Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Dear Assignment / News / Business Section Editor

Hong Kong Institute of Certified Public Accountants hands down a disciplinary decision against certified public accountants (practising) and a firm of CPAs

(HONG KONG, 24 December 2013) - A Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants today handed down its decision against Ernst & Young ("EY"), Yen Kai Shun, Catherine ("Catherine Yen") and Wu Ting Yuk, Anthony ("Anthony Wu") in respect of their involvement in the auditing of the accounts of a group company. As against each of the respondents, the Disciplinary Committee found as follows:

EY was found guilty of failing or neglecting to observe, maintain or otherwise apply a professional standard, namely Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence", as they had, in their capacity as a firm registered with the Institute in public practice, failed to be, and to conduct themselves in a way seen to be, free of interest(s) which might detract from their objectivity in accepting or continuing the professional work they undertook in connection with the audit of a company or companies in the Group in respect of the financial years 31 December 1995 to 31 December 1997. The Disciplinary Committee found that EY had failed to have any or any adequate review machinery which would have alerted it to the risk of the appearance of its independence being impaired.

Catherine Yen was found guilty of failing or neglecting to observe, maintain or otherwise apply a professional standard, namely Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence", as she had, in her capacity as a member registered with the Institute in public practice, failed to be, and to conduct herself in a way seen to be, free of interest(s) which might detract from her objectivity in accepting or continuing the professional work she undertook in connection with the audit of a company or companies in the Group in respect of the financial years 31 December 1995 to 31 December 1997.

Anthony Wu was found guilty of professional misconduct, as a result of his failure to observe, maintain or otherwise apply the independence requirements of the Institute, namely Statements of Professional Ethics 1.200 "Professional Ethics – Explanatory Foreword" and Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence", in participating in the management of the company and/or otherwise having an involvement with the company and its subsidiaries whilst also a senior partner of EY who acted as auditors of the company in respect of the financial years ended 31 December 1995 to 31 December 1997, and whilst being a deemed auditor under section 131(9) of the Companies Ordinance, Cap. 32.

In the Disciplinary Committee's view, Anthony Wu, as a senior partner of EY, should have ensured that he carried out his professional life in a manner that would not raise the spectre of the appearance of independence being impaired. Instead Anthony Wu remained (a) as a member of the Executive Committee of an audit client, (b) was an authorized signatory to almost 13 bank accounts of the group company (a function usually perceived to be one of management), (c) had personal dealings involving considerable sums of money with the company's subsidiaries who were also audit clients of EY, (d) whilst at the same time a significant retainer was being paid to EY for Anthony Wu being the Financial Advisor, (e) making loans either personally or indirectly through a third party company to an audit client

of EY and (f) that Anthony Wu was a deemed auditor pursuant to section 131(9) of the Companies Ordinance (Cap. 32).

Hong Kong Institute of CPAs will file submissions on sanctions and costs with the Disciplinary Committee.

Disciplinary proceedings of the Institute are conducted in accordance with Part V of the ordinance by a five-member Disciplinary Committee. The majority (three members) of each committee, including the chairman, are non-accountants chosen from a panel appointed by the Chief Executive of the HKSAR, and the other two members are CPAs.

Disciplinary hearings are held in public unless the Disciplinary Committee directs otherwise in the interests of justice. A hearing schedule is available at the Institute's website. A CPA who feels aggrieved by an order made by a Disciplinary Committee may appeal to the Court of Appeal, which may confirm, vary or reverse the order.

The Disciplinary Committees have the power to sanction members, member practices and registered students. Sanctions include temporary or permanent removal from membership or cancellation of a practising certificate, a reprimand, a penalty of up to $500,000, and payment of costs and expenses of the proceedings.

- End –

About the Hong Kong Institute of Certified Public Accountants

The Hong Kong Institute of CPAs is the only body authorized by law to register and grant practising certificates to certified public accountants in Hong Kong. The Institute has more than 36,000 members and more than 17,000 registered students. Members of the Institute are entitled to the description *certified public accountant* and to the designation CPA.

The Hong Kong Institute of CPAs evolved from the Hong Kong Society of Accountants, which was established on 1 January 1973.

The Institute operates under the Professional Accountants Ordinance and works in the public interest. The Institute has wide-ranging responsibilities, including assuring the quality of entry into the profession through its postgraduate qualification programme and promulgating financial reporting, auditing and ethical standards in Hong Kong. The Institute has responsibility for regulating and promoting efficient accounting practices in Hong Kong to safeguard its leadership as an international financial centre.

The Hong Kong Institute of CPAs is a member of the Global Accounting Alliance – an alliance of the world's leading professional accountancy bodies, which was formed in 2005. The GAA promotes quality services, collaborates on important international issues and works with national regulators, governments and stakeholders.

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Hong Kong Institute of
Certified Public Accountants
香港會計師公會

致：編採主任／新聞／財經版編輯

香港會計師公會對執業會計師及一間會計師事務所作出紀律裁決

（香港，二零一三年十二月二十四日）— 香港會計師公會轄下一紀律委員會今天就安永會計師事務所、嚴嘉洵及胡定旭就有關參與審核一集團公司的財務報表事宜作出裁決。紀律委員會對每一位答辯人的裁決如下：

紀律委員會裁定安永沒有或忽略遵守、維持或以其他方式應用公會的專業準則 Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence"。委員會認爲安永作爲公會的一間註冊執業會計師事務所，沒有作出適當的措施避免利益衝突，因而有可能影響他們就接受及持續執行有關一間公司或該集團內的數間公司自 1995 年 12 月 31 日至 1997 年 12 月 31 日的審計專業工作的客觀性。紀律委員會認爲安永沒有任何或任何足夠的監察系統，能夠在他們的獨立性受到損害時作出警示。

紀律委員會裁定嚴嘉洵沒有或忽略遵守、維持或以其他方式應用公會的專業準則 Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence"。委員會認爲嚴嘉洵作爲公會的一個註冊執業會員，沒有作出適當的措施避免利益衝突，因而有可能影響她就接受及持續執行有關一間公司或該集團內的數間公司自 1995 年 12 月 31 日至 1997 年 12 月 31 日的審計專業工作的客觀性。

紀律委員會裁定胡定旭專業行爲不當，是由於他沒有遵守、維持或以其他方式應用公會的 Statements of Professional Ethics 1.200 "Professional Ethics – Explanatory Foreword" 及 Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence" 有關獨立性的要求。胡定旭有份參與該公司的管理及/或與該公司及其附屬公司有關連，但同時安永是該公司自 1995 年 12 月 31 日至 1997 年 12 月 31 日財政年度的核數師。當時胡定旭是安永的高級合伙人，及根據香港法例第 32 章公司條例第 131(9)條被視爲是核數師。

紀律委員會認爲，胡定旭作爲安永的高級合伙人，應該要確保在執行他的專業工作時，能避免其獨立性受到損害。但胡定旭卻(1)擔任一審計客戶的執行委員會成員; (2)是該集團公司大約 13 個銀行戶口的核准簽署人(這通常被認爲是管理層的任務); (3)與該公司的附屬公司有私人且大額金錢來往，而該附屬公司也是安永的審計客戶; (4)因爲擔任該公司的財務顧問而令安永獲得可觀的服務費;(5)以個人名義或透過第三者公司間接向安永審計客戶作出貸款;(6)根據香港法例第 32 章公司條例第 131(9)條被視爲是核數師。

香港會計師公會將會向紀律委員會提交有關罰則及費用的呈請。

公會的紀律程序是根據《專業會計師條例》第 V 部份，由五位成員組成的紀律委員會執行。每個紀律委員會的大多數成員，即包括主席在內的三名成員，是由香港特別行政區行政長官從業外人士組成的紀律小組中選派委任，另外兩名成員由專業會計師出任。

除非負責的紀律委員會因公平理由認為不恰當，否則紀律聆訊一般以公開形式進行。紀律聆訊的時間表可於公會網頁查閱。如當事人不服紀律委員會的裁判，可向上訴法庭提出上訴，上訴法庭可確定、修改或推翻紀律委員會的裁判。

紀律委員會有權向公會會員、執業會計師事務所會員及註冊學生作出處分。紀律處分範圍包括永久或有限期地將違規者從會計師註冊紀錄冊中除名或吊銷其執業證書、對其作出譴責、下令罰款不多於五十萬港元，以及支付紀律程序的費用。

－ 完 －

關於香港會計師公會

香港會計師公會是香港唯一獲法例授權負責專業會計師註冊兼頒授執業證書的組織，會員人數超過三萬六千，註冊學生人數逾一萬七千。公會會員可採用「會計師」稱銜 (英文為 certified public accountant，簡稱 CPA)。

公會(Hong Kong Institute of Certified Public Accountants)於一九七三年一月一日成立，當時的英文名稱為 Hong Kong Society of Accountants。

公會根據《專業會計師條例》履行職責，以公眾利益為依歸。其職能廣泛，包括開辦專業資格課程(Qualification Programme)以確保會計師的入職質素，以及頒布香港的財務報告、審計及專業操守準則。此外，公會亦負責在香港監管和推動優良而有效的會計實務，以鞏固香港作為國際金融中心的領導地位。

香港會計師公會是全球會計聯盟（Global Accounting Alliance，GAA）的成員之一。全球會計聯盟於二零零五年成立，聯合了全球頂尖的專業會計團體，推動優質服務，並積極與各地監管機構、政府及關連人士就國際重要議題共同合作。

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Proceedings No: D-03-IC16H

IN THE MATTER OF

A complaint made under section 34(1) (a) of the Professional Accountants Ordinance (Cap.50)

BETWEEN

An Investigation Committee of the Hong Kong Institute of Certified Public Accountants	**COMPLAINANT**
AND	
Ernst & Young	**1ST RESPONDENT**
Catherine Yen Kai Shun	**2ND RESPONDENT**
Anthony Wu Ting Yuk	**3RD RESPONDENT**

DETERMINATION

A. BACKGROUND

1. The three Respondents face a total of five complaints made by the Investigation Committee of the Hong Kong Institute of Certified Public Accountants {"the Institute"}. The complaints all relate to the involvement of the Respondents in the preparation and auditing of the accounts of the New China Hong Kong Group Limited {"NCG"}. R1 faced just one complaint {First Complaint}, whilst R2 and R3 faced two complaints each, namely professional misconduct {Complaints 2 and 4 respectively} or alternatively, a failure or neglect to observe, maintain or otherwise apply a professional standard {Complaints 3 and 5 respectively}.

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2. In order to understand the events that have led to this Committee having to hear these complaints against the Respondents we feel it would be necessary to set out the relevant background facts that have brought us here to this point. The underlying common denominator running through these complaints is NCG and its subsidiaries and the involvement of the Respondents with them.

3. On 8th September 1992 an entity called SKH Group Limited was incorporated. It changed its name to NCG on 10th November 1992. There were four directors appointed to NCG, one of whom was R3. On 18th February 1993, R3 resigned as a director and was instead appointed to be a member of the Executive Committee {EC} of, and as the Financial Advisor to NCG. The EC comprised of seven members, including R3 as the Financial Advisor and Mr. Victor Chu, as the legal advisor to the NCG. By Article 103 of the NCG's amended Articles of Association, the legal and financial advisors were not entitled to vote at the meetings of the Executive Committee or counted as quorum but were entitled to receive notices of and attend such meetings. {**B5/Appendix 3/p3**}.

4. R3's appointments were reported to the management of R1 on 23rd February 1993 {**B6/Tab 3/32**}. NCG paid a monthly retainer of $100,000 to R1 for the services of R3 as a financial advisor. R3 was also an authorised signatory to 13 bank accounts of NCG and also had personal dealings with at least two, if not three, subsidiaries of NCG.

