INVESTIGATION REPORT

[Case number]

on

[Auditor]

in relation to

Audit of the Accounts

of

[Listco] and its subsidiaries

for the year ended 31 December 2008

Audit Investigation Board

18 April 2011

This report was adopted by the Financial Reporting Council on 5 May 2011 in accordance with section 35(3) of the Financial Reporting Council Ordinance (Cap. 588).

TABLE OF CONTENT

		Page
	Abbreviations	**i-ii**
	Executive summary	**iii-v**
1.	**Introduction**	**1-2**
2.	**Initiation of investigation**	**3-4**
3.	**Process of investigation**	**5-6**
4.	**Audit evidence obtained from the audit of [Subsidiary] Group**	**7-11**
4.1	Findings of fact	7-10
4.2	Relevant auditing and assurance requirements	10-11
4.3	Views of the AIB	11
4.4	Comments on draft investigation report from [Auditor]	11
4.5	Comments on draft investigation report from [Subsidiary Group Auditor]	11
4.6	Comments on draft investigation report from the Company	11
5.	**Audit documentation of [Subsidiary] Review**	**12-16**
5.1	Findings of fact	12-15
5.2	Relevant auditing and assurance requirements	15-16
5.3	Views of the AIB	16
5.4	Comments on draft investigation report from [Auditor]	16
5.5	Response of the AIB to comments from [Auditor]	16
5.6	Comments on draft investigation report from the Company	16
6.	**Engagement quality control review**	**17-19**
6.1	Findings of fact	17-18
6.2	Relevant auditing and assurance requirements	18-19
6.3	Views of the AIB	19
6.4	Comments on draft investigation report from [Auditor]	19
6.5	Comments on draft investigation report from the Company	19

The enclosures are not published because they may contain non-public third party information.

Notes concerning this report

This report relates to the possible occurrence of an auditing irregularity in respect of the audit of the accounts of a listed entity under the Financial Reporting Council Ordinance (Cap. 588).

Any references in this report to breaches of any law, regulation, standards of accounting, auditing and assurance, practice or principle, or Main Board Listing Rules should be understood in the context of that Ordinance only and pursuant to which this report was prepared.

This report, whenever it relates to the private rights of third parties between themselves, makes and implies no comment as to the rights and obligations, and the merits of the conduct, of these third parties as between themselves.

Abbreviations

AIB	Audit Investigation Board
Audit Working Papers	Working papers in relation to the 2008 Audit by [Auditor] (excluding 21 files which [Auditor] claimed that it did not rely on to support its auditor's opinion on the Relevant Financial Statements)
[Subsidiary]	[Name of Subsidiary], a direct non-wholly owned subsidiary of the Company
[Subsidiary] Audit	Audit of the accounts of the [Subsidiary] Group for the year ended 31 December 2008 by [Subsidiary Group Auditor]
[Subsidiary] Group	[Subsidiary] and its subsidiaries
[Subsidiary] Review	Review of [Subsidiary Group Auditor]'s audit working papers on the [Subsidiary] Audit
[Legal Representative]	[Name of Legal Representative], legal representative acting on behalf of [Auditor]
Council	Financial Reporting Council
[Subsidiary Group Auditor]	[Name of Subsidiary Group Auditor]
FRC Ordinance	Financial Reporting Council Ordinance (Cap. 588)
[Listco]/Company	[Name of Listco]
Group	[Listco] and its subsidiaries
[Auditor]	[Name of Auditor]
HKAS	Hong Kong Accounting Standard
HKFRS	Hong Kong Financial Reporting Standard
HKSA	Hong Kong Standard on Auditing
HKSA 220	HKSA 220 *Quality Control for Audits of Historical Financial Information*
HKSA 230	HKSA 230 *Audit Documentation*

HKSA 500	HKSA 500 *Audit Evidence*
HKSA 560 (Revised)	HKSA 560 (Revised) *Subsequent Events*
HKSA 700	HKSA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*
Relevant Financial Statements	Consolidated financial statements of the Group for the year ended 31 December 2008
SAS 510	Statement of Auditing Standards 510 *Principal auditors and other auditors*
Secretariat	Secretariat of the Council
2008 Audit	Audit of the Relevant Financial Statements

Executive summary

Introduction

This report is prepared pursuant to section 35 of the FRC Ordinance and contains the findings of the investigation conducted by the AIB pursuant to section 23(3)(b) of the FRC Ordinance in respect of the audit of the Relevant Financial Statements (Annex 2A) by [Auditor]. The investigation focused on the [Subsidiary] Review.

