 69.3% of the consolidated net assets of the Group for the years ended 31 March 2011 to 31 March 2016.
19. The key accounting issue is whether the water supply arrangements fulfilled the Relevant Condition,<sup>10</sup> which provides that HK(IFRIC)-Int 12 applies if “the

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<sup>10</sup> For completeness, paragraph 5 of HK(IFRIC)-Int 12 specified two conditions that need to be satisfied for water supply arrangements to be accounted for in accordance with HK(IFRIC)-Int 12. It was undisputed that the first condition as set out in paragraph 5(a) of HK(IFRIC)-Int 12 was met.

*grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement”. Paragraph AG4 of HK(IFRIC)-Int 12 further provides that “the grantor’s control over any significant residual interest should both restrict the operator’s practical ability to sell or pledge the infrastructure and give the grantor a continuing right of use throughout the period of the arrangement”.*

20. During the relevant years, the Company’s management assessed that the Group retained the beneficial entitlement to the significant residual interest in the relevant water supply infrastructure at the end of the relevant water supply arrangements and therefore such arrangements did not fulfil the Relevant Condition. As a result, those arrangements were not accounted for in accordance with HK(IFRIC)-Int 12.
21. The Auditor assessed the relevant water supply arrangements and concurred with the management’s assessment in each of the 2011 to 2016 Audits. However, the AFRC found that the Auditor’s work in reaching this conclusion suffered from a range of deficiencies, including those summarised below.

### ***The Auditor’s Deficiencies During the 2011 to 2016 Audits***

#### ***Evaluation of the accounting of water supply arrangements***

22. The Auditor failed to obtain a sufficient understanding of the relevant documents, including various agreements and the PRC rules and regulations applicable to water supply business at the time, critically evaluate the terms therein and consider whether the Relevant Condition was fulfilled or not.
23. In respect of Subsidiaries A to C:
  - 23.1. These subsidiaries entered into service concession agreements with their respective grantors (**Service Concession Agreements**), which explicitly (a) mandated the subsidiaries to return or handover all water supply infrastructure to the PRC government authorities or designated party at the end of the concession arrangements, and (b) restricted the Group’s right to transfer, lease, mortgage or pledge the concession right and water supply infrastructure without the grantor’s consent.
  - 23.2. The grantor had the discretion to determine, at the expiry of the concession period, whether to grant an existing operator a second concession term, to allow a new operator to acquire and operate, or to acquire the assets and bring the arrangement “*in house*”.
  - 23.3. In the circumstances, contrary to the management’s assessment, the water supply arrangements of these subsidiaries fulfilled the Relevant Condition and should fall within the scope of HK(IFRIC)-Int 12. The accounting of these water supply arrangements in the 2011 to 2016 Financial Statements therefore did not comply with HK(IFRIC)-Int 12.

23.4. In concurring with the management's assessment, the Auditor failed to critically evaluate whether the accounting of the above water supply arrangements was in accordance with the requirements of HK(IFRIC)-Int 12 in forming the unmodified auditor's opinions.

24. In respect of Subsidiaries D to H:

24.1. There were no service concession agreements relating to the water supply arrangements of Subsidiaries D to H. These subsidiaries operated as joint venture enterprises (jointly with the government authorities / state-owned enterprises) or a wholly foreign-owned enterprise and were governed by various documents such as joint venture agreements, co-operation agreements and/or articles of association. There were no expressed provisions on how the water supply infrastructure should be dealt with at the end of the water supply arrangements.

24.2. The Auditor concurred with the management's assessment that the water supply arrangements of Subsidiaries D to H were outside the scope of HK(IFRIC)-Int 12. The Auditor considered that these subsidiaries did not enter into any service concession agreements, and in the absence of any specific provisions about the disposition of infrastructure at the end of the water supply arrangements in the agreements and articles of association, the grantor was unable to force the Group to dispose of and/or transfer them without the Group's consent. Therefore, the grantor could not be deemed to have control of the significant residual interest in the relevant water supply infrastructure.