5. On 26th May 1993, NCG became an unlisted public company upon the allotment of shares to 49 new shareholders. This resulted in it having a total of 51 shareholders, exceeding the maximum of 50 shareholders permitted by section 29(1) of the Companies Ordinance (cap 32) for a private company.

6. R1 were appointed auditors of NCG on 28th May 1993 and remained so until the Group and its subsidiaries subsequently went into liquidation {**B2/112**}. They were paid an audit fee in respect of the same. On 1st July 1996, R2 was

appointed as the engagement partner for the audit work undertaken by R1 for NCG.

7. NCG went into liquidation in early 1999. By an originating summons issued on 24th September 2002, the Joint and Several Liquidators of NCG sought various orders pursuant to sections 255 and 221 of the Companies Ordinance (Cap 32) against all three Respondents. By a judgment dated 28th April 2003, Kwan J granted the orders sought.

8. The judgment attracted considerable publicity and came to the attention of the Institute's Council. On 10th June 2003, the Council decided to set up an Investigation Committee {"IC"} under the then operative section 42C (2) (a) of the Professional Accountants Ordinance {PAO}. On 16th July 2003, the Council wrote to all three Respondents informing them of the decision to set up the IC and subsequently identifying the members who would constitute the IC.

9. A draft report was circulated to the Respondents in April 2009 for their comments. On 13th May 2009, one of the members of the IC tendered his resignation. The remaining two members proceeded to complete the investigation and submitted their finalised report on 14th October 2009 {**B1/Ex 1**}.

10. On 9th December 2009, the Council resolved to refer the matter to the Disciplinary Panel. The Complainant filed its case on 14th July 2011. The Respondents filed their respective replies on 23rd August 2011. The Complainant's Reply to the Submissions of the Respondents was filed on 19th September 2011, and this was followed by the Respondents' respective Replies thereto, which were all filed on 14th October 2011.

11. A Directions Hearing was scheduled and heard on 2nd November 2012. That Hearing was directed to address a number of preliminary issues, including whether we, as the DC, had jurisdiction to consider the validity of our

appointment by the Council, whether the final report of the IC was ultra vires for being inquorate when it was completed and also whether the IC exceeded the remit of its jurisdiction in recommending complaints of professional misconduct against the 2nd and 3rd Respondents, when they were only asked by the Council to consider possible breaches of professional standards by the Respondents. This DC rejected the Respondents' submissions on 2nd November 2012 and the Reasons for the same were circulated to the parties on 7th May 2013.

B. THE COMPLAINTS

12. It may be appropriate at this stage to set out the complaints filed against the Respondents and requiring our Determination:

(a) First Complaint (Against Ernst & Young only)

Ernst & Young failed or neglected to observe, maintain or otherwise apply a professional standard, namely Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence", as it had, in its capacity as a firm registered with the Institute in public practice, failed to be, and to conduct itself in a way seen to be, free of interest(s) which might detract from its objectivity in accepting or continuing the professional work it undertook in connection with the audit of New China Group or companies in the Group in respect of the financial years ended 31 December 1995 to 31 December 1997. (Section 34(1 (a) (vi) of the Professional Accountants Ordinance, Cap. 50 ("**PAO**")

(b) Second Complaint (Against Catherine Yen only)

Catherine Yen is guilty of professional misconduct, as a result of her failure to observe, maintain or otherwise apply the independence requirements of the Institute (including those contained in Statements of Professional Ethics, namely Statements 1.200, 1.203, 1.290D and Guidance Statement 1.303) in

accepting or continuing the professional work she undertook in connection with the audit of New China Group or companies in the Group in respect of the financial years ended 31 December 1995 to 31 December 1997. (Section 34(1) (a) (viii) of PAO)

(c) Third Complaint (Alternative to the Second Complaint against Catherine Yen only)

Catherine Yen failed or neglected to observe, maintain or otherwise apply a professional standard, namely Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence", as she had, in her capacity as a member registered with the Institute in public practice, failed to be, and to conduct herself in a way seen to be, free of interest(s) which might detract from her objectivity in accepting or continuing the professional work she undertook in connection with the audit of New China Group or companies in the Group in respect of the financial years ended 31 December 1995 to 31 December 1997. (Section 34(1) (a) (vi) of PAO)

(d) Fourth Complaint (Against Anthony Wu only)

Anthony Wu is guilty of professional misconduct, as a result of his failure to observe, maintain or otherwise apply the independence requirements of the Institute (including those contained in Statements of Professional Ethics, namely Statements 1.200, 1.203, 1.209, and 1.290D and Guidance Statement 1.303) in participating in the management of New China Group and/or otherwise having an involvement with New China Group and its subsidiaries whilst a senior partner of Ernest & Young who acted as auditors of New China Group in respect of the financial years ended 31 December 1995 to 31 December 1997, and whilst being a deemed auditor under section 131(9) of the Companies Ordinance, Cap. 32. (Section 34(1) (a) (viii) of PAO)

(e) **Fifth Complaint (Alternative to the Fourth Complaint against Anthony Wu only)**

Anthony Wu failed or neglected to observe, maintain or otherwise apply a professional standard, namely Statement 1.203 "Professional Ethics – Integrity, Objectivity and Independence", as he had, in his capacity as a member registered with the Institute in public practice, failed to be, and to conduct himself in a way seen to be, free of interest(s) which might detract from his objectivity in participating in the management of New China Group and/or otherwise having an involvement with New China Group and its subsidiaries whilst a senior partner of Ernest & Young who acted as auditors of New China Group in respect of the financial years ended 31 December 1995 to 31 December 1997, and whilst being a deemed auditor under section 131(9) of the Companies Ordinance, Cap. 32. (Section 34(1 (a) (vi) of PAO)

13. The DC heard legal arguments in respect of these complaints on 6th - 9th May 2013. There were no witnesses called by any of the parties and the hearing proceeded purely on the basis of the documents contained in 6 Box Files marked volume 1-6 and the various submissions made on behalf of the various parties.

14. One of the remaining outstanding preliminary issues was the Respondents' complaint of delay in the institution and investigation of these matters which it was said go back in time to events that occurred and documentation that were generated almost 17-20 years. The contention on behalf of all the Respondents was that such prolonged delay prejudiced them such that a permanent stay of proceedings by the DC was the only and proper course in the circumstances.

15. Having heard arguments by the parties on the question of delay, we refused the Respondents' application to stay the proceedings in the late afternoon of 7th May 2013 {the second day of hearing} indicating we will give our reasons

later. We turn now to address the issue of delay and give our reasons for our decision to refuse the stay.

C. DELAY

16. Mr. Strachan, counsel for R3, led the attack on this issue for the Respondents with Mr. Beresford, counsel for R1 and 2 largely adopting those points which were applicable and relevant to his clients. It was common ground that the relevant period encapsulated by the Complaints related to the audited accounts of NCG covering the three years of 1995-1997. This essentially meant the period July 1995 – 7th November 1998, which is when the audited accounts for the year ending December 1997 were completed and signed off by R1 {**B3/569**}.

17. The first line of attack was to identify the different periods of delay. It was argued that the IC was constituted on 10th June 2003, which was almost six years after the last audited accounts were undertaken by R1. It was argued that this already long time lapse made it incumbent and imperative on the IC to thereafter carry out its investigations fully, efficiently and expeditiously.

18. The Institute first communicated with R3 on 16th July 2003 and the last communication with his legal advisors was on 8th June 2004. It was submitted that there followed a further delay of almost 5 years until 29th April 2009, when R3 and his legal advisers were provided with the draft report of the IC for their consideration. It was argued that despite repeated requests no explanation has been provided to date by the Complainant for this prolonged delay and exceptional silence.

19. The IC's Final report was completed on 10th October 2009, and in December 2009 the Council resolved to refer the matter to the disciplinary panels for appointing members to constitute the DC. On 9th June 2011, the Clerk of the DC informed the parties of commencement of proceedings.

20. Our attention was drawn to and reliance placed on the following dicta of Lord Lane CJ in ***Attorney General's Reference (No 1 of 1990)*** {1992} 1 QB 630:

> "*Stays imposed on the grounds of delay or for any other reason should only be employed in exceptional circumstances. If they were to become a matter of routine, it would only be short time before the public understandably, viewed the process with mistrust and suspicion.*
>
> *In principle, therefore, even where the delay can be said to be unjustifiable, the imposition of a stay should be the exception rather than the rule. Still more rare should be cases where a stay can be properly imposed in the absence of any fault on the part of the complainant or prosecution. Delay due merely to the complexity of the case or contributed to by the actions of the defendant himself should never be the foundation for a stay.*
>
> *... no stay should be imposed unless the defendant shows on the balance of probabilities that owing to the delay he will suffer serious prejudice to the extent that no fair trial can be held: in other words, the continuance of the prosecution amounts to a misuse of the process of the court.* " {at 643G- 644B}

21. It was argued that to call upon the Respondents to answer to events that historically occurred 16-18 years earlier was not only unfair but constituted "exceptional circumstances" so as to justify a stay of these proceedings. Emphasis was placed on the fact that for almost 5 years between 2004 and 2009, there was simply no communication between the IC with R3 or his legal advisors. This it was argued, would not unreasonably have led and induced R3 to believe the matter was not proceeding any further and that it had come to an end.

22. We were referred to an extract from paragraph 10.37 of Harris QC's textbook "Disciplinary and Regulatory Proceedings" 5th Edition to highlight the point

that when the period of delay was long it would be legitimate for this Committee to infer prejudice without proof of specific prejudice, relying on the two cases in the footnote to support that proposition.

23. It was argued that with a delay stretching almost 20 years, this Committee was entitled to and should readily infer prejudice to the Respondents. It was further contended that in this case there was actual prejudice suffered by R3 by reason of the following matters:

    (a) as regards R3's role in the Executive Committee of NCG, it is said that due to the lapse of time the engagement letter appointing him as financial advisor cannot now be located. This would identify what were the terms upon which he was so engaged by NCG;

    (b) further, although there was no dispute that R3 attended a number of meetings of the Executive Committee, given the passage of time R3 is now unable to remember how many he did attend nor what was discussed or what advice, if any, he gave at any of these meetings. It is said that the death of NCG's Chairman on 2nd April 2010 and that of the Vice-Chairman in 2006 further impairs R3 in answering these allegations so many years on as they, it is said, would be the most appropriate and direct persons who could corroborate R3's steadfast contention that although he was a member of the Executive Committee, he did not participate in or involve himself with the management of NCG;

    (c) it was submitted that although R3 was a co-signatory to the bank accounts of NCG, his exercise of this authority was purely as a back-up when other members of the 5 member Executive Committee were unable to sign due to their absence from Hong Kong. It was said that now, given the passage of time, R3 was prejudiced in not being able to recollect what were the occasions he did co-sign, what the amounts

were or what those cheques were payments for. It was further argued that R3 did not initiate the payments which had been first approved by the management of NCG;

(d) as regards the financial dealings that R3 is said to have had with the subsidiaries of NCG, it was contended that although R3 accepted he did have dealings with the securities subsidiary, he now has no recollection of any margin finance being extended to him by that entity, Further, he maintained his position that he never opened any account with the capital subsidiary of NCG. It was argued that the long passage of time deprived R3 from further exploring or investigating these matters to rebut any suggestion or impression of wrongdoing or inappropriate conduct on his part.