Background information

The Company is incorporated in the Cayman Islands and its shares are listed on the Main Board (stock code: [stock code]) of The Stock Exchange of Hong Kong Limited.

[Auditor] was the principal auditor reporting on the Relevant Financial Statements. The financial information of the [Subsidiary] Group was material to the Group and was audited by [Subsidiary Group Auditor].

The profit of the Group for the year ended 31 December 2008 was HK$33.6 million and the consolidated net assets of the Group was HK$2,687.1 million at 31 December 2008. It was stated that the Relevant Financial Statements were prepared in accordance with HKFRSs while the audit was conducted in accordance with HKSAs.

Initiation of investigation

The Council received two complaints from the same complainant on 25 September 2009 (Annex 1A) and 9 October 2009 (Annex 1B) respectively. The complainant alleged that there was auditing irregularity in relation to the audit of the Relevant Financial Statements by [Auditor], which had issued an unqualified auditor's report.

Having considered all the information laid before it, the Council, on 5 November 2009, decided to initiate an investigation and directed the AIB in accordance with section 23(3)(b) of the FRC Ordinance to investigate the possible auditing irregularity and the question whether or not there is such an irregularity in relation to the audit of the Relevant Financial Statements.

Scope of investigation

The investigation was to collect information and evidence relating to the question whether or not there is an auditing irregularity in relation to the audit of the Relevant Financial Statements in respect of the following areas:

(a) audit evidence obtained from the audit of the [Subsidiary] Group;

(b) audit documentation of the [Subsidiary] Review; and

(c) engagement quality control review performed by [Auditor] before issuance of its report.

Relevant auditing and assurance requirements

The auditing and assurance requirements applicable at the time of the audit of the Relevant Financial Statements and relevant to the findings in this report are set out below:

HKSA 220	*Quality Control for Audits of Historical Financial Information*
HKSA 230	*Audit Documentation*
HKSA 500	*Audit Evidence*
HKSA 560 (Revised)	*Subsequent Events*
HKSA 700	*The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*
SAS 510	*Principal auditors and other auditors*

Views of the AIB

Audit evidence obtained from the audit of [Subsidiary] Group

Based on the audit procedures performed by [Auditor], it appears to the AIB that there is no evidence suggesting that [Auditor] did not obtain sufficient appropriate audit evidence from its audit of the [Subsidiary] Group to enable it to express an unqualified audit opinion on the Relevant Financial Statements.

Audit documentation of [Subsidiary] Review

The AIB is of the view that [Auditor] did not properly document the nature, timing and extent of the audit procedures performed and the conclusion reached on the [Subsidiary] Review in accordance with paragraphs 2, 9 and 23 of HKSA 230 and paragraph 18 of SAS 510.

Engagement quality control review

Assuming that the "Engagement Quality Control Review Worksheet", which was subsequently provided by [Auditor], is part of the Audit Working Papers, there is no evidence indicating that [Auditor] did not complete the engagement quality control review for the audit of the Relevant Financial Statements as required under HKSA 220.

Comments on draft investigation report from [Auditor]

The relevant sections of the draft investigation report were sent to [Auditor] for comments on 16 February 2011. [Legal Representative], on behalf of [Auditor], provided comments on the draft investigation report on 9 March 2011 (Annex 4P).

Comments on draft investigation report from [Subsidiary Group Auditor]

The relevant sections of the draft investigation report were also sent to [Subsidiary Group Auditor] for comments on 16 February 2011 and a reply from [Subsidiary Group Auditor] was received on 2 March 2011. [Subsidiary Group Auditor] did not express any comments on the draft investigation report (Annex 4M).

Comments on draft investigation report from the Company

The relevant sections of the draft investigation report were also sent to the Company for comments on 16 February 2011 and a reply from the Company was received on 7 April 2011. The Company did not express any comments on the draft investigation report (Annex 4R).