24.3. However, under HK(IFRIC)-Int 12, the grantor's control is not limited to those arrangements governed by contract and the grantor could control any significant residual interest through ownership, beneficial entitlement or otherwise. Further, the grantor's control does not necessarily mandate the transfer of the infrastructure to the grantor at the end of the concession period.

24.4. In the circumstances, given the rights to the relevant water supply infrastructure were granted to the Group in the form of equity interests over these subsidiaries, an assessment of control over significant residual interest in such infrastructure should include an understanding and evaluation of the parties' respective rights and obligations in the transfer of equity interest in or dissolution of the relevant entities. The grantor could through its proportionate shareholding restrict the Group's practical ability to sell or pledge the relevant infrastructure and have a continuing right.

24.5. Besides, some of the relevant agreements and articles of association contained terms to the effect that a transfer of equity interest of the subsidiaries or renewal of the subsidiaries' operation period would require the approval of the relevant government authority. In such

case, the grantor could restrict the relevant subsidiaries' practical ability to sell the relevant infrastructure and had the continuous right to determine the use of the relevant infrastructure.

- 24.6. Therefore, the Auditor failed to obtain a sufficient understanding and critically evaluate the terms of the relevant documents governing the operations of Subsidiaries D to H and the PRC rules and regulations applicable at the time. The Auditor also failed to seek further clarifications with the management and/or the Company's legal advisers to determine whether the water supply arrangements fulfilled the Relevant Condition or not. As a result, the Auditor failed to obtain sufficient appropriate audit evidence to assess whether the Relevant Condition was fulfilled or not.

*Evaluation of the management's assessment and judgments*

25. Further, the Auditor failed to critically assess and challenge the management's assessment and judgments, including their validity and relevance to the accounting issue in question, with professional skepticism.
26. Certain views taken by the management in support of its assessment that the Group had control over the significant residual interest in the water supply infrastructure at the end of the relevant water supply arrangements were inconsistent with or contradictory to other audit evidence which might indicate possible misstatement due to error. For example:
- 26.1. The management considered that the grantor cannot force the transfer of the water supply infrastructure, and the Group could retain the water supply infrastructure and consider another method of operating them, if no agreement was reached on a satisfactory price for a transfer between the Group and the grantor at the end of the concession period. However, such view was contradictory to other audit evidence obtained by the Auditor. Amongst others, the Service Concession Agreements of Subsidiaries A to C contained expressed provisions to the contrary, as summarised in paragraph 23.1 above.
- 26.2. The management considered that the Group had priority rights to renew the water supply arrangements unless they did not intend to continue their operations. However, neither the agreements of the relevant water supply arrangements of Subsidiaries A to H nor the PRC rules and regulations considered by the Auditor and applicable at the time of the 2011 to 2015 Audits contain any provisions for a priority right to renew. To the contrary, the applicable PRC rules and regulations expressly provided that the grantors shall select an operator through tender in accordance with the stipulated procedures. It was only until June 2015 when a new PRC measure (**New**



**Measure**)<sup>11</sup> came into operation that provides for a priority right to renew, and therefore was applicable to the 2016 Audit only.

- 26.3. It should have been readily apparent to the Auditor that some of the management's views were irrelevant to the accounting issue in question, for example, whether there were significant barriers for new operators to enter into the relevant water supply arrangements.
27. The Auditor, however, failed to alert to such inconsistencies and seek further clarifications with the management, and failed to properly evaluate the management's judgments in applying the applicable financial reporting framework and critically assess whether sufficient appropriate audit evidence had been obtained.
28. In light of the above, the AFRC found that, in each of the 2011 to 2016 Audits, the Auditor:
- 28.1. failed to critically challenge the management's assessment and judgments with professional skepticism in accordance with HKSA 200.15;
- 28.2. failed to exercise appropriate professional judgment in evaluating the appropriateness of the accounting of the relevant water supply arrangements in accordance with HKSA 200.16 and A26;
- 28.3. failed to perform adequate audit procedures and obtain sufficient appropriate audit evidence in accordance with HKSA 500.6 in evaluating the accounting of the relevant water supply arrangements, such as obtaining a sufficient understanding of the relevant agreements and the rules and regulations applicable to the water supply business, critically evaluating the terms therein and considering whether they fulfil the conditions under HK(IFRIC)-Int 12; and
- 28.4. failed to critically evaluate whether the accounting of the water supply arrangements for Subsidiaries A to C was in compliance with HK(IFRIC)-Int 12 in forming the unmodified auditor's opinion in accordance with HKSA 700.10 and 13.