24. It was also submitted that the combination of the long passage of time, the crucial and unexplained delay and silence on the part of the IC between 2004-2009, the actual prejudice suffered by R3 as identified above and combined with the inferred prejudice from the long delay all constituted 'exceptional circumstances' within the test laid down by Lord Lane CJ justifying this DC to grant a permanent stay of the proceedings against R3.

25. The Chairman informed the parties that in view of the thrust and focus of the arguments on the question of delay the DC was of the preliminary view that it would hear the parties on the delay issue first and make a ruling on it. This was suggested to the parties for their consideration on the basis that if the Respondents application for a stay found favour with the DC, then no useful purpose would be served in hearing full arguments being advanced by the parties on the remaining substantive issues in relation to the complaints. The parties indicated their agreement to the DC's proposal and the hearing thereafter proceeded on that basis.

26. Mr. Beresford for R1 and 2 then addressed us. As stated earlier, he understandably and quite properly adopted the arguments on the effect of delay which it was contended impaired and prejudiced also his clients' ability to properly defend these proceedings.

27. He addressed the question of the three deferrals of decision by the IC sought by the legal advisors of R1 and 2 on 22nd August 2003, 20th August 2008 and 22nd October 2008. He argued that the first request was because of a pending appeal that his clients were then intending to pursue against the judgment of Kwan J ordering an examination on oath of R2. This request was acceded to by the Institute. As the appeal was not pursued, the request was subsequently withdrawn in November 2003. The second and third requests related to the draft report of the IC which was refused by the Institute.

28. Mr. Beresford argued that these requests did not cause any delay as such. Accordingly, he argued that R1 and 2 were not responsible for any of the delay that has plagued these proceedings. He made it clear that his clients were not alleging any mala fides on the part of the Institute for the clear and long delay that had occurred in these proceedings.

29. He argued that these were not complex proceedings and there was no involvement of any witnesses as such. There was clear, indisputable but unexplained delay in bringing these matters to a hearing, a period of delay during which the Chairman and the Vice-Chairman of NCG died. He claimed that these two persons were potentially crucial witnesses who could speak to relevant matters encompassed by the Complaints. As he put it, in the present case there was prima facie delay of such duration that R1 and 2 could not have a fair hearing now and this would amount to an abuse of process.

30. For the Complainant, Mr. Peter Duncan SC candidly admitted that there had been delay in these proceedings. He acknowledged that such delay was regrettable. He however contended that when regard is had to the applicable

legal principles and to the facts of this case, there was no good reason why the DC should order a permanent stay of these proceedings. He drew our attention to the fact that the investigation only commenced in 2003 when the matter came to the Institute's attention in April 2003 after the judgment of Kwan J (as she then was).

31. He emphasized that as early as July 2003 all three Respondents had been informed of the appointment of the IC and directing all three of them to retain all working papers in respect of the audit of NCG for the years ended 31st December 1995-1997. Further that in relation to R1. R2 and R3 they were specifically asked to keep under lock and key all documents relating to the provision of financial advice to the companies within NCG {**B5/Tab 6/pp. 1,4 and 7**}.

32. Mr. Duncan SC asserted that the unavailability of the engagement letter complained about by Mr. Strachan on behalf of R3 cannot in the light of the requests by the Institute to the Respondents be placed at the doorstep of the Complainant, who had asked for such relevant documents to be collated and preserved.

33. Mr. Duncan SC acknowledged that the applicable legal principles were that identified by Lord Lane CJ in the **AG's Reference case**. He identified the following principles which he argued could be distilled from that case:

(a) even if the delay was unjustified, the imposition of a stay should be the exception and not the rule;

(b) even if there was any fault on the part for the prosecution or the Complainant, that in itself was not sufficient to justify a stay because stays are not granted to punish the prosecution or the Complainant;

(c) there was an onus on the person applying for a stay to show on the balance of probabilities that owing to the delay he/they would suffer

serious prejudice to such an extent that a fair trial was not possible. It was said that this was relevant in the context of the question raised by the members of the DC as to why even if the Chairman and the Vice-Chairman of the NCG had died, why could inquiries not be made with the former legal advisor of the NCG who could perhaps speak to the role and function of R3 for the relevant periods the subject matter of these complaints. Mr. Duncan SC's argument here was to simply emphasise the point that the Rs' were wrong in asserting they had no onus, when in fact they did have a burden to show they would suffer serious prejudice;

(d) the length of delay in any particular case will not by itself justify a stay.

34. Mr. Duncan SC also referred us to the case of **R v B** {2003} 2 Cr. App R 197 where there was a delay of 30 years between the alleged incidents of sexual abuse and the complaints being made. He drew our attention to paragraph 18 of the judgment where Lord Woolf CJ stated as follows:

> "*However, the passage of time in this jurisdiction has never been a ground in itself for the staying of a prosecution. Just as the courts do not close the door to allowing appeals out of time if new evidence is forthcoming to show that someone who is innocent has been convicted, so if the prosecution decides that there is a case to go before the jury, the courts do not in the ordinary way consider it right to interfere with the prosecution process as long as (and this is an important qualification) a fair trial is possible.*" {p 202}

35. We note that the Court of Appeal there stated that the trial judge's reasons for refusing to stay the proceedings were correct and that the summing up to the jury also could not be faulted. They however allowed the appeal on the basis that the Court of Appeal had a residual discretion to set aside a conviction if they felt it was unsafe or unfair to allow it to stand even if the trial process

could not be faulted, a discretion which they said had to be sparingly used and with caution.

36. We have carefully considered the arguments advanced by the Respondents in support of the stay application by reason of the delay occasioned and complained of in these proceedings. We recognise that there has been delay in the present case, and particularly so for the period June 2004 until April 2009 when the IC was investigating the complaints, a delay period which has not been fully explained. We note that the draft report of the IC was circulated to the Respondents' legal advisers in April 2009. On 13th May 2009, one of the three members of the IC resigned and the final report was completed by the remaining two members on 14th October 2009 {**B1/Ex 1**}.

37. The quorum of the IC which completed the final report and the vires of their findings and recommendations was the subject matter of a separate challenge by the Respondents. The DC held a preliminary hearing to deal with these arguments on 2nd November 2012 and we rejected the challenge of the Respondents. Our decision setting out the reasons for the ruling was handed down on 7th May 2013.

38. We accept and recognise that the passage of time may in some cases cause some difficulties in terms of recollections of events, the locating of witnesses and the retrieval of documents. Giving due allowance and proper recognition to all these matters, the crucial question in our view is whether these Respondents can have a fair hearing before this DC. In this regard, we find the following dicta of Ribeiro PJ in **HKSAR v Lee Ming Tee** {2001} 4 HKCFAR 133 particularly apposite:

> "*In the first place, it is only in the most exceptional circumstances that a court can properly be satisfied that a fair trial is "impossible". The "fairness" achievable is judged in practical and not absolute terms. As*

Brennan J pointed out in ***Jago v District Court of New South Wales*** (1989) 168 CLR 23 at 49:

'If it be said that judicial measures cannot always secure perfect justice to an accused, we should ask whether the ideal of perfect justice has not sounded in rhetoric rather than in law and whether the legal right of an accused , truly stated, is a right to a trial as fair as the courts can make it. Were it otherwise, trials would be prevented and convictions would be set aside when circumstances outside judicial control impair absolute fairness.'

More importantly, the court's primary endeavour is to ensure that a fair trial takes place, employing the law's available resource, and not to abort it on the ground that fairness cannot be attained, save as a last resort. To quote Brennan J again:

A power to ensure a fair trial is not to stop a trial before it starts. It is a power to mould the procedures of the trial to avoid or minimise prejudice to either party" (at p. 46).

39. The CFA went on to emphasise that "***The public interest lies in the guilt or innocence of the accused being fairly and openly determined at trial. For this to be displaced, powerful reasons must exist for concluding that such a trial, although fair, would nonetheless constitute an intolerable abuse of the court's process. The instances where such an argument has any prospects of success must necessarily be rare.***"{ at p351 F-G}

40. We would also observe that from the time the Council resolved to appoint the DC in December 2009, the time taken to actually hear and determine the Complaints cannot be said to be caused by any delay by any party. There were preliminary and interlocutory issues that needed to be resolved as well as finding suitable dates convenient to all the parties concerned.

41. R3 strongly condemns the almost five years silence between 2004- 2009 when there was apparently no communication at all by the IC with R3 or his legal advisors. Regrettable as this delay and lack of communication was, we believe that Mr. Strachan was perhaps over-pitching his case to suggest that this would have induced R3 to believe that matter had gone away and lulled him into thinking that he was no longer the subject of being under the radar of any potential disciplinary hearing.

42. In our view, as an experienced professional man with experienced professional advisors, R3 could not have realistically believed that the matter had simply gone away with the IC not bothering to inform him of that fact. That may well have been his hope and desire which perhaps explains why he and his legal advisers would appear to have adopted the tactic of "let sleeping dogs lie" and not try and inquire with the IC as to the status of its investigation over that almost five year period.

43. We would also observe that the various assertions of actual prejudice suffered by the Respondents were made in the context of legal submissions filed by them. None of the Respondents elected to give evidence before us in support of the claim of prejudice. The Committee recognises that the Respondents were entitled to exercise their right to elect not to give evidence. The point remains that the legal submissions asserting prejudice do not constitute evidence of prejudice as such. In our view they remain legal submissions which do not elevate to constitute evidence in the strict legal sense. We have however taken into account what has been submitted on behalf of them in arriving at our decision.

44. We would also like to emphasise that we have ignored the fact that R3 was appointed one of the first directors of NCG on 20th November 1992. We note that he resigned from that post on 18th February 1993. We take the view that this appointment is irrelevant to the issues we are asked to determine – firstly because they relate to an appointment which is outside the period covered by

the complaints which is 1995-1998; and secondly because the appointment and resignation were events which occurred before the appointment of R1 as the auditors of NCG, which only occurred on 26th May 1993.

45. Taking into account all the circumstances of this case, and weighing the period of delay with the question of whether the Respondents have been in any way seriously prejudiced from having a fair hearing before this Committee, we are not satisfied that the Respondents have discharged their onus in showing on the balance of probabilities that they have been or would be prevented from having a fair hearing in these proceedings. In fact we find that the Respondents can have a fair hearing and are not seriously prejudiced by any delay that has transpired in this case. We accordingly refused the Respondents' application for a permanent stay of these proceedings.

D. COMPLAINANT'S OPENING

46. In opening the case of the Complainant, Mr. Duncan SC indicated that he would be relying on the various 'pleading' documents filed by the Complainant in support of their case. He stated that he proposed to provide a nutshell overview of the Complainant's case for the DC's appreciation and understanding of the Complainant's case.

47. He placed at the forefront of his argument the need for and the primary importance of independence in the accounting profession. This professional independence was the underpinning and fundamental principle that lay behind the Institute's Professional Standards 1.200 and 1.203. According to him, the Standards make it plain that apart from avoiding actual conflict, members should ensure there was no appearance of conflict so that he/she can carry out their work with objectivity, integrity and impartiality. The constantly repeated and refraining theme of the Standards was to highlight the importance and need for members to be, and to "be seen to be," independent at all times in their work. He argued that two principles that can be distilled from all this

was firstly, the fundamental nature of the obligation and secondly, the necessity for the appearance of independence.

48. In addressing the Case against R3, it was argued that as a partner of R1 who were the auditors of the NCG and it subsidiaries for the relevant period, R3 was, pursuant to section 131(9) of the Companies Ordinance (cap 32), to be treated as a 'deemed auditor' of those companies as well, even if he himself did not undertake the actual audit engagement. At the same time R3 was a member of the Executive Committee of the NCG which comprised seven members. This was the Committee that was entrusted by the board of directors of NCG to carry out the management functions of the board. Furthermore, it was said that R1 was paid handsomely for that role played by R3, a yearly sum of $1.2 million.