Section 1 Introduction

1.1 Background information

1.1.1 The Company is incorporated in the Cayman Islands and its shares are listed on the Main Board (stock code: [stock code]) of The Stock Exchange of Hong Kong Limited.

1.1.2 The principal activities of the Group as set out in the Relevant Financial Statements were investment holding, manufacturing and sale of household products, industrial products, cosmetics and skincare products and bio-technology products with medical and cosmetics applications, provision of loan financing services and investment and/or trading in market securities, bonds, foreign currencies, various funds and other income generated fixed assets' portfolios.

1.1.3 [Auditor] was the principal auditor reporting on the Relevant Financial Statements. The financial statements of one of the subsidiaries of the Company, [Subsidiary], and its subsidiaries, were audited by [Subsidiary Group Auditor]. [Auditor] expressed an unqualified audit opinion in relation to the Relevant Financial Statements on 20 April 2009.

1.2 Financial information

1.2.1 The Relevant Financial Statements showed that the consolidated profit for the year ended 31 December 2008 was HK$33.6 million and the consolidated net assets was HK$2,687.1 million at 31 December 2008.

1.2.2 Extracts of the financial information of the Group and the [Subsidiary] Group for the year ended 31 December 2008 are set out below:

	Group	[Subsidiary] Group	% of [Subsidiary] Group to the Group[i]
	HK$' million	HK$' million	
Turnover	1,339.7	617.4	46.1
Profit for the year	33.6	177.6	528.6
Total equity	2,687.1	973.1	36.2

[i] Excluding intercompany transactions

1.2.3 It was stated in note 2 to the Relevant Financial Statements that the Relevant Financial Statements were prepared in accordance with HKFRSs and it was stated in the auditor's report of [Auditor] that the audit was conducted in accordance with HKSAs.

1.3 Audit of the Relevant Financial Statements

1.3.1 The schedule titled "Planning Memorandum" <section A340 of working paper of [Listco]> (Annex 3A) stated that the engagement team for the 2008 Audit consisted of 10 team members, excluding the engagement director. [Legal Representative] advised on 9 July 2010 (Annex 4I) that 11 team members were involved in the 2008 Audit, excluding the engagement director.

1.3.2 According to the schedule titled "Planning Materiality" <section A310 of working paper of [Listco]> (Annex 3B), the planning materiality in relation to the audit of the financial statements of [Listco] (company level) was HK$500,000. However, there is no audit documentation indicating the amount of planning materiality for the audit of the Relevant Financial Statements.

Section 2 Initiation of investigation

2.1 Potential auditing irregularities

2.1.1 On 25 September 2009 and 9 October 2009, the Council received two complaints from the same complainant regarding the Relevant Financial Statements. The complainant alleged that there was auditing irregularity in relation to the audit of the Relevant Financial Statements and questioned the issuance of an unqualified auditor's report by the auditor, [Auditor].

2.1.2 After receiving the complaints, the Secretariat reviewed the Relevant Financial Statements, other related announcements of the Company, and information provided by the complainant, the Company and its auditor. Potential irregularities in the audit of the Relevant Financial Statements were identified in relation to the allegations listed below:

(a) [Auditor], as the principal auditor, might not have obtained sufficient appropriate audit evidence to support its unqualified audit opinion on the Relevant Financial Statements as it might not have collected sufficient appropriate audit evidence on the [Subsidiary] Group;

(b) The audit documentation might not have provided a sufficient and appropriate basis for the issuance of an unqualified auditor's report by [Auditor] on 20 April 2009; and

(c) [Auditor] might not have performed an engagement quality control review before it issued the auditor's report on the Relevant Financial Statements. The complainant questioned whether [Auditor] had an adequate system of quality control in place for undertaking audit engagements.

2.2 Scope of the investigation

2.2.1 Having considered all the information laid before it, the Council, on 5 November 2009, decided to initiate an investigation (reference I03-09) and directed the AIB, in accordance with section 23(3)(b) of the FRC Ordinance, to investigate the possible auditing irregularity and the question whether or not there is such an irregularity in relation to the audit of the Relevant Financial Statements in respect of the following areas:

(a) audit evidence obtained from the audit of the [Subsidiary] Group;

(b) audit documentation of the [Subsidiary] Review; and

(c) engagement quality control review performed by [Auditor] before issuance of its report.

