

Press Release
15 May 2017

Completed investigation

On 11 May 2017, the FRC adopted the investigation report on the audit of the consolidated financial statements of a listed entity for the year ended 31 December 2013.

The Audit Investigation Board (**the AIB**) found that the auditor failed or neglected to observe, maintain or otherwise apply certain professional standards in the audit in relation to the impairment assessment of assets and the acquisition of a subsidiary.

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 14 July 2016, the FRC directed the AIB to conduct an investigation on the audit in relation to (a) the impairment assessment of the exploration and evaluation assets, and (b) the acquisition of a subsidiary that was accounted for as a business combination. As a result of the investigation, the AIB had the following findings:

(a) Impairment assessment of the exploration and evaluation assets

The listed entity acquired the exploration and evaluation assets several years ago and there was no development or production activity since acquisition. The auditor used the external valuation as part of audit evidence for the purpose of impairment assessment. However, the auditor failed to understand and evaluate the appropriateness of the valuation method used, the reasonableness and appropriateness of the estimations and assumptions applied and the relevance and accuracy of other source data used in the business forecast and the valuation.

(b) Acquisition of a subsidiary that was accounted for as a business combination

The purchase consideration of the acquisition was satisfied by the issuance of convertible bonds and included a contingent consideration in the nature of a financial asset. The auditor failed to obtain sufficient appropriate audit evidence regarding the

acquisition-date fair value of the purchase consideration. Specifically, the auditor accepted management's assessment that the principal amount of the convertible bonds approximated their acquisition-date fair value but failed to properly evaluate the external valuation. The auditor also failed to adequately evaluate the reasonableness of the profit forecast in determining the acquisition-date fair value of the contingent consideration.

The listed entity did not recognise any assets acquired or liabilities assumed in the acquisition except for a very small amount of other payable, despite that the investment circular mentioned a number of potential identifiable assets. The auditor failed to challenge management's assessment and did not perform adequate procedures to obtain sufficient appropriate audit evidence in respect of whether all the identifiable assets acquired and liabilities assumed in the acquisition were recognised.

In respect of the above findings, the AIB found that

- there were non-compliances with paragraph 15 of Hong Kong Standard on Auditing (**HKSA**) 200 (Clarified) *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraphs 6, 8 and A48 of HKSA 500 (Clarified) *Audit Evidence* and paragraphs 17 and 18 of HKSA 540 (Clarified) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*;
- the engagement quality control reviewer failed to properly perform and document the review in accordance with paragraphs 20 and 25 of HKSA 220 (Clarified) *Quality Control for an Audit of Financial Statements*; and
- the engagement director and the engagement quality control reviewer failed to act diligently in accordance with applicable technical and professional standards as required by section 130.1 of the Code of Ethics for Professional Accountants.

On 11 May 2017, the FRC adopted the investigation report prepared by the AIB, which summarised 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.

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