49. During the relevant three year period, there were a total of 96 meetings of the Executive Committee of which R3 attended 88 of them. The Complainant acknowledged that R3 did not have a vote at these meetings but it was contended that R3's presence was obviously a meaningful one. It was argued that it is clear that R3 was an authorised signatory to 13 bank accounts of NCG, and did sign cheques from time to time. This it was contended is significant, because such authority and signing were important and serious functions, which were normally reflective of functions of management.

50. It was argued that R3 had a further dimensional involvement with NCG in that he had personal financial dealings with their subsidiaries providing services in the securities and futures markets and margin finance. It was argued that these activities and involvement of R3 breached the independence requirements under the Standards and when considered collectively amounted to professional misconduct, which was the gravamen of the 4th Complaint. Alternatively, they amounted to breach of Standard 1.203, dealing with the importance of maintaining the appearance of independence.

51. As regards the Case against R1, it was argued on behalf of the Complainant that by its own written Independence Policy R1 acknowledged and exhorted its members to ensure that their independence was not impaired either in fact or appearance. R1 was receiving during the relevant period $100,000 a month for R3's participation in the Executive Committee of NCG, an audit client of R1. The Complainant argued that R1 failed to establish adequate review machinery to ensure its independence was not compromised contrary to paragraph 3 under Guidelines of the Standard 1.203, which stipulates as follows:

> "*Because of the need to guard against loss of independence, a practice should establish adequate review machinery, including an annual review, in order to satisfy itself that each engagement can properly be accepted or it be continued, having regard to the guidance given in the statement, and to identify situations where independence may be at risk and where the appropriate safeguards should be applied.*"

52. Mr. Duncan SC went on to remind the DC that it was part of the Complainant's case that R1, as the firm, was liable for the breaches of standards proved to have been committed by its partners on the principle of attribution {paragraph 122 of the Complainant's Case}. He also relied on the then applicable section 41A of the PAO to reinforce his submission on this point, which expressly spells out this principle of attribution statutorily.

53. Turning to the Case against R2, it was the Complainant's contention that as the partner responsible for the audit of NCG, R2 had a particular responsibility to ensure that the independence obligations were complied with and adhered to. It is said that she simply failed in her obligations in this regard. It was argued that R2 had access to the minutes of meetings of the Executive Committee {EC} which would have shown R3's regular attendance of these meetings.

54. Further that by reason of her auditing status, R2 should have been aware of the $100,000 monthly retainer which accrued to the practice of which she was a member/partner. When asked by the Chairman whether there was any document that the Complainant was relying upon to support the contention that R2 must be aware of the $100,000 retainer, Mr. Duncan SC fairly conceded that although he was not relying on any specific documentation, he claimed that the debit notes were and would have been part of the records of NCG and as part of the audit it would have been apparent to R2 that this not inconsiderable monthly sum was being paid to her firm R1, of which she was a partner.

55. The Complainant says that it was therefore incumbent on R2 to enquire into the relationship of R3 with the NCG and to then make an assessment as to whether R1 should continue to act as the auditor in the circumstances. This they say she simply failed to do.

E. SUBMISSIONS ON BEHALF OF R1 AND 2

56. Mr. Beresford in his submissions identified 8 issues which he believed were in issue in respect of his clients. As an introduction he made complaint of the fact that the case of the Complainant as presented at the hearing was different from the one the IC was investigating. He argued that the Complainant's case had 'mutated' and that the goal posts have been moved. This was a theme that Mr. Strachan for R3 also developed in respect of his client.

57. Mr. Duncan responded to this by arguing that the case of the Complainant has all along been consistently the same. He explained that it was "in the nature of the beast" that there may be variations between the matters that the IC identified in their report and what is contained in the ultimate complaints filed by the Council for determination by the DC. He emphasised that what this Committee is concerned with is the complaints as presented to us and the case

as advanced by the Complainant in support of the complaints and not what is contained in the IC Report.

58. We have carefully reviewed the complaints themselves and considered the arguments submitted to us on this matter and are satisfied that there has been no material change between the complaints made and the case as advanced by the Complainant in support of them. We are of the view that the Respondents have not been placed in any disadvantage in meeting the case pressed against them by the Complainant and that there has been no "ducking and diving" by the Complainant in the presentation of their case.

(i) Adequate and Appropriate Steps

59. This is the first of the issues identified by Mr. Beresford. He pointed out that the relevant years covered by the complaints were between 12th September 1995 – 7th December 1998 {the relevant period}. He stated that R2 was appointed engagement partner of the audit for NCG on 1st July 1996. He invited the DC to bear in mind that when evaluating the care and attention which R2 was to be expected to bear in discharging her duties as the engagement partner that she would be entitled to expect that R3 as a senior partner would also have appreciated and guarded against risks to his or R1's independence.

60. He argued that as the engagement partner in 1996, R2 cannot and should not be expected to undertake a client review of NCG to the same degree of intensity as a new client review back in 1993. He contended that R2 was entitled to factor in that R1 had undertaken two previous years of audit satisfactorily and that NCG had been classified as a "low risk" client. He drew our attention to the case of **Sharp v Council of the Law Society of Scotland** {1983} SC 129 for the proposition that it would be wrong to hold a junior and salaried partner liable for the misconduct of a senior partner, where the former is not in a position to affect the firm's policy.

61. It was submitted that there was no reason to suppose that R2 did not undertake R1's continuance procedures that was required of her or to doubt that she held the honest view it was appropriate for R1 to continue as auditors of NCG. He argued that there was simply no evidence to support the allegation that R2 did not undertake adequate and appropriate steps to ensure her and R1's compliance with the independence requirements under the Professional Ethics Statements.

62. He pointed out that in respect of R2 the Complainant does not allege any conflicting interest she may have that would detract from her objectivity, as compared to the case against R1 where the retainer is alleged to be the conflicting interest. He argues that the retainer was agreed in 1993, and R2 only became a partner in July 1996, and was therefore not a party to the retainer. He stressed that even it be proved that R2 failed to take some appropriate or adequate measures so as not to compromise R1's independence this would at most go towards supporting the complaint against R1 but not her.

ii. Notice – Actual or Constructive of R3's connections with NCG

63. Mr. Beresford argued that the crucial question here was whether R2 had notice that R3 was undertaking any management functions in NCG. He stated that the Complainant relies on the minutes of the EC meetings of NCG but that there was not a single minute which would clearly show that R3 was carrying out management functions. He drew our attention to Standard 1.203 paragraph 37 {**B5/Tab 4/p.11**} to emphasise that there was no objection in principle to a practice providing services to a client additional to audit, the only prohibition being that they should not be performing management functions or make management decisions.

64. He protested that the Complainant introduced a haystack of minutes of the EC meetings of NCG and expects R2 to have somehow seen the minutes which note that R3 was an authorized signatory of NCG's bank accounts. He pointed

out that for the relevant period there were only 4 minutes which record this – none in 1995, two in 1996 and two in 1997. He argued that this is simply insufficient to raise the inference of constructive notice. He complained that there was no formal minute book of NCG and that the minutes of the EC produced were unreliable as some of them were unsigned or undated and some appeared to be awaiting signature.

65. He submitted that although R1 was aware that R3 was appointed Financial Advisor to NCG and that R2 was also aware of the appointment and of R1's knowledge of it, this did not mean that they knew R3 was participating in management or even if he was, that R1 and 2 were aware of it. He drew our attention to Article 103 of NCG's Articles of Association to highlight the point that constitutionally neither the Financial or Legal Advisor was allowed to vote and therefore incapable of making management decisions.

66. He argued that the word "advisor" normally does not suggest participation in management. He claimed that the obligation on the Complainant was to establish what management functions R3 in fact carried out and in respect of R1 and 2 that they had notice that R3 was doing so. He suggests that the Complainant has singularly failed to do this. Furthermore he claimed that the fact R3 was the Financial Advisor did not mean he lacked independence. If anything it indicated the contrary, as an advisor was usually an independent person.

67. He asked the DC to bear in mind that this case was all about 'appearance' and that neither the IC nor the Complainant have said that anyone's independence was in fact impaired or compromised.

68. He contended the fact that R3 was an authorised signatory to NCG's bank accounts would appear to be purely 'ministerial'. The only notice that R1 and 2 would have arguably have had were the 4 minutes for the relevant period. He argued that there was no evidence that R1 and 2 were aware of R3's

personal dealings with subsidiaries of the NCG. Even as regards any alleged loans that R3 may have had with NCG subsidiaries, he argued that there was no evidence before the DC that R1 and 2 knew of this at any time. He was careful to point out that he was not making a positive or affirmative case on this point but simply highlighting that the Complainant has not adduced evidence to establish his clients were aware of any of these things. Similarly, his clients are not in position to dispute if R3 says he had these dealings or signed some cheques.

iii. Professional Misconduct

69. Mr. Beresford contended that although this phrase is not defined in the PAO, it must mean something more serious than just a failure to maintain the Standards. He traced the history of the PAO since its enactment in 1973 and argued that the long standing judicial pronouncements indicating that professional misconduct required an element of moral turpitude still remained relevant. He contended that the amendments in 1991 to introduce breach of professional standards in sections 34(1) (a) (vi) of PAO would suggest that it introduced a lower standard to that in relation to professional misconduct.

70. He argued that something more than a breach of the Standards was necessary to bring home the charge of professional misconduct. He also argued that in addressing this charge the DC should bear in mind whether the person charged is a junior or senior partner and whether the acts complained of were done by a more senior partner and/or approved by senior management. If the evidence only establishes a technical breach, then that was not tantamount to professional misconduct.

71. He emphasised that there was no hint by the Complainant that there was any moral turpitude on the part of R2 in her actions or inactions. Accordingly, he contended that R2 cannot be found guilty of professional misconduct.

v. Independence of R1

72. It was argued that the appointment of R3 as Financial Advisor to NCG did not or could not appear to be in conflict with the requirement that R1 performed the audit work objectively and impartially. The very fact that the accounts of NCG for 1996 and 1997 were qualified with disclaimers by R1 would debunk any notion that any rational shareholder would consider R1's independence was or would appear to be compromised.

73. It was submitted that there was nothing in the manner that R1 carried out its duties towards its audit client NCG that could be said to have affected its objectivity, integrity or independence.

vi. Retainer

74. It was argued that by its nature, a retainer is paid for in advance of services to be rendered and the retainer fee that R1 was paid did not give it any greater interest in the success or otherwise of NCG than an audit fee would. If anything the retainer would reflect lesser interest because it was paid irrespective of the advice given.

75. Reliance was places on paragraph 37 of Standard 1.203 to support the argument that R1 was perfectly entitled to provide additional services NCG so long as it did not involve participation in management or making management decisions. It was argued that in the circumstances of this case, neither the retainer nor the acceptance of payment for it could be said to detract from R1's objectivity in continuing and carrying out the audit work for the years 1995-1998.

vii. Attribution of R2 and R3's conduct to R1

76. Mr. Beresford contended that this was the most important aspect of the Complainant's case against R1. He argued that the Complainant was relying on section 41A of the PAO to underpin this point. He argued that complaints

2 and 4 if proved against R2 and 3 cannot be attributed to R1 because the latter was not charged with professional misconduct. Similarly charge 5 he argued also cannot be attributed to R1 because the allegation there against R3 was of participation in management of NCG which was not what was alleged against R1, namely to conduct itself to be free of interests that may detract from its objectivity.