2.3 Membership of the AIB

2.3.1 The AIB comprises the following members:

(a) Mr. M.T. Shum, Chairman (up to 31 January 2010);

(b) Dr. P.M. Kam, Chairman (from 1 April 2010);

(c) Ms. Velma Cheung, Acting Chairman (from 1 February 2010 to 31 March 2010);

(d) Ms. Anna Lau;

(e) Ms. Florence Wong; and

(f) Ms. Joyce Woo.

Section 3 Process of investigation

3.1 Requirements issued

3.1.1 For the purpose of the investigation, the AIB issued requirements under section 28 of the FRC Ordinance to [Auditor] for the production of the Audit Working Papers, the provision of explanations/further particulars of the Audit Working Papers, correspondences related to the audit of the Relevant Financial Statements and the [Subsidiary] Group, and response to written questions.

3.1.2 The AIB noted that 52 files in relation to the audit of the Relevant Financial Statements by [Auditor] were seized by an enforcement agency. On 20 November 2009, [Auditor] confirmed that these files were the complete set of audit working papers for the audit of the Relevant Financial Statements (Annex 4C). The AIB obtained these files on 16 December 2009 for a detailed review. According to the letter from [Legal Representative] dated 7 July 2010, [Auditor] clarified that, among these 52 files, it only relied on 31 files (i.e. the Audit Working Papers) to support its audit opinion on the Relevant Financial Statements (Annex 4I).

3.1.3 On 9 February 2010, the AIB obtained additional relevant audit working papers from [Subsidiary Group Auditor] in relation to the [Subsidiary] Audit (Annex 4G).

3.2 Auditing standards relevant to the investigation

3.2.1 The AIB referred to the following auditing and assurance requirements applicable at the time of the audit of the Relevant Financial Statements during the investigation:

HKSA 220	*Quality Control for Audits of Historical Financial Information*
HKSA 230	*Audit Documentation*
HKSA 500	*Audit Evidence*
HKSA 560 (Revised)	*Subsequent Events*
HKSA 700	*The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*
SAS 510	*Principal auditors and other auditors*

3.3 The investigation report

3.3.1 This report is prepared pursuant to section 35 of the FRC Ordinance and contains the findings of the investigation conducted by the AIB pursuant to section 23(3)(b) of the FRC Ordinance in respect of the audit of the Relevant Financial Statements by [Auditor].

3.3.2 The relevant sections of the draft investigation report were sent to [Auditor], [Subsidiary Group Auditor] and the Company for comments on 16 February 2011.

3.3.3 On 9 March 2011 and 18 March 2011, [Legal Representative], on behalf of [Auditor], provided comments (Annexes 4P and 4Q) which are included in the relevant sections of this investigation report.

3.3.4 A reply from [Subsidiary Group Auditor] was received on 2 March 2011 (Annex 4M). [Subsidiary Group Auditor] did not express any comments on the draft investigation report.

3.3.5 A reply from the Company was received on 7 April 2011. The Company did not express any comments on the draft investigation report (Annex 4R).

3.3.6 This investigation report was adopted by the AIB on 18 April 2011.

Section 4 Audit evidence obtained from the audit of [Subsidiary] Group

4.1 Findings of fact

4.1.1 Background information

4.1.1.1 The complainant alleged that [Auditor] might not have obtained sufficient appropriate audit evidence to support its unqualified audit opinion on the Relevant Financial Statements issued on 20 April 2009 as it might not have collected sufficient appropriate audit evidence on the [Subsidiary] Group. The complainant alleged the following:

(a) other than the [Subsidiary] Review, no further audit work on the [Subsidiary] Group was conducted by [Auditor] before 20 April 2009, the date of issuance of the unqualified auditor's report, despite the fact that [Subsidiary Group Auditor] had informed that it had not completed the [Subsidiary] Audit;

(b) two staff from [Auditor] spent less than two days on the [Subsidiary] Review; and

(c) certain audit working papers in relation to the [Subsidiary] Group were dated after 20 April 2009, the date of the auditor's report of the Relevant Financial Statements.

