AFRC Accounting and Financial Reporting Council
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Press Release

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AFRC reprimands Centurion ZD CPA Limited, Chan Kam Fuk and Ling Chun Kwok for serious breaches of professional standards, imposes pecuniary penalties totalling HK$700,000 and cancels the practising certificate of Chan Kam Fuk for 12 months

The Regulatees

The Accounting and Financial Reporting Council (**AFRC**) has imposed sanctions on the following regulatees:

(i) Centurion ZD CPA Limited (M0561) (**Centurion**);

(ii) Engagement partner Mr Chan Kam Fuk (A20032) (**Chan**); and

(iii) Engagement quality control reviewer (**EQCR**) Mr Ling Chun Kwok (A19094) (**Ling**)

for their serious breaches of professional standards in relation to the audit of the consolidated financial statements of a Hong Kong listed company, China Infrastructure Investment Limited (**Company**) and its subsidiaries,[1] for the financial year ended 31 December 2016 (**Audit Engagement**).

The AFRC found the engagement team failed to obtain sufficient appropriate evidence to evaluate the measurement and impairment assessment of goodwill arising from an acquisition, and failed to follow basic audit requirements and exercise adequate professional skepticism. Their failures gave rise to the risk of material misstatement in the 2016 Financial Statements as a whole.

[1] Trading in the shares of the Company was suspended on 11 July 2022 due to its failure to publish its 2021 Audit Results and Annual Report arising from outstanding major audit issues.

Our Decisions

The AFRC reprimanded Centurion, Chan and Ling (collectively, **Regulatees**) for their serious breaches of professional standards, and imposed pecuniary penalties of HK$350,000, HK$250,000 and HK$100,000 respectively.[2] In addition, the AFRC ordered that Chan's practising certificate be cancelled, and no practising certificate be issued to him for 12 months with effect from 29 August 2023.

The sanctions are imposed in order to promote and uphold proper standards of conduct amongst regulatees, deter regulatees from committing misconduct, prevent repetition of similar failings and maintain public confidence in the regulation of the accountancy profession.

Ms Hester Leung, Head of Discipline, said, "It is vital that proper standards of conduct by regulatees are upheld through an effective disciplinary regime. To safeguard audit quality of the regulated market and protect the public interest, the AFRC will not hesitate to hold to account those guilty of misconduct."

Background

The Company was primarily engaged in property investment and natural gas businesses. In late 2016, the Company acquired a 51% equity interest (**Acquisition**) in a company (**Subsidiary**) with its main assets consisting of two buildings, which the Company intended to develop into a logistics base. The Company recognised a goodwill of HK$49.3 million (**Goodwill**) arising from the Acquisition, which was more than 15 times the materiality level of HK$3.2 million for the Audit Engagement.

When preparing the 2016 Financial Statements, the Company conducted an impairment assessment of the Goodwill arising from the Acquisition (**Impairment Assessment**), and concluded that no impairment was required in 2016 at year-end. However, in the 2017 Financial Statements, the Company fully impaired the value of the Goodwill.

Centurion and Chan identified five key audit matters in the Audit Engagement, including (i) the Company's accounting for the business combination (i.e. the Acquisition) and (ii) the Impairment Assessment. These matters were material to the Company's financial statements and, if not properly assessed, would give rise to a risk that its investors would be misled as to the financial position of the Company.

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[2] As the Audit Engagement was completed prior to 1 October 2019, the Regulatees were regarded as professional persons and sanctioned pursuant to section 37CA of the Accounting and Financial Reporting Council Ordinance (**AFRCO**) for committing a CPA misconduct under the transitional arrangements. For each CPA misconduct, the AFRC may order a regulatee to pay a pecuniary penalty not exceeding HK$500,000. However, for PIE engagements completed on or after 1 October 2019, the AFRC may order a regulatee to pay a pecuniary penalty not exceeding the amount which is the greater of HK$10,000,000 or three times the amount of the profit gained or loss avoided by the regulatee as a result of each misconduct, pursuant to sections 37D and 37E of the AFRCO.

Despite Centurion and Chan having identified the Acquisition and the Impairment Assessment as key audit matters, they did not perform robust and rigorous assessment and obtain sufficient appropriate audit evidence on these areas.

Serious breaches

Centurion and Chan

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. Auditors play a key role in ensuring quality financial reporting. An engagement partner is responsible for the overall quality of the audit engagement, including taking responsibility for the performance of the audit engagement in compliance with professional standards.