77. He argued that only the conduct of R2, if found to be established in respect of charge 3, could be arguably attributed to R1 but not charge 2. He claimed that nothing found against R3 could be attributed to R1 as they relate to completely distinct and different matters.

78. It was argued that the appointment of R3 as Financial Advisor was not kept a secret. It was disclosed in the annual accounts and was recorded in the minutes of the EC meeting of NCG as well as in the minutes of the meeting 0f the management committee of R1. There was therefore nothing which would alert R1 that its independence may or would be compromised or appear so in either agreeing to or continuing with the appointment.

viii. Review Machinery

79. It was argued that three was no suggestion that R1 had not carried out an annual review. Reliance was placed on R1's procedures and policies to argue that the presumption of regularity would suggest that such procedures and policies were in fact followed. It was submitted that the Complainant's argument that there was a positive duty to comply with the Statement does not take the matter further because there was no absolute duty but only a duty to take reasonable steps to ensure compliance with the Standards.

80. It was said that the Statements do not have the force of law imposing absolute obligations. This, it was argued, was wrong and that the Statements provide basic advice expressed in broad and general terms. The argument ran that paragraph 16 of Statement 1.200 makes it clear that failure to follow the

guidelines in the Statements does not of itself constitute misconduct, but that the member is at risk of having to explain his actions in answer to a complaint.

81. It was argued that the Statements involve an evaluation and Mr. Beresford invited the DC to make allowances for the reasonable disagreement as to what was done by his clients as compared to what ought to have been done. Accordingly, the fact that someone would have done things differently does not mean that the way his clients conducted themselves was not in line with the Statements. He further argued that DC had to be satisfied which of the specific allegations made by the Complainant have been made out to the requisite standard.

82. He pointed out that the Complainant has put its case against R1 on several basis (a) taking and keeping a retainer (b) not establishing adequate review machinery (c) attribution due to breach by R1 and/or R2. He argued that we had to be satisfied which in particular, if any, of these allegations has been made out against R1. Similarly in relation to R2 he argued that the allegations against her had also to be specifically identified before she could be found guilty of any charge. He invited the DC to find that the allegations against his clients have simply not been made out and asked us to dismiss the complaints against R1 and 2.

SUBMISSIONS OF R3

83. Mr. Strachan provided a 'road map' of the 5 issues {apart from the delay issue} that he believed were relevant to his client's case. In his introductory remarks he pointed out that although charge 4 makes reference to 4 Statements, namely 1.200, 1.203, 1.209D and 1.303, he argued that only the first two were really relevant insofar as the complaint bites R3 at all. He argued that Statements 1.209D dealing with directors and 1.303 touching on de facto director were not relevant because, according to him, the Complainant had

made a concession in respect of them in paragraph 125(a) and (b) respectively of the Complainant's Case.

84. He also highlighted that as the Complainant's case against all the Respondents was premised on the basis of 'appearance' of lack of independence rather than actual lack of independence, he argued that the test to be adopted should be; whether a reasonable observer seized of ***all*** the facts would consider the interest to likely affect the objectivity of the practice relying on paragraph 52 of Statement 1.203.

i. Application of independence requirements of the Statements to R3

85. Mr. Strachan's primary point was that the Statements in terms of their independence requirements are principally directed towards the person(s) *actually* undertaking the audit work and have no application to a member of the practice who is not undertaking the work. His contention was that the Statements all refer to the practice or the person actually undertaking the audit work. He says that the Statements are conspicuously silent as to whether they apply to other persons in the firm who are *not* undertaking the audit engagement. He argued that there were other paragraphs such as paragraphs 14, 17 and 18 of Statement 1.203 which impact on members of the practice who are not undertaking the actual work. As he colourfully put it, the Statements do not impact on the 'man down the corridor' from the person undertaking the audit engagement.

86. It was argued that the Complainant's case against R3 on the basis that he was a deemed auditor under section 131(9) of the Companies Ordinance (cap 32) was irrelevant because it does not have the effect of attributing professional standards to the partners of an auditing firm. His point was that who the Statements apply to was to be gleaned from the Statements themselves and not from this section which is a statutory regime designed to state the legal

position when a practice is appointed as auditor of an entity, making all the partners deemed auditors, as the practice has no legal personality.

87. He argued that section 131(9) was only concerned with the partners of an audit firm, whereas the Statements apply to all members of the accounting profession, whether they are partners or not.

88. He also protested that the Complainant appears to have resiled from the concession made in paragraph 125 of its primary case that it was not pursuing the allegations of R3 being a director or de facto director. As he put it, Statement 1.209D and 1.303 are simply not applicable to R3 as he was not a director of NCG during the relevant period.

89. He further argued that there was an internal inconsistency in the Complainant's case because if the Complainant still asserts that R3 was a director of some kind, then this was inconsistent with the Complainant's case that R3 was a deemed auditor. The thrust of his argument here was that if R3 was a director or officer of NCG, then he would not be eligible to be appointed as an auditor under section 131(9). He described this as a nice legalistic point but one that throws the Complainant's case off the rails and that the inconsistency causes the Complainant's case to fall apart at this fundamental level.

ii. R3 as Financial Advisor - is it performing management functions?

90. It was argued R3 was Financial Advisor to the EC and not a member of it. He could not vote or be counted for the purposes of quorum. At most, he could attend and have notice of the meetings of EC. Constitutionally his role was circumscribed. He pointed to 6 factors which he claimed showed that R3 was not undertaking management functions or participating in management decisions:

(a) NCG already had a Finance Director who exercised true executive and management power. R3 was only an advisor;

(b) the Annual Reports of NCG consistently stated that the EC comprised of 5 members and a Financial Advisor and Legal Advisor;

(c) the minutes of EC meetings for the relevant years 1995-1998 consistently record the members of EC as 'present' and the two advisors as 'in attendance' mirroring the distinction which was contained in Article 103 of NCG's articles of association;

(d) R3 only gave advice when sought and did not offer unsolicited advice;

(e) R3 did not have his own office, secretary or any other administrative support at NCG;

(f) Complainant appears to accept R3 was not a de facto director.

91. He further points out that there was no attempt to keep R3's role as a secret. He suggests the fact that this appointment and role was in the public domain militates against there being any impropriety on his part. According to Mr. Strachan, R3's role was that of a 'trusted external advisor' rather than someone actively engaged in the management of NCG's affairs.

iii. Signatory to bank accounts – performing management functions?

92. The submission here was that although cheque signing would prima facie suggest performing management functions, he invited the DC to apply the test of a reasonable observer seized of *all* the facts to consider whether R3's objectivity was or would appear to be compromised by his having such authority.

93. He highlighted the following matters for the DC's attention:

(a) all the cheques signed by R3 involved payments approved by NCG – R3 neither initiated nor approved such payments;

(b) R3's signing was limited as a backup after NCG management had approved the payment(s) and was only done when there were no two authorised signatories available;

(c) there were safeguards and R3 did not keep the cheque books and there was backup documentation to support such payments. R3 was not able to requisition a cheque to be issued;

(d) R3 signed less than 10 times over the three relevant years.

94. Mr. Strachan invited the DC to err in favour of R3 in drawing any inferences. He argued that no reasonable observer would form the view that there was any appearance of R3's objectivity or independence being compromised because he had cheque signing authority. It did not encroach on management functions he submitted.

iv. R3's Personal Financial Dealings with NCG's subsidiaries

95. He argued that the issue on this complaint had narrowed down to the applicability of paragraphs 32 and 33 of Statement 1.203. The submission here was that R3's dealings with the subsidiaries came within the exception of '*or similar financial institution*' and therefore were not proscribed.

96. Mr. Strachan emphasised that although R3 accepts he had personal accounts with the NCG subsidiaries of finance, securities and futures, he denies having any account with NCG Capital at anytime. It was contended that R3 was unaware of why cheques he had written in favour of those entities with whom he had accounts was entered into the books of NCG Capital. He also argued

that at no time was there any indebtedness by R3 because his account was always in credit.

97. Our attention was drawn to paragraphs 95-100 of R3's submissions to distill the following matters:

(i) the accounts involved deposit and not loans from NCG Capital;

(ii) funded by cheques signed by R3 and drawn in favour of NC Securities or NC Futures. No evidence to suggest that R3 was aware or approved the entries of these deposits into NCG Capital's account;

(iii) monies deposited by or behalf of a company for whom R3 was the nominee and not for R3 personally.

98. It was finally contended that these dealings were with entities that were statutorily regulated by the Securities and Futures Commission, and therefore the question of the appearance of independence being compromised did not arise in the circumstances.

v. Professional Misconduct

99. The central argument here by Mr. Strachan was that in order for the Complainant to bring home this charge against his client, there had to be something more than just an infringement of the Statements. His argument was that this would require a serious breach of the professional standards such that the consensus view within the accountancy profession would agree that it amounted to misconduct. He relied as the touchstone of this test the decision of the Court of Final Appeal in the case of **Medical Council of Hong Kong v Helen Chan** {2010}3 HKCFAR 248.

100. He further pointed out that the PAO itself draws a distinction between breach of a Statement and professional misconduct by enacting two distinct provisions in sections 34(i) (a) (vi) and (viii) respectively.

101. He also prayed in aid paragraph 16 of Statement 1.200 in support of his contention that not every breach of the Statements /guidelines constituted professional misconduct. He argued that if all the allegations pressed against R3 are looked at in their totality, and even assuming these allegations are established, they do not amount to professional misconduct as they are not flagrant breaches of the Statements. He pointed out that there was simply no suggestion that the independence of the audit itself was compromised – the only issue was whether there is any appearance that it was or may have been.

REPLY SUBMISSIONS ON BEHALF OF THE COMPLAINANT

102. Mr. Duncan SC emphasised that the Complainant's case on attribution against R1 was not just based on R2's actions or inactions but also R3. He drew our attention to paragraph 122 of the Complainant's case and to paragraphs 22-26 of the Complainant's Reply Submissions to R1 and 2's Submissions. He pointed out that the common thread running through charges 1, 3 and 5 is a failure to carry out conduct in a way seen to be free of interests which might detract from objectivity. This he underlined was the recurrent theme.

103. He argued that section 41A of PAO specifically deals with attribution and makes crystal clear that attribution is possible from the conduct of the partners to the firm R1, from a statutory perspective.

104. Mr. Duncan SC went to pains to point out that there was no concession made by the Complainant as regards Statements 1.290D and 1.303 relating to de facto director and directors. He argued that the Complainant was simply not pursuing those allegations against R3 and that they were not advancing any specific allegation in respect of those matters.

105. He argued that under section 34(1) of PAO the obligation under the Statements was absolute and there was no need to prove any negligence. He submitted that a failure was a failure and no further extrapolation was required on that score. In relation to R2 he argued that she was aware that R3

was the Financial Advisor to the NCG and from the minutes of the EC meetings she would be aware that he attended a vast majority of the meetings. Further, she would also be aware of the 'handsome' amount that R1 was being paid every month for the services of R3 to NCG. It was contended that these were two red flags that should have alerted R2 to bring the audit engagement to en end.

106. In response to the complaint by Mr. Beresford that the Complainant has failed to make clear what exactly was it that R2 failed to do, he submitted that this had been abundantly made clear in the Complainant's case and drew our attention to paragraphs 114-117 of the Complainant's case. In essence it was argued that the duty on R2 was to bring to an end R1's engagement as auditor. He argued that it was her obligation to be satisfied that it was appropriate for R1 to continue with the engagement and that R1 was in compliance with the independence requirements. It was said that she simply failed to do so.