4.1.1.2 Note 23(b) to the Relevant Financial Statements disclosed that the [Subsidiary] Group was *"Audited by one of the "Big Four" accounting firms"*.

4.1.2 Review of audit working papers in relation to audit of the Relevant Financial Statements

4.1.2.1 The AIB is unable to locate documentation on the audit planning in relation to the [Subsidiary] Group and the audit procedures of the [Subsidiary] Review in the Audit Working Papers.

4.1.2.2 The AIB noted that certain audit working papers of [Auditor] in relation to the [Subsidiary] Group were dated after 20 April 2009.

4.1.3 Information and explanation provided by [Auditor] and [Subsidiary Group Auditor]

Audit work on [Subsidiary] Group

4.1.3.1 [Legal Representative], acting on behalf of [Auditor], confirmed on 9 July 2010 (Annex 4I) that [Auditor] *"had not performed other audit procedures in relation to the [Subsidiary] Group in addition to the review of the audit working papers prepared by [Subsidiary Group Auditor] for the purpose of the audit of the Relevant Financial Statements."*

4.1.3.2 [Auditor] advised, through [Legal Representative], on 9 July 2010 (Annex 4I) and 9 August 2010 (Annex 4J) that it had sent a requisition letter to [Subsidiary Group Auditor] for the review of the audit files of the [Subsidiary] Group but it had not sent other written instructions to [Subsidiary Group Auditor] requesting it to carry out any procedures, and to report the results and financial position of the [Subsidiary] Group for the purpose of the 2008 Audit.

4.1.3.3 In response to the AIB's requirement dated 6 November 2009 (Annex 4A), [Subsidiary Group Auditor] advised on 19 November 2009 (Annex 4B) that *"At the date of the auditor's report (i.e. 20 April 2009) of the consolidated financial statements of [Listco] for the year ended 31 December 2008, we had not obtained sufficient appropriate audit evidence to support an expression of audit opinion either on the consolidated financial statements of [Subsidiary] Group or on the respective financial statements of the subsidiaries …"*

4.1.3.4 [Subsidiary Group Auditor] also stated in its reply that *"In our letter dated 10 July 2009 … to the Board of Directors of [Subsidiary] (with a copy to [Auditor] ("[Auditor]")), we set out the significant issues we had encountered during our audit. We advised the Board that as a result of the significant outstanding issues and in light of the regulatory attention, we would not be in a position to consider the resumption of our audit until an independent forensic investigation has been satisfactorily completed."*

4.1.3.5 According to the letter from [Subsidiary Group Auditor] to the Board of Directors of [Subsidiary] dated 10 July 2009 (Annex 4B), the significant outstanding issues related to (i) the validity of sales transactions; (ii) the completeness of related party transactions disclosure; and (iii) the potential understatement of tax liabilities and the reliability of management representation in respect of the seizure of accounting vouchers by the tax bureau.

4.1.3.6 [Auditor] was requested to explain the following on 20 November 2009 (Annex 4D):

(a) audit procedures it had performed on the [Subsidiary] Group in general for the purpose of supporting its audit opinion on the Relevant Financial Statements issued on 20 April 2009; and

(b) audit procedures it had performed to address the issues of (i) the validity of sales transactions; (ii) the completeness of related party transactions disclosure; and (iii) the potential understatement of tax liabilities and the reliability of management representation in respect of the seizure of accounting vouchers by the tax bureau, in relation to the [Subsidiary] Group for the year ended 31 December 2008.

4.1.3.7 In response to the AIB's request on 20 November 2009, [Auditor] provided its reply through [Legal Representative] on 15 January 2010 (Annex 4E). An extract of the reply is set out below:

"We have reviewed and studied the audit working papers and records (including such other documents and evidence available) prepared by [Subsidiary Group Auditor] on the [Subsidiary] Group and discussed with [Subsidiary Group Auditor]'s engagement manager and partner. Based on their factual findings from their audit work performed, their conclusion arrived from their testing and analysis, and the engagement manager and partner's oral representation, we were not aware of any significant issues which would hinder us from forming our own opinion and issuing a clean report for the 2008 Accounts. … (i) We have reviewed the working paper prepared by [Subsidiary Group Auditor] on the [Subsidiary] Group, and this included the audit work performed on trade receivables and sales. As there was no special issue raised by [Subsidiary Group Auditor] concerning the validity of sales transactions made during the year ended 31st

