

Press Release
12 February 2016

Completed investigation

On 21 January 2016, the FRC adopted the investigation report on the audits (**the March 2011 Audit and the December 2011 Audit**) of the consolidated financial statements of a listed entity for the year ended 31 March 2011 (**the March 2011 Financial Statements**) and for the period from 1 April 2011 to 31 December 2011 (**the December 2011 Financial Statements**).

The Audit Investigation Board (**the AIB**) found that the auditor failed or neglected to observe, maintain or otherwise apply a number of professional standards in the March 2011 Audit and the December 2011 Audit. The AIB also found that the engagement director failed to maintain professional knowledge and skill at the level required and act diligently.

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

On 12 September 2013, the FRC directed the AIB to conduct an investigation on the March 2011 Audit and the December 2011 Audit following the receipt of a complaint. The listed entity made retrospective restatements in its consolidated financial statements for the year ended 31 December 2012 (**the 2012 Financial Statements**) to correct prior period errors in the March 2011 Financial Statements and the December 2011 Financial Statements.

As a result of the Investigation, the AIB considered that the auditor failed to identify the following non-compliances with accounting requirements during the March 2011 Audit and the December 2011 Audit.

Acquisitions of 50% equity interest in a subsidiary (Acquisition I) and 100% equity interest in another subsidiary (Acquisition II)

- (a) Certain identifiable assets and liabilities acquired in Acquisition I and Acquisition II were not recognized separately from goodwill.
- (b) The convertible bonds issued for the consideration for Acquisition I were not measured at fair value and the embedded call option was not separated from the liability component and accounted for as a derivative.

*Convertible bonds issued to an entity owned by the key management of the listed entity (**Convertible Bond I**) and a third party (**Convertible Bond II**)*

The identifiable consideration received by the listed entity appeared to be less than the fair value of Convertible Bond I and Convertible Bond II. There were unidentifiable goods or services received by the listed entity.

- (c) The fair value of the unidentifiable goods or services, being the difference between the consideration received and the fair value of Convertible Bond I and Convertible Bond II, was not recognized as an expense.
- (d) The equity components of Convertible Bond I and Convertible Bond II were not recognized as equity-settled share-based payment transactions and measured at fair value upon initial recognition.
- (e) The liability components of Convertible Bond I and Convertible Bond II were not recognized as cash-settled share-based payment transactions and measured at fair value upon and after initial recognition.
- (f) The embedded derivatives of Convertible Bonds II were not identified and no assessment was made as to whether they should be separately recognized from the liability component.

Presentation of financial statements

- (g) Deposits for land use rights and property, plant and equipment were inappropriately presented as current assets instead of non-current assets.
- (h) Certain payables with unconditional right to defer settlement of the liability for at least 12 months after the reporting period were inappropriately presented as current liabilities instead of non-current liabilities.
- (i) Certain receivables and payables from/to a shareholder of a joint venture without the legally enforceable right to set off were inappropriately offset.
- (j) Capital contribution from non-controlling interests of the listed entity's subsidiary was inappropriately classified as cash flows from investing activities instead of financing activities.
- (k) Certain deposits for land use rights and property, plant and equipment were inappropriately classified as cash flows from operating activities instead of investing activities.

Share-based payment transactions

- (l) The inputs to the option pricing model used in determining the fair value of share options and warrants were not reasonable and consistent with the terms of the arrangement.
- (m) The warrants granted were vested in stages but the related share-based payment expenses were not properly recognized over the vesting period.

The AIB concluded that, during the March 2011 Audit and the December 2011 Audit, the auditor failed to sufficiently evaluate the terms and substance of the relevant transactions and the applicable accounting requirements and failed to perform audit procedures to obtain sufficient appropriate audit evidence to support their unmodified opinions on the March 2011 Financial Statements and the December 2011 Financial Statements in accordance with paragraph 6 of HKSA 500 (Clarified) *Audit Evidence*, paragraph 18 of HKSA 540 (Clarified) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* and paragraphs 10 to 13 of HKSA 700 (Clarified) *Forming an Opinion and Reporting on Financial Statements*.

The AIB also concluded that the engagement director failed to maintain professional knowledge and skill at the level required and failed to act diligently in accordance with section 130.1 of the Code of Ethics for Professional Accountants.

On 21 January 2016, the FRC adopted the investigation report prepared by the AIB, which summarized the findings of the investigation. The investigation report has been referred to the HKICPA to determine if any disciplinary actions are warranted. Names of the relevant parties are withheld pending the conclusion of such disciplinary proceedings, if any.

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

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Note to editors

About the FRC

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