107. He took issue with the Respondents contention that the approach to the issue of appearance of lack of independence was to apply the test from the perspective of a person seized of *all* the facts. He argued that the Institute's emphasis in the Statements of 'appearance' underscores the position that the person may not be seized of all the facts but it is the ***appearance*** that is fundamental.

108. He argued that the Respondents contention that a degree of moral turpitude is required before a person can be found guilty of professional misconduct was an unwarranted and unjustified embellishment and not what the PAO suggests needs to be established in relation to this particular provision of sections 34(1) (a) (viii). He contended that what is professional misconduct was fact sensitive and was ultimately a matter for the DC.

109. He pointed out that there was a separate offence of dishonourable conduct under section 34(1)(a)(x) which raises issues of moral turpitude, unlike the

other offences in that section. Mr. Duncan stressed that the Statements represented the consensus of the accountancy profession which are issued under a formal procedure pursuant to section 18 of PAO.

110. He acknowledged the import of paragraph 16 of Statement 1.200 but emphasised that whether a breach of the professional standards promulgated in the Statements amounted to professional misconduct would depend on the conduct involved and the Statement concerned. He pointed out that in the present case the DC is concerned with the most fundamental principle that permeated the Statements – independence and/or the appearance of it not being compromised.

111. In reply to Mr. Strachan's submissions that the Statements do not apply to someone in the position of R3 since he was not engaged in the audit work, he contended that this was too restrictive an approach to the thrust and import of the Statements. He emphasised that the Statements were not exhaustive in their application.

112. As to the deemed auditor point Mr. Duncan SC pointed out that there was no inconsistency in the Complainant's case on this score. He pointed out that the real issue here was that R3 should not have conducted himself in the manner that he did when R1, of which he was a senior partner, was undertaking the audit work. His high point was that R3 having these personal dealings given his position within NCG and within R1 are what causes the gravest concerns about the appearance of independence.

DETERMINATION

113. We have carefully considered the detailed written and comprehensive oral submissions made to us by all the parties dealing with the issues that required our determination. We would like to state at the outset that we have attempted to set out above the salient aspects of the arguments addressed to us. We have

not set out each and every argument advanced by the parties, and this is with no disrespect to Counsel who went out of their way to assist us in our task.

114. We have taken on board the importance of all that has been drawn to our attention in terms of the relevant case-law, documentation and the statutory provisions germane to the matters before us. The fact that we have not set out in detail all of what has been addressed to us does not mean we have not considered or taken them into account in arriving at our decision or considered them irrelevant. We have set out the salient points in the interest of the need to balance the length of our determination and its comprehension.

115. We would also like to point out that we have carefully considered the matters contained in the IC Report and have done so purely from the basis of providing the DC with the historical background of dates and events to show how this matter has come to be before this DC. We have ignored any views formed by the IC in relation to any of these Respondents and have been careful to keep the IC's opinions on various matters in respect of the Respondents out of our consideration. We are fully aware that it is *our* views and conclusions on the evidence placed before us that is important, and not the views or conclusions of the IC.

116. Although the factual background to the subject matter of the complaints in respect of the Respondents have a common theme, we have approached the charges against each of the Respondents on the basis of examining closely the evidence and law in relation to each of them separately and individually.

117. We have borne in mind and reminded ourselves that the onus is on the Complainant to establish the charges against each of the Respondents to the requisite standard of proof, which is a higher standard than the civil standard of on the balance of probabilities and just short of the criminal standard of proof beyond reasonable doubt. We fully appreciate and are aware of the fact that there is no burden on any of the Respondents to prove their innocence.

118. We accept that on the evidence there is no question that the independence of any of the Respondents has been impaired or compromised in fact. It is common ground that complaints against the Respondents are premised on the "***appearance***" of independence being impaired and we approach the complaints on that basis only.

119. We remind ourselves of some of the important principles promulgated by the Institute by way of Statements to provide guidance to the whole of the accountancy profession. We recognise that the Statements are not exhaustive and do require the members to exercise their common sense and judgment to ensure compliance with and adherence to the precepts set out there. We set out below some of the salient precepts identified in the Statements:

Statement 1.200

FUNDAMENTAL PRINCIPLES

1. *In accepting or continuing a professional assignment or occupation a member should always have regard for any factors which might reflect adversely upon his integrity and objectivity in relation to that assignment or occupation.*

3. *A member should follow the ethical guidelines of the Society and in circumstances not provided for by that guidance should conduct himself in a manner consistent with the good reputation of the profession and the Society.*

Form of Guidance

9. *The Fundamental principles are drawn by the duties owed by members of the profession, whether in practice or not. They are framed in broad and general terms and constitute basic advice on professional conduct.*

10. *They set out the overriding requirement that, as a professional man, a member must at all times perform his work objectively and impartially and free from influence by any consideration which might appear to be in conflict with this requirement. The Fundamental Principles also define a member's duties to the community. These comprise his duties to the public including those with whom he has a client relationship or, in the case of an employed member his duties to those for whom he carries out professional work, as well as his duties to the Society, representing the profession as a whole, and to fellow members of the profession.*

11. *The Statements provide more detailed information as to what is expected of a member in certain circumstances. The fact that the Fundamental Principles are of primary importance must not, however, be lost sight of, and conduct which can properly be said to be contrary to any one of them may expose a member to a complaint of misconduct, even though his act or omission does not fall specifically within the circumstances provided for by the Statements.*

14. *Of the first of these areas it cannot too often be emphasized that professional independence is a concept fundamental to the accountancy profession. It follows that where a member has any reasonable doubt as to the propriety of his accepting instructions, he should not act.*

Failure to follow the guidance

16. *Failure to follow the guidance given by the Statements does not of itself constitute misconduct, but means that the member concerned may be at risk of having to justify his actions in answer to a complaint.*

Enforcement of ethical standards

24. *As misconduct cannot be defined generally but has to be determined in each individual case by the Disciplinary Committee, it follows that the Council cannot promulgate mandatory instructions where the mere breach of which amounts to misconduct. Nor can the Council say that in any given set of circumstances a member will or will not be guilty of misconduct. What the Council may do is advise that certain conduct may expose a member to the risk of disciplinary action.*

Statement 1.203

Professional Ethics

Integrity, Objectivity and Independence

The Statement

1. *Professional independence is a concept fundamental to the accountancy profession. It is essentially an attitude of mind characterized by integrity and an objective approach to professional work.*

2. *A member in public practice should be, and be seen to be, free in each professional assignment he undertakes of any interest which might detract from objectivity. The fact that this is self-evident in the exercise of the reporting function must not obscure its relevance in respect of other professional work.*

Audit and other financial reporting functions

Review procedures

3. *Because of the need to guard against loss of independence a practice should establish adequate review machinery, including an annual*

review, in order to satisfy itself that each engagement may properly be accepted or be continued having regard to the guidance given in this Statement, and to identify situations where independence may be at risk, and where the appropriate safeguards should be applied.

Personal relationships

12. *Close personal or business relationships can affect objectivity. There is a particular need, therefore, for a practice to ensure that its objective approach to any assignment is not endangered as a consequence of any such relationship. By way of example, problems may arise where the same partner or senior staff member works for a number of years on the same audit or where anyone in the practice has a mutual business interest, close friendship or relationship by blood or marriage with an officer or employee of a client or has an interest in a joint venture with a client or where the work is being done for a company dominated by one individual.*

Financial involvement with or in the affairs of clients

14. *Financial involvement with a client may affect or is likely to be seen as affecting objectivity. Such involvement can arise in a number of ways of which a shareholding in a company upon which the practice is retained to report is a typical example. However, the above is not intended to preclude a beneficial holding in an authorized unit or a listed investment trust which holds shares in a client company, except where the unit or investment trust is itself a client on which the practice reports.*

Loans

30. *Objectivity may be threatened or appear to be threatened by a loan to or from an audit client.*

31. *A practice or anyone closely connected with it should not, either directly or indirectly or, by way of a trust or other intermediary:*

   a. *make a loan to or guarantee borrowings by an audit client;*

   b. *accept a loan from such a client; or*

   c. *have borrowings or other obligations guaranteed by such a client.*

32. *This advice does not normally apply to any account in credit with a client bank or similar financial situation.*

Provision of other services to audit clients

36. *There are occasions where objectivity may be threatened or appear to be threatened by the provision to an audit client of services other than the audit.*

37. *There is no objection in principle to a practice providing to a client services additional to the audit. However, care must be taken not to perform management functions or to make management decisions.*

Conflicts of Interest Conflicts between a practice's interests and those of its client

51. *A practice should not accept or continue an engagement in which there is or is likely to be a significant conflict of interest between the practice and its clients.*

52. *Whether a significant conflict of interest exists will depend on all the circumstances of the case. The rest is whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect the objectivity of the practice. However, any material financial gain which accrues or is likely to accrue to the practice as a result of the*

engagement, otherwise than in the form of fees or other reward from the client for its services, or commission, etc. properly earned and declared under the services, or commission, etc. properly earned and declared under the terms of paragraph 53 below, will always amount to a significant conflict of interests.

COMPLAINT 1 – AGAINST R1

120. The thrust of the complaint against R1 is that it failed to be or conduct itself in a way seen to be free of interests which might detract from its objectivity in accepting or continuing the professional work it undertook with the audit of the NCG or its subsidiaries for the relevant three years. Independence and the appearance of independence being the cornerstone of the accountancy profession, it was incumbent for R1 to have in place both an adequate and sufficient review machinery including an annual review to ensure that they can accept and/or continue the professional engagement which would not detract from their independence or impair the appearance of independence.

121. It is clear that the NCG was seen as a potentially major client. This was recognised by the minutes of the Management Committee meeting of R1 on 23rd February 1993 where it was recorded:

"8. Major Client Development

c) New China Hong Kong – AW reported that E&Y was appointed financial advisor as well as auditor and the company will be listed in twelve to eighteen months. SC is the engagement partner" {**B6: Tab 3:p32**}

122. The reference to AW is a reference to R3. Although no mention is made to the fact that R1 was to be paid a monthly retainer of $100,000 it would appear not in issue that R1 was aware of the fact and the amount of the retainer, which is

not an insignificant sum more than twenty years ago back in 1993. There is no evidence before us as to whether, if at all, any review was undertaken by R1 of this dual appointment or what the result of any annual review was from the time of these appointments to the end of the relevant period in 1998.

123. We would observe that despite R1 being told to retain all records in relation to the NCG audit in July 2003 by the Institute not a single working paper, or annual review documentation for the relevant years was made available to us. For an internationally reputed accountancy practice with its own Policies and Procedure rules to have not kept any of these basic working records of an audit client we find both surprising and to put it mildly, rather disturbing.

124. We were told that R1 had a document destruction policy of 6 years so that the records of 1993 and 1994 were no longer available. However no explanation has been offered as to why there are completely no records for the remaining years of audit, bearing in mind R1 as the auditors of NCG would be aware that their client went into liquidation in January 1999, and it must be obvious to the management of R1 that the working papers of the audit, declarations of interest of the partners and annual review papers would all be relevant and necessary documentation in the liquidation process which was to follow.

125. We recognise and accept that paragraph 37 of Statement 1.203 permits a practice to provide services in addition to audit to a client with the prohibition against performing management functions or making management decisions. In our view, paragraph 36 of the same Statement perhaps provides the important and salutary reminder of the fundamental importance of being seen to be independent in the provision of services additional to audit.

126. Looking at the matter as a whole and from the perspective of an independent, reasonable and rational observer, the overwhelming impression and conclusion we are driven to is that R1 failed to fully and properly address its mind to the independence requirements and principles which underline the

Statements and weighing it in the balance against the securing of a major and lucrative client account.