December, 2008, we have no further audit work performed in relation to this issue. (ii) We have reviewed the working paper prepared by [Subsidiary Group Auditor] regarding the related party transactions on [Subsidiary] Group, and we have received representation letter from the Group confirming the completeness of the information provided regarding the identification of related parties. ... The client had further orally confirmed us that no related party transaction was made outside the Group, we considered our audit work performed in related to this issue was sufficient and the disclosure in the 2008 Accounts was adequate. (iii) We were not aware of nor informed by the client or any other party in respect of the seizure of accounting vouchers by tax bureau on or before the issuance of the auditor's report of the 2008 Accounts. We were not aware of any indication in the audit working papers prepared by [Subsidiary Group Auditor] stating there was a potential understatement of tax liabilities."

4.1.3.8 [Legal Representative] also pointed out in its letter dated 15 January 2010 that in about mid-April 2009, a "staff from [Subsidiary Group Auditor]" informed the engagement director of the 2008 Audit in a telephone conversation that *"the audit of [Subsidiary] Group conducted by [Subsidiary Group Auditor] had been completed and concluded, and ready to be signed-off. It was only due to the internal issues of [Subsidiary Group Auditor], and not [Subsidiary], that the 2008 Accounts was by then not yet signed".* However, in its letter dated 9 March 2011 (Annex 4O), [Subsidiary Group Auditor] replied that *"We have had enquiries made of the members of our engagement team who are still with our firm and they have confirmed that they did not have any telephone communication in April 2009 with the engagement director ... of [Auditor] about the status of our audit of [Subsidiary] and its subsidiaries prior to the issuance of the auditor's report on the Relevant Financial Statements by [Auditor] on 20 April 2009."* The AIB confirmed that the abovementioned "staff from [Subsidiary Group Auditor]" was still working in [Subsidiary Group Auditor] on 9 March 2011.

4.1.3.9 On 26 January 2010, [Subsidiary Group Auditor] was requested to confirm whether it had communicated with [Listco] or the [Subsidiary] Group or [Auditor] in relation to the significant issues mentioned in Paragraph 4.1.3.5 (i) and (ii) on or before 20 April 2009 (Annex 4F).

4.1.3.10 [Subsidiary Group Auditor] replied on 9 February 2010 (Annex 4G) that *"The significant issues mentioned in our letter dated 10 July 2009 to the Board of Directors of [Subsidiary] Group did not come to our attention until early May 2009. Accordingly, we were not in a position to communicate the issues with [Listco] or [Subsidiary] Group or [Auditor] on or before 20 April 2009. We would, for completeness, wish to inform you that in this case we did not receive instructions from [Auditor] to carry out any procedures and to report the results to them in connection with their audit of the consolidated financial statements of [Listco] for the year ended 31 December 2008."*

4.1.3.11 [Subsidiary Group Auditor] further mentioned that *"We clarify that we resigned as auditors of [Subsidiary] Group on 6 August 2009 without completing the 2008 audit and without issuing our auditor's report."*

4.1.3.12 In view of the three significant issues mentioned in Paragraph 4.1.3.5, which [Auditor] became aware of after the issuance of the Relevant Financial Statements but which

existed at the date of the auditor's report, [Auditor] was requested on 4 March 2011 to explain what actions it had taken in respect of the three significant issues to satisfy itself that the Relevant Financial Statements need not be amended in accordance with paragraph 15 of HKSA 560 (Revised) (Annex 4N).

4.1.3.13 [Legal Representative], on behalf of [Auditor], replied on 18 March 2011 (Annex 4Q) that [Auditor] had considered the three significant issues and was of the opinion that no amendment to the Relevant Financial Statements was necessary.

[Subsidiary] Review

4.1.3.14 [Legal Representative], acting on behalf of [Auditor], advised on 9 July 2010 (Annex 4I) that two staff (an audit manager and an audit supervisor) spent around 11 hours in the [Subsidiary] Review.