### ***The Auditor's Additional Deficiencies During the 2015 and 2016 Audits***

29. In addition to those failures summarised in paragraphs 22 to 28 above, additional deficiencies were identified during the 2015 and 2016 Audits.

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<sup>11</sup> The Measures for the Administration of Concession for Infrastructure and Public Utilities (基礎設施和公用事業特許經營管理辦法) issued by National Development and Reform Commission, the Ministry of Finance, the Ministry of Housing and Urban-rural Development, the Ministry of Transport, the Ministry of Water Resources of the PRC and the People's Bank of China in April 2015.

30. It was the Auditor's submission that:
  - 30.1. during the 2015 Audit, the Auditor noted diversified approaches in the market regarding the accounting treatments for water supply arrangements through research and agreed with the management to obtain new PRC legal opinions in respect of the relevant water supply arrangements; and
  - 30.2. during the 2016 Audit, the Auditor was aware of, among other things, the New Measure which was issued in April 2015 and became effective on 1 June 2015, and agreed with the management to obtain a new PRC legal opinion on the effect of the New Measure.
31. The Auditor relied upon eight PRC legal opinions obtained by the Company in the 2015 Audit in relation to each of Subsidiaries A to H, and a legal opinion obtained by the Company in the 2016 Audit. However, some of those PRC legal opinions contained contents that were contradictory to the management's assessment on whether the accounting of the water supply arrangements were in scope of HK(IFRIC)-Int 12, which might indicate possible misstatement due to error.
32. Most notably, the three PRC legal opinions obtained during the 2015 Audit for Subsidiaries A to C expressly referred to the provisions in the Service Concession Agreements outlined in paragraph 23.1 above. The Company's legal advisers advised that the Group had to return or handover the water supply infrastructure after the end of the concession period, and the Group could not sell, lease or pledge the water supply infrastructure without the grantors' approval.
33. Therefore, the audit evidence (including the Service Concession Agreements and the legal opinions) contradicted with the management's assessment that the Group had control over the significant residual interest of the relevant water supply infrastructure at the end of the concession period.
34. However, the Auditor failed to alert to such inconsistencies, failed to seek further clarifications with the management, failed to properly evaluate the management's judgments in applying the applicable financial reporting framework and failed to critically assess whether sufficient appropriate audit evidence had been obtained.
35. Further, the Auditor failed to critically assess whether the various PRC legal opinions obtained during the 2015 and 2016 Audits were relevant and/or sufficient in evaluating whether the Relevant Condition was fulfilled or not. For example, the PRC legal opinion obtained during the 2016 Audit opined on the applicability of the New Measure to service concession arrangements entered into before the effective date of the New Measure, but did not specifically advise on whether the New Measure was applicable to the specific water supply arrangements of the Group. The Auditor ought to have sought clarifications from the Company's legal advisers but failed to do so.

36. In light of the above, the AFRC found that, in each of the 2015 and 2016 Audits, the Auditor failed to critically assess whether the PRC legal opinions obtained during the 2015 and 2016 Audits were relevant and/or sufficient in evaluating whether the grantor had control over any significant residual interest in the water supply infrastructure at the end of the term of the arrangement to determine the applicability of HK(IFRIC)-Int 12 and seek further clarification with the Company's legal advisers in accordance with HKSA 500.8 and A48.
37. Further, the AFRC found that, in light of the deficiencies summarised in paragraphs 22 to 36 above, Lo and Lam, as the engagement partners of the 2011 and 2012 Audits and the 2013 to 2016 Audits respectively, failed or neglected to observe, maintain or otherwise apply the fundamental principle of professional competence and due care in sections 100.5(c) and 130.1 of the COE to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services, and to act diligently in accordance with applicable technical and professional standards.
38. As a result of the deficiencies summarised above, the 2011 to 2016 Financial Statements contained material misstatements.