127. We note Mr. Beresford's argument as to how could anyone consider that R1's independence may be impaired having regard to the fact that for audited accounts for the years 1996 and 1997 R1 had recorded disclaimers in the accounts contained in the NCG Annual Reports.

128. We however would observe that these two disclaimers were issued just over 2-3 months before NCG went into liquidation on 25th January 1999. The 1996 accounts were disclaimed on 8th October 1998 and the 1997 accounts on 7th November 1998. In our view the appearance of independence is to be viewed not from the context of any one specific event but from the perspective of the appearance of independence throughout the relevant period.

129. Having carefully reviewed all the evidence placed before us and giving due regards to the submissions of the parties, we are satisfied that R1 failed or neglected to observe, maintain or otherwise apply the professional standard required of them under Statement 1.203. We are satisfied that R1 failed to have any or any adequate review machinery which would have alerted it to the risk of the appearance of its independence being impaired.

130. We are satisfied that the 1st complaint has been established to the requisite standard of proof against R1 and accordingly find R1 guilty of the same.

COMPLAINT 2- AGAINST R2

131. The complaint here is of professional misconduct against R2. We have carefully reviewed the evidence against her in respect of this complaint and reviewed the submissions made both on her behalf and by the Complainant. We have come to the unanimous view that this Complaint has not been made out against R2. We therefore dismiss this Complaint.

COMPLAINT 3 – AGAINST R2 {alternative to 2 above}

132. The nub of the complaint here is that after she took over as the engaging partner of the audit of NCG and its subsidiaries she fell short of the professional standards requiring her to undertake her work in such a way that she was free of interest(s) that may appear to impair her objectivity.

133. It has been urged upon us that as a junior partner in 1996, R2 was entitled to assume that R3, as a senior partner would have taken steps to guard against any risks to either his or R1's independence obligations. The implicit suggestion being that since senior management of R1 had approved the retainer back in 1993, that therefore R2 could safely assume or proceed on the basis that there was nothing wrong with R1 being both financial advisor and auditor.

134. In our view, such an argument if allowed to gain currency and be given validity, would entitle a member of the accountancy profession to abdicate his or her independence obligations by claiming that they relied on the fact that others senior to them thought there was nothing improper so they could assume that it was permissible. In our view such a contention would in effect drive a horse and carriage through the fundamental principles of independence that are the foundation of the Statements issued by the Institute and will become the thin edge of the wedge that undermine the foundation platform from which the Standards are promulgated.

135. As we see it, it is precisely because R2 was coming into the engagement fresh, the greater was the obligation on her to ensure that she was satisfied upon a proper review and careful examination of all the surrounding facts that it would be proper for R1 to continue carrying out the dual engagements. This was an obligation that was expected of her by the standards of the accountancy profession. Abdicating one's personal obligations on the basis of an expectation that someone else must have done the necessary checks may

provide a mitigation factor but does not absolve the individual from compliance with the Standards.

136. We take note that there is no evidence before us that R2 was aware of the fact that R3 had personal dealings with NCG's subsidiaries or that he actually signed any cheques on behalf of NCG during the relevant years of 1995-1998. We would have expected R2 should be aware of the fact that R3 was signing cheques for NCG from the 4 minutes during the relevant years of 1995-1998 if she was undertaking the audit engagement with due and proper diligence.

137. We were told that there were no records available as to whether R3 had or had not declared his interests in the NCG subsidiaries with R1 or R2. We have already expressed our surprise of this state of affairs in paragraphs 123-4 above. We have therefore taken no account of the evidence of the personal dealings of R3 when addressing the case in respect of R2. For the avoidance of doubt, we would like to emphasise that we have also ignored R3's personal dealings when we were considering the case against R1.

138. We were told that R2 was aware that R3 was a member of the EC of the NCG and that she was also aware of the monthly retainer that was paid to R1 by the audit client. It was suggested on behalf of R2 that there was no evidence that she was aware as to the actual amount of the retainer. We would only observe that it would be surprising if she was not actually aware of the amount of that retainer particularly if she was the newly appointed engaging partner in audit and if she was carrying out proper due diligence and properly discharging her duties in compliance with the Standards.

139. For the purposes of our decision we however do not believe it is important whether she knew of the exact amount of the retainer and we make no findings on that matter. What is more germane is that she was aware of the dual roles played by R1 vis-à-vis the audit client and that R3 was member of

the EC of the client and should have been aware that R3 was authorized to sign cheques on behalf of the audit client.

140. We were told that R3 had apparently attended about 167 out of the 199 EC meetings between 1993 and the time NCG went into liquidation representing over 80% attendance of these meetings. Even for the period since R2 was made the engagement partner between July 1996-1998, the minutes of the EC reveal that R3 attended a vast majority of such meetings {**B2/280 -401**}.

141. In our view, if R2 was being faithful to her obligations under the Standards and was keeping alert to the independence requirements of both herself and R1, she would and should have realised that given the role R3 was playing in the audit client, that if R1 continued with its dual capacity relationship with the audit client there was a risk that the appearance of independence principle may be impaired or compromised and taken steps to relinquish either one of the roles. It was incumbent on her to bring the audit engagement to an end or at the very least bring the potential risk to the appearance of independence to the attention of the management of R1.

142. In our view, the fact that the previous engagement partner of R1 may not have thought that there was or may not be any risk of the appearance of independence being impaired did not and should not have given her any comfort so as to absolve her from taking steps to ensure and satisfy for herself that there was no risk of the appearance of independence being compromised. This is a point that sounds more in mitigation rather than provides the platform for a defence to the complaint.

143. It is clear that she did not appear to have taken any steps to either terminate the audit engagement or raise the issue with the management of R1. In our view, her failure to do so amounted to a breach by her of observing, maintaining or otherwise applying a professional standard in breach of section 34(1) (a) (vi). We are satisfied that on a careful examination of all the

evidence the 3rd Complaint laid against her has been made out to the requisite standard of proof. We accordingly find her guilty of the 3rd Complaint.

COMPLAINT 4 –AGAINST R3

144. The thrust of the complaint here is that R3 is guilty of professional misconduct by reason of his failure to observe the independence requirements of the Standards by participating in the management of or otherwise having an involvement with NCG and its subsidiaries. It is averred that all this was whilst R3 was a senior partner of R1 who were the auditors of NCG and whilst R3 himself was a deemed auditor under section 131(9) of the Companies Ordinance (cap 32).

145. In his submissions to us Mr. Strachan sought to place a distance between the EC of NCG and the role of R3 vis-a vis the Group. He argued that R3 was really just the Financial Advisor to EC of NCG and to describe him as a member of the EC was not illuminative but rather confusing. In our view there can be little doubt that R3 was a member of the EC of NCG and this is spoken clearly to by the very minutes of NCG dated 18th February 1993 recording the appointment of the members of the EC where the seven members of the EC are named and their respective positions demarcated. R3 was denominated as the Financial Advisor {**B2/98**}.

146. We also note that R3 himself sought to distance himself in terms of his appointment as Financial Advisor of NCG when in his affirmation filed on 4th December 2002 he asserted as follows {**B1/39**}:

> 8. "*It is important to understand both the basis and the context of my appointment as Financial Advisor. I carried out the vast majority of my work for NCHK Group* {NCG} *prior to and just after it was set up. I did this in my capacity as a partner of E&Y. For example, during 1992 I had numerous meetings with Ministers in the PRC and spent considerable time assisting with the fundraising. Indeed in the early*

days, in 1992, I was spending up to three to four days a week in Beijing. Ultimately, $500 million was raised for the launch of NCHK Group.

9. *Neither I nor E&Y was paid an upfront fee for this work (which would have been entirely reasonable). Rather, it was agreed that E&Y would be paid a retainer of HK$100,000 per month going forward for me to act as "Financial Advisor." This sum largely reflected the work that I had carried out (as a partner of E&Y) prior to the launch of NCHK Group. Once the initial fundraising had been completed and the company was set up and running* ***(by mid-1993), however, my involvement with NCHK Group was significantly reduced***" {our emphasis}.

147. We would only observe that the passage emphasised above does not sit well and appears to be contradicted by the reality as reflected by the minutes of the meetings of the EC of NCG and the number of meetings that R3 was recorded as attending as set out in paragraph 140 above.

148. We note that the details of Complaint 4 against R3 are premised on a dual basis – that he participated in the management of NCG and/or that he otherwise had involvement with NCG and its subsidiaries in breach of the independence requirements under the Statements.

149. We have very carefully examined the evidence that could be said to establish R3 was participating in management of NCG. We have reminded ourselves that the onus is not on R3 to satisfy us that he did not participate in management. He was clearly a '*trusted external advisor*' of NCG, to quote his counsel. The fact that he is an authorised signatory to 13 bank accounts of NCG for the relevant years of 1995-1998 would prima facie raise the suspicion that he was exercising management functions, as cheque signing would usually be considered to be a function of management.

150. This is something that could not be lost on R3 as the Policies and Procedures Release issued by R1 in July 1997 entitled Independence – Consulting and Other Additional Services to Audit Clients under '**Certain activities of the firm**' states

151. "*The following restrictions apply to activities of the firm:*

1. *Acting as management – In performing management consulting services or other advisory work for attest clients, care should be taken to assure that the firm is functioning only in an advisory role and not acting in the role of management –as would be the case if the firm had custody of assets or exercised authority on behalf of the client (by, for example,* ***signing checks****, making policy decisions or negotiating on behalf of the client.*" - our emphasis {**B5/Tab 6:51**}

152. Although he is recorded as having attended a preponderance of the EC meetings of NCG there is nothing that can be gleaned from the details of the minutes themselves which would clearly indicate that he undertook management functions at any of these meetings. In our view there is a high index of suspicion that given R3's own admitted close involvement with the initial promoters of the Group, his considerable efforts to get the Group funded and what would appear to be his close relationship with the Chairman that R3 may have been participating in the management of NCG. This is an extremely serious charge to make against an accountancy professional and therefore requires clear, cogent and compelling evidence to bring home the charge.

153. However on closer analysis, we are of the view that taken at its highest this remains just that – suspicion. In our view even if one piles suspicion upon suspicion it does not elevate itself to become proof of the fact that the Complainant needs to establish of actual participation by R3 in the management of NCG. We have come to firm view that the Complainant has

not established to our satisfaction that R3 was participating in the management of NCG.

154. We turn next to examine the question of whether R3 was otherwise having an involvement with NCG *and* its subsidiaries that would appear to an objective third party observer to compromise the independence standards demanded of someone in R3's position given his relationship with R1 as a senior partner and with NCG as well as its subsidiaries such that it amounted to professional misconduct.

155. The fact that R3 had involvement with at least two and possibly three subsidiaries of NCG is not a matter of dispute. It is common ground that he had dealings with the securities and finance subsidiaries of NCG. He denies that he had any dealings with NCG Capital or being aware that he had an account with Capital. According to R3's affirmation filed on 4th December 2002 "*having checked my personal records again I can find no record of having had an account with NCHK Capital (neither can I find any account statements, nor transaction advices therefrom. I stand by my previous statement that I have no recollection of either having had such an account or having had any personal direct dealings with that entity.* " **{B/1 43 paragraph 23(i)}**

156. We however note that there are several letters addressed to R3 by NCG Capital whereby R3 signed acknowledging withdrawals from his account with NCG Capital and making payments to his personal account or to named third parties pursuant to R3's instructions. The sums involved were relatively large and sometimes running into several millions of dollars **{B/4: pp 820, 831, 850, 854, 912, 999}**. There is also a letter dated 31st March 1995 from NCG Capital addressed to R3 enclosing two cheques totaling $6,894,941.48 payable to him in "*repayment of* ***your loan*** *plus accrued interest.*" –our emphasis**{B4/1000}** The letter contains R3's signature indicating "accepted and agreed." **{B4/Tab 2e: 4}**

157. We also note that there are a total of 10 cheques issued by NCG Capital in favour of R3 personally covering the period March 1994 to August 1995, the smallest sum being $300,000 and the largest amount $5,809,216.99. Of the remaining eight cheques, all save two, were between $1-3 million each.