Audit working papers in relation to [Subsidiary] Group

4.1.3.15 On 9 July 2010, [Legal Representative], on behalf of [Auditor] (Annex 4I), advised that [Auditor] relied on the Audit Working Papers to support its audit opinion on the Relevant Financial Statements. It did not rely on other audit working papers, including those dated after 20 April 2009, in relation to the audit of the [Subsidiary] Group.

4.2 Relevant auditing and assurance requirements

4.2.1 Paragraph 2 of HKSA 500 states that "*The auditor should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion*."

4.2.2 Paragraph 8 of SAS 510 states that "*The principal auditors are required to express an opinion on the group financial statements and have sole responsibility for this opinion even where those group financial statements include amounts derived from accounts which have not been audited by them. As a result, they cannot discharge this responsibility to report on the group financial statements by an uninformed acceptance of components' financial statements, whether audited or not. However, the principal auditors can take account of the extent of work and the report of the other auditors through carrying out certain procedures. The extent of these procedures is determined by the materiality of the amounts derived from financial statements of components and the level of risk that the principal auditors are willing to accept that such statements contain material errors*."

4.2.3 Paragraph 11 of SAS 510 further states that "*The principal auditors should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditors is adequate for the principal auditors' purposes, in the context of the specific assignment*."

4.2.4 Paragraph 15 of HKSA 560 (Revised) states that *"When, after the financial statements have been issued, the auditor becomes aware of a fact which existed at the date of the auditor's report and which, if known at that date, may have caused the auditor to modify the auditor's report, the auditor should consider whether the financial statements need*

revision, should discuss the matter with management, and should take the action appropriate in the circumstances."

4.2.5 Paragraph 52 of HKSA 700 states that *"The auditor should date the report on the financial statements no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements..."*

4.3 Views of the AIB

4.3.1 Based on the analysis of the financial information as set out in Paragraph 1.2.2, it appears to the AIB that the [Subsidiary] Group was significant to the Relevant Financial Statements. [Auditor] should perform procedures to obtain sufficient appropriate audit evidence that the work of [Subsidiary Group Auditor] is adequate for its audit of the Relevant Financial Statements.

4.3.2 Despite the fact that [Subsidiary Group Auditor] resigned as auditors of the [Subsidiary] Group on 6 August 2009 without issuing an auditor's report due to the significant outstanding issues set out in Paragraph 4.1.3.5, the AIB acknowledged that these outstanding issues were identified by [Subsidiary Group Auditor] in early May 2009, after the issuance of the Relevant Financial Statements. It appears to the AIB that it is not unreasonable that [Auditor] was not aware of these issues at the time it issued the auditor's report on the Relevant Financial Statements.

4.3.3 The AIB was not in a position to judge whether having two staff spending around 11 hours to conduct the [Subsidiary] Review was sufficient.

4.3.4 Based on the audit procedures performed by [Auditor] as set out in Paragraph 4.1.3.7, it appears to the AIB that there is no evidence suggesting that [Auditor] did not obtain sufficient appropriate audit evidence that the work of [Subsidiary Group Auditor] was adequate for the purpose of the 2008 Audit to enable it to express an unqualified audit opinion on the Relevant Financial Statements.

4.3.5 Based on the audit procedures performed by [Auditor] as set out in Paragraph 4.1.3.13, it appears to the AIB that there is no evidence suggesting that [Auditor] did not comply with paragraph 15 of HKSA 560 (Revised) with respect to the three significant issues as mentioned in Paragraph 4.1.3.5.

4.4 Comments on draft investigation report from [Auditor]

4.4.1 [Auditor] did not provide any comment on this section.

4.5 Comments on draft investigation report from [Subsidiary Group Auditor]

4.5.1 [Subsidiary Group Auditor] did not provide any comment on this section.

4.6 Comments on draft investigation report from the Company

4.6.1 The Company did not provide any comment on this section.

Section 5 Audit documentation of [Subsidiary] Review

5.1 Findings of fact

5.1.1 Background information

5.1.1.1 The complainant alleged that [Auditor] might not have adequate and sufficient audit documentation with respect to the 2008 Audit, in particular, the [Subsidiary] Review. The complainant alleged the following:

(a) two staff from [Auditor] only documented certain schedules prepared by [Subsidiary Group Auditor] with very limited review notes;

(b) there was no documentation to substantiate how [Auditor] resolved its audit queries with [Subsidiary Group Auditor] during the [Subsidiary] Review;

(c) some audit working papers in relation to the [Subsidiary] Review did not contain the initials of the reviewer and the review date; and

(d) certain audit checklists for the [Subsidiary] Group were incomplete or totally blank.