Centurion and Chan failed in their respective role as the independent auditor to obtain reasonable assurance on whether the 2016 Financial Statements as a whole were free from material misstatement. As set out in the Statement of Disciplinary Action, the AFRC found multiple deficiencies in the audit relating to the two key audit matters.

In respect of the Acquisition, Centurion and Chan failed to conduct any audit procedures to assess the acquisition-date fair values of the other identifiable assets acquired and liabilities assumed in the Acquisition.

In respect of the Impairment Assessment, their failings included, among other things:

(i) failure to exercise sufficient professional skepticism to critically assess how the information provided by the Company could support the valuation of the Subsidiary;

(ii) failure to obtain sufficient appropriate audit evidence in assessing the reasonableness of the Company's revenue projection that formed the basis of the Subsidiary's valuation, including how six agreements of intent between the Subsidiary and potential customers were sufficiently reliable to support the Company's ambitious revenue projection for a 16-year period;

(iii) failure to evaluate the appropriateness of, and adequately challenge, the Company valuer's incorrect treatment of the entirety of two buildings of the Subsidiary as non-operating assets where it was apparent that these buildings were predominantly income-generating assets; and

(iv) failure to evaluate the competence, capabilities, and objectivity of the auditor's valuer and the adequacy of its work in respect of its review of the Company valuer's report.

Ling

An EQCR plays an important role in safeguarding the audit quality of an audit engagement by objectively evaluating the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report.

As the EQCR of the Audit Engagement, Ling failed to perform an objective evaluation of the engagement team's decisions on:

(i) the extent and nature of work performed, and the evidence obtained; and

(ii) the significant judgments and conclusions reached

in relation to the measurement of the Goodwill on acquisition date and the Impairment Assessment.

Our rationale of sanctions

In deciding the appropriate disciplinary sanctions against the Regulatees, the AFRC considered all relevant circumstances of the case, including the nature, seriousness, frequency, duration and impact of the misconduct, as well as any aggravating and/or mitigating factors.

Among other things, the AFRC considered the breaches of professional standards in this case were serious. The multiple breaches identified stemmed from the auditor's failure to exercise professional skepticism, a necessary attitude which should be adopted throughout an audit engagement.

There was, however, no evidence of intentional, dishonest or deliberate misconduct by the Regulatees. Had there been such evidence, the breaches would have been considered as very serious and the sanctions imposed would be more severe.

In determining the appropriate sanctions against each Regulatee, the AFRC has also taken into account as an aggravating factor that Centurion had one disciplinary record in 2017 and Chan had three recent disciplinary records in 2016, 2019, and 2021 respectively with the Hong Kong Institute of Certified Public Accountants, and as a mitigating factor that Ling has no prior disciplinary record.

The sanctions are intended to send a strong deterrent message to the Regulatees to prevent repetition of similar failings, and ensure that the market understands how our regulatory principles are applied in order to uphold audit quality.

Ms Leung seriously stressed: "This case was assessed under the old regime where the maximum pecuniary penalty for a misconduct was HK$500,000. If a similar case were to arise under the new regime in respect of PIE engagements on or after 1 October 2019, the pecuniary penalty to be imposed will be assessed under a different scale where the upper limit for each misconduct is HK$10 million or three times the profit gained or loss avoided (whichever is higher), and hence a more severe sanction could be expected."

For details of the decision, please refer to the Statement of Disciplinary Action.

The AFRC also urges auditors to pay particular attention to the common areas of audit deficiencies identified by the AFRC in its 2022 Annual Inspection Report and 2022 Annual Investigation and Compliance Report, including the importance of (i) exercising professional skepticism in the context of asset impairment assessment, and (ii) adequately evaluating the work of auditors' experts, and to improve the audit quality accordingly.

Mr Marek Grabowski, CEO of the AFRC, said, "Quality audits enhance public confidence in Hong Kong's capital market. As the independent regulator of the accounting profession, the AFRC will continue to take robust action to uphold the proper standards of conduct amongst regulatees and enhance public confidence in the integrity of the accounting profession and the quality of financial reporting."

End

About the Accounting and Financial Reporting Council

The Accounting and Financial Reporting Council (AFRC) is an independent body established under the Accounting and Financial Reporting Council Ordinance. As an independent regulator, AFRC spearheads and leads the accounting profession to constantly raise the level of quality of professional accountants, and thus protects the public interest.

For more information about the statutory functions of the AFRC, please visit www.afrc.org.hk.

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