158. Furthermore, we were told that R3 was a nominee director and signatory of a company called Galvanic Limited. We note that there are three letters issued by NCG Capital to Galvanic Limited acknowledged by R3 of the withdrawals from Galvanic's account with NCG Capital. The corresponding cheques are drawn on NCG Capital's account and made payable to third parties, including one cheque to R3 himself in the sum of $300,000. {**B4/988, 991 and 998**}

159. We also note that on 15th March 1994, Galvanic made a loan to NCG Capital of $11 million and the loan agreement is signed on behalf of Galvanic by R3 {**B4/984-5**} and a letter of the same date from Galvanic to NCG Capital and signed by R3 informing NCG Capital that R3 was the authorized agent of Galvanic for the purposes of depositing and withdrawing funds on its behalf {**B4/986**}.

160. Against that backdrop of written communications between NCG Capital and R3 or companies he acted for, we find it a rather difficult to understand or accept R3's assertion that at the time he signed these various acknowledgements of letters from NCG Capital that they "*did not register at the time as being significant.*" For an experienced professional accountant like R3 it is difficult to understand how he could have no recollection of being instrumental in extending loans to an audit client and believe that such conduct was in compliance with the precepts set out in the Standards. These were significant sums of money that were being credited or debited to R3 as well as a loan of $11 million by a company of which he was the nominee director and signatory.

161. In this regard we note that in R1's own Professional Conduct Policies and Procedures dated 1st June 1991 which are intended to supplement the guidance given by the Statements issued by the Institute, it is specifically provided in paragraph 5.1 that "*Loans to clients are prohibited under all circumstances*" {**B5/Tab 6:41**]. This may perhaps explain R3's attempt to keep a distance from NCG Capital in terms of knowledge or dealings.

162. It was argued that these dealings with the subsidiaries of NCG were permissible under the Statement 1.203 paragraph 32 as they could be considered to come within the umbrella of a "*bank or similar financial institution.*" We are of the view that securities and futures trading entities are not the same as a bank or similar financial institution, and paragraph 32 of Statement 1.203 does not really provide R3 with an exemption on the facts of this case.

163. We have considered the argument advanced on behalf of R3 that the various Statements exhorting the need for both independence and the appearance of independence do not apply to R3 since he was not the person undertaking the audit work but just the "partner down the corridor". In our view, the Statements are applicable to *all* persons in the accountancy profession and are not limited only to the partner or person engaged in the audit work. In our view the very fact that R1 of which R3 was senior partner would clearly mandate that the Standards would apply to all the partners as well as other accountancy professionals in the practice regardless of whether they themselves were undertaking the audit engagement.

164. If R3's argument is correct it would mean that any partner of R1 could engage in conduct in relation to the audit client which breaches the fundamental principles of independence of that partner and the practice on the excuse that he/she was not doing the audit work but someone else is. When that argument is so brazenly stated, it is clear to us that it is both wrong and misconceived. If such was the thinking of R3 during the relevant years then it appears to us that

despite being a senior partner of R1, he would appear not to have properly understood or applied the fundamental principles underlying the Statements.

165. As paragraph 9 of Statement 1.200 makes clear the fundamental principles are "framed in broad and general terms and constitute basic advice on professional behaviour."

166. Even the Policies and Procedures of R1 issued in 1991 mandate the need for individual responsibility in relation to the concept of independence:

> "2. **INDIVIDUAL'S RESPONSIBILITY**
>
> 2.1 The concept of independence is not precisely defined. Each professional is responsible for maintaining familiarity with, and adhering to existing and any new professional independence standards.
>
> 2.2 Neither this policy nor the authoritative legal and professional pronouncements on independence can address all of the circumstances which could affect independence. ***You*** should evaluate the individual circumstances that could affect ***our*** independence and abide by the ***spirit*** as well as the rules of independence." {**B4/Tab 6:40**} our emphasis

167. We have looked at R3's dealings with NCG's subsidiaries as a whole for the relevant years. We note that these dealings were being undertaken by R3 with companies who were audit clients of R1 and whilst he was himself a senior partner of R1. We would observe that these were entities that paragraphs 30 and 31 of Statement 1.203 exhort loans should not be made to or obtained from as it may threaten objectivity.

168. We recognise and accept that a failure to adhere to the guidelines identified in the Statements is not necessarily tantamount to professional misconduct {paragraph 16 of Statement 1.200}. The question of whether it amounts to professional misconduct would be fact sensitive and dependent on the nature

and extent of the failure. It is precisely because it is fact sensitive there is no definition of professional misconduct in the PAO. The question of whether any conduct or course of conduct amounts to professional misconduct is left fairly and squarely in the hands of the DC hearing the complaint(s). This is clearly recognised by paragraphs 21-24 of Statement 1.200 where the enforcement of the ethical standards espoused by the Statements is left in the hands of the DC.

169. Having looked at overall conduct of R3 in respect of his dealings and involvement with the subsidiaries of NCG, we are satisfied to the requisite standard that they breached the appearance of independence fundamental principles as set out in Standards 1.200 and 1.203. As an experienced professional and being a senior partner of R1, we are of the view that R3 should have been alive to the risk of the appearance of independence on both his part and that of R1 being perceived as being compromised. These breaches were persistent and flagrant for a considerable period of time.

170. In our view, as a senior partner of R1, it was incumbent on R3 to have ensured he carried out his professional life in a manner that would not raise the spectre of the appearance of independence being impaired. Instead he remained (a) as a member of the EC of an audit client, (b) was an authorised signatory to almost 13 bank accounts of NCG (a function usually perceived to be one of management), (c) had personal dealings involving considerable sums of money with NCG's subsidiaries who were also audit clients of R1, (d) whilst at the same time a handsome retainer was being paid to R1 for R3 being the Financial Advisor (e) making loans either personally {paragraph 156 above} or indirectly through Galvanic to an audit client of R1 {paragraph 159 above} and (f) that R3 was a deemed auditor pursuant to section 131(9) of the Companies Ordinance (cap. 32).

171. When all these matters are looked at cumulatively we are satisfied unanimously that these breaches of the Statements by R3 are very serious,

flagrant and inexcusable infringements of the Statements 1.200 and 1.203 that strike at the very core of the fundamental principle of independence that is the bedrock of the accountancy profession. Such a course of conduct coming from an experienced and senior member of the profession amounts in our view to professional misconduct. We find that Complaint 4 has been established to the requisite standard against R3 and we accordingly find him guilty of the same.

172. For completeness sake we would like to state that we find that R3 was a deemed auditor pursuant to section 131(9) of the Companies Ordinance (cap 32). In our view this is further red flag that should have alerted R3 that his various dealings and involvement with NCG and its subsidiaries risked the appearance of independence principles of the Statements 1,200 and 1.203.

COMPLAINT 5 – AGAINST R3

173. This was alternative to Complaint 4. Since we have found him guilty of Complaint 4 we do not need to fully address this. In the event we are wrong in finding R3 guilty of professional misconduct under Complaint 4, we would like to record that for all the reasons identified in respect of R3's conduct under Complaint 4, that we are unanimous in our view that R3 is guilty of Complaint 5 for failing to observe, maintain or otherwise apply a professional standard in adherence to Statement 1.203 to conduct himself to be free of interest (s) by reason of his involvement with the audit client subsidiaries of NCG.

ATTRIBUTION

174. We also find that the conduct of R2 and R3 of which we have found both of them guilty can pursuant to section 41A of the PAO be attributable to R1, which is further reason why R1 is guilty of Complaint 1.

MISCELLANEOUS MATTERS

175. We would like to make clear that in arriving at our decision in respect of R3 we have taken no account of Statements 1.209, 1.209D and 1.303. In our view, given our view on whether R3 was undertaking management functions as set out in paragraphs 144-149 above, we do not believe those Statements are relevant for the purposes of our decision.

176. We would observe that Mr. Duncan SC tried to valiantly argue that the Complainant had made no concession as to the "de facto director" point by paragraph 125 of the Complainant's Case. In our view whether that paragraph is tantamount to a concession is not the point. If the Complainant expressly states that it "*does not pursue specific allegation in relation*" to those matters, then we do not believe that we need to address or be concerned with these Statements. It would not be fair to the Respondents for the DC to make findings on matters that are not being pursued by the Complainant, and we decline to do so.

177. We have also ignored from our consideration whether the personal dealings of R3 were matters that he did not inform R1 and/or R 2. We have looked at his personal dealings in the context of his case alone and not drawn any inferences in respect of them in relation to R1 and R2.

178. We have taken at face value the assertions told to us from the Bar table by Mr. Beresford that there was no evidence before us that R1 and R2 were aware of them. Mr. Duncan SC on behalf of the Complainant also confirmed that to be the position.

GENERAL OBSERVATIONS

179. We feel constrained to make a few general observations in respect of this case for future guidance. This matter has had a chequered history in terms of the time it has taken for the IC to complete their report. The delay in the IC's

report being completed and finally submitted to the Council for its consideration is regrettable and inexcusable. It occurs to us that when investigating professional accountants who have their professional reputations and lives at stake it is imperative that such investigations should be carried out comprehensively and as expeditiously as possible. The understandable tension and pressure that any pending investigation against a professional person for possible breaches of professional standards or professional misconduct imposes on the individual or entity as a whole is clearly obvious and need not be spelt out.

180. We hope that the Institute will carry out a careful review and post-mortem of this case. There were a number of matters which one would have thought would have been covered by the IC and/or the Complainant before the case was brought before the DC. Members of this DC had to ask counsel of the concerned parties at the hearing for clarification on a number of evidential matters, which consequently had to be answered from the Bar table.

181. We have already expressed our disquiet at the failure by any of the Respondents to comply with the direct request from the Institute to preserve all the papers in respect of the audit of NCG {see paragraphs 123-4 above; **B5/Tab 6 pp1, 4 and 7**. Such blatant and unexplained disregard of the Institute's request is disturbing and yet appears not to be a matter that the IC addressed, which is equally puzzling to us.

182. We appreciate and acknowledge the assistance and cooperation that all counsel and their respective solicitors extended to the extent they could to the DC to provide the answers sought. We would hope in future such clear and obvious matters are addressed and attended to well before the matter comes before any DC. This is perhaps a further indication that strongly suggests that the Institute should consider an overhaul of the entire process and machinery of investigating complaints against its members.

183. We would finally like to thank all Counsel for their comprehensive and helpful submissions which have been of great assistance to this DC in arriving at a decision in this matter.

Dated this 24th day of December 2013

Kumar Ramanathan SC
Chairman Disciplinary Committee

James Taylor Fulton
Member Disciplinary Committee

Dr. Lui Hon Kwong
Member Disciplinary Committee

Tony Chan Tung -Ngok
Member Disciplinary Committee

Angelina Kwan
Member Disciplinary Committee

DEFINITIONS

NCG	**New China Hong Kong Group**
NC Securities	**New China Securities**
NC Capital	**New China Capital**
NC Finance	**New China Finance**
IC	**Investigation Committee of the Institute**
Institute	**Hong Kong Institute of Certified Public Accountants**