#### ***Admission of Failures and CPA Misconduct by the Auditor***

39. The Auditor has each accepted without reservation the AFRC's findings in full and admitted the CPA misconduct found by the AFRC as summarised in paragraphs 4 to 38 above.

#### **D. Conclusion**

40. Having considered all relevant circumstances, the AFRC is of the view that each of the regulatees has failed or neglected to observe, maintain or otherwise apply the PAO professional standards in the relevant years of audits. Each of them is therefore guilty of CPA misconduct pursuant to section 71 of the Transitional Regulation.
41. In determining the Disciplinary Action, the AFRC has had regard to its Sanctions Policy for Professional Persons, Guidelines for Exercising the Power to Impose a Pecuniary Penalty for Professional Persons and the Guidance Note on Cooperation with the AFRC (**Guidance Note on Cooperation**), and has taken into account all relevant circumstances, including those summarised in the following.

#### ***Nature, seriousness, duration, frequency and impact of the misconduct***

42. Having considered the admitted facts and circumstances, the AFRC takes the view that the breaches were serious. The regulatees' misconduct as summarised in Section C above involved multiple audit deficiencies and breaches of the PAO professional standards in areas that are fundamental to the work of an auditor. This is particularly the case when the regulatees knew that the water supply business was the core operation of the Group and was

significant to the 2011 to 2016 Financial Statements. The regulatees' misconduct also demonstrated a concerning lack of understanding of HK(IFRIC)-Int 12.

43. That said, the AFRC does not make any finding of intentional, dishonest or deliberate misconduct by any of the regulatees.
44. The regulatees also admitted, which the AFRC accepted, that:
  - 44.1. the regulatees' breaches were repeated over a period of 6 years;
  - 44.2. the regulatees' breaches resulted in material misstatements in each of the 2011 to 2016 Financial Statements;<sup>12</sup> and
  - 44.3. since the relevant audits were conducted for a listed company, public confidence in the quality of corporate reporting and financial statements has inevitably been affected.

#### ***Aggravating and mitigating circumstances***

45. The AFRC has considered whether there are any aggravating and mitigating factors in this case, including the following.

#### ***Aggravating circumstances***

46. BDO has a clean disciplinary record with the AFRC, but has been the subject of sanctions in four disciplinary cases of the HKICPA in the past. In each of those cases, BDO was publicly reprimanded and ordered to pay financial penalties and costs. There were two other previous instances where the HKICPA issued disapproval letters to BDO. All the said HKICPA cases (save for one case) concerned audit engagements with companies listed in Hong Kong in 2010 to 2013, and in particular, two of those disciplinary cases involved breaches of HKSA 500 (which was one of the auditing standards concerned in the present case). These suggest a tendency of repeated failures to comply with auditing and professional standards and recurring misconduct. These are aggravating circumstances for BDO.

#### ***Mitigating circumstances***

47. Both Lo and Lam<sup>13</sup> have a clean disciplinary record with the HKICPA and the AFRC.
48. The AFRC has also taken into account the cooperation provided by the regulatees in this case. Amongst others, the regulatees admitted their

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<sup>12</sup> See the prior year adjustments made by the Company as briefly summarised in paragraph 15 above.

<sup>13</sup> There has been one previous instance of the HKICPA issuing a disapproval letter to Lam. However, having considered the circumstances of the case, the AFRC is of the view that no adjustment to the level of sanctions against Lam is required in the circumstances.

liabilities in full and initiated resolution discussions with the AFRC. The regulatees further accepted the Disciplinary Action against each of them and entered into an agreement with the AFRC pursuant to section 371(1A) of the AFRCO before the issuance of a Notice of Proposed Disciplinary Action against each of them. In addition to public reprimands and pecuniary penalties, Lo and Lam accepted to undertake additional CPD hours as a remedial action.

49. Having considered all the relevant circumstances in the present case and the Guidance Note on Cooperation, the AFRC is of the view that a reduction of 30% to the original pecuniary penalties assessed against each of the regulatees is appropriate, and that it is in the interest of the investing public and the public interest for the AFRC to enter into an agreement pursuant to section 371(1A) of the AFRCO with each of the regulatees.