

Press Release
16 January 2017

Completed investigation

On 12 January 2017, the FRC adopted the investigation report on the audits of the consolidated financial statements of a listed entity for the years ended 30 June 2011 (**2011 Financial Statements**) and 30 June 2012 (**2012 Financial Statements**) (**collectively the Audits**).

The Audit Investigation Board (**the AIB**) found that the auditor failed or neglected to observe, maintain or otherwise apply certain professional standards in the Audits concerning (i) the classification and measurement of a contingent consideration in a business combination; (ii) impairment assessments on goodwill and intangible assets at the end of the reporting periods; and (iii) the recognition of intangible assets and goodwill at the date of the acquisition. The AIB also found that the engagement partner and the engagement quality control reviewer (**the EQCR**) failed to act diligently in accordance with applicable technical and professional standards in the Audits.

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 8 May 2014, the FRC directed the AIB to conduct an investigation into the Audits.

As a result of the investigation, the AIB found the following auditing irregularities:

(a) The classification and measurement of the contingent consideration

The auditor failed to

- (i) identify the classification and measurement of the contingent consideration as one of the risks of material misstatement in accordance with paragraph 25 of Hong Kong Standard on Auditing (**HKSA**) 315 (revised) *Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment* and to design and implement overall responses to address the assessed risks as required by

paragraph 6 of HKSA 330 (clarified) *Planning an Audit of Financial Statements* (**HKSA 330**) in auditing the 2011 Financial Statements;

- (ii) identify that the classification of the contingent consideration as equity in the 2011 Financial Statements was a non-compliance with the relevant financial reporting standards. There was a non-compliance with paragraph 6 of HKSA 500 *Audit Evidence* (**HKSA 500**);
- (iii) sufficiently challenge management as to the failure to fair value the contingent consideration at the acquisition date as required by paragraph 20 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**), paragraph 6 of HKSA 500 and paragraph 18 of HKSA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* (**HKSA 540**); and
- (iv) identify that, having put through a prior year restatement to correct the classification of the contingent consideration in the 2012 Financial Statements, there should have been re-measurement at the 2011 year end in accordance with paragraph 20 of HKSA 200, paragraph 6 of HKSA 500 and paragraph 18 of HKSA 540.

The auditor should have expressed a modified opinion on the (i) 2011 financial statements in relation to the classification and measurement of the Contingent Consideration and (ii) 2012 financial statements in relation to the measurement of the Contingent Consideration as at 30 June 2011. Accordingly, the requirements of paragraphs 10 and 12 of HKSA 700 *Forming an opinion and reporting on financial statements* (**HKSA 700**) were not observed.

(b) Impairment assessments on goodwill and intangible assets at the end of the reporting periods

In auditing the 2011 Financial Statements, the auditor failed to

- (i) properly design and implement overall responses to address the assessed risks as required by paragraph 6 of HKSA 330; and
- (ii) perform adequate audit procedures to obtain sufficient appropriate audit evidence in accordance with paragraphs 6, 8 and A48 of HKSA 500 and paragraph 13 of HKSA 540 to challenge the management's assertion that goodwill and intangible assets were not impaired as at 30 June 2011.

(c) Recognition of intangible assets and goodwill at the date of the acquisition

The auditor failed to perform adequate audit procedures on the accounting estimates being used in the valuation according to paragraphs 6 and 8 of HKSA 500 and paragraph 13 of HKSA 540 to support the fair value of intangible assets and the amount allocated to goodwill as at the date of the acquisition.

Based on the above, the AIB found that the EQCR did not fully comply with paragraph 20 of HKSA 220 *Quality Control for Audits of Historical Financial Information* in performing the engagement quality control review on the audits.

The AIB also found that the engagement partner and the EQCR did not fully comply with section 130.1 of the Code of Ethics for Professional Accountants as they failed to act diligently in accordance with applicable technical and professional standards when providing professional services.

On 12 January 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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