5.1.1.2 Based on the above, it appears that [Auditor] might not have properly documented the nature, timing and extent of the audit procedures performed on the [Subsidiary] Group, significant matters arising during the [Subsidiary] Review and the conclusions reached thereon. The audit documentation might not have provided a sufficient and appropriate basis for the issuance of an unqualified auditor's report by [Auditor] on 20 April 2009.

5.1.2 Review of audit working papers in relation to audit of the Relevant Financial Statements

5.1.2.1 [Legal Representative] advised on behalf of [Auditor] on 9 July 2010 (Annex 4I) that *"All the working paper files included in your Appendix A* [Audit Working Papers] *are used to support our audit opinion on the accounts of [Listco] for the year ended 31 December 2008…"*.

5.1.2.2 The AIB could not locate any documentation in respect of the [Subsidiary] Review in the Audit Working Papers.

5.1.3 Information and explanation provided by [Auditor]

5.1.3.1 Since it appears to the AIB that there was no documentation in relation to the [Subsidiary] Review in the Audit Working Papers, the AIB requested [Auditor] to locate the audit working papers which documented its audit work performed in respect of the [Subsidiary] Review in the Audit Working Papers on 8 June 2010 (Annex 4H). On 9 July 2010, [Auditor] provided the following document, which was not included in the Audit Working Papers, in respect of its review of [Subsidiary Group Auditor]'s audit working papers in relation to certain accounts of [Name of a major subsidiary of

Subsidiary Group], a major subsidiary of the [Subsidiary] Group as an attachment to the letter of [Legal Representative] dated 9 July 2010.

Extract from the first page of Appendix 5 to the reply from [Auditor] dated 9 July 2010 (Annex 4I)

Property, plant and equipment Question Any physical inspection only for additions?	Work done Depreciation checked Additions test checked to invoice and payment details
Inventory Question	Work done Valuation test done Inventory taking done Cut-off test done
Trade receivable Question Any recoverability problem?	Work done Confirmation sent but not returned. Alternative work done, but no s/s Aging analysis done Amount increased due to change of policy. Client no need to pay deposit first

5.1.3.2 Assuming that the document as set out in Paragraph 5.1.3.1 was part of the Audit Working Papers, the AIB noted that the following items were not recorded in the document:

(a) Who performed the audit work and the date such work was completed;
(b) Who reviewed the audit work performed and the date and extent of such review;
(c) The nature of audit procedures [Auditor] performed in respect of the review of the audit working papers of the [Subsidiary] Group prepared by [Subsidiary Group Auditor] (e.g. valuation test on inventory);
(d) The extent of audit procedures performed (e.g. the number of samples [Auditor] reviewed in respect of the audit work performed by [Subsidiary Group Auditor]); and
(e) The results of the audit procedures and the audit evidence obtained, i.e. whether [Auditor] was satisfied that the audit work performed by [Subsidiary Group Auditor] was sufficient and that it complied with the requirements of HKSAs, and whether the accounts reviewed were fairly stated. For example, in respect of trade receivables, the document did not record whether [Auditor] followed up with [Subsidiary Group Auditor] on the outstanding confirmation(s) and what alternative procedures were performed by [Subsidiary Group Auditor] to satisfy that the balances of these receivables were fairly stated. The document also did not conclude whether [Auditor] was satisfied with the audit procedures performed by [Subsidiary Group Auditor] in respect of trade receivables and whether [Auditor] considered that the account was fairly stated.

5.1.3.3 On 13 September 2010, [Auditor] was requested to confirm AIB's observations in Paragraph 5.1.3.2 (Annex 4K). [Legal Representative] advised on 11 October 2010 (Annex 4L) that *"Our client agrees to your observation."*

5.1.3.4 In the same requirement (Annex 4K), the AIB requested [Auditor] to confirm whether the following audit procedures, which were not recorded in the document as set out in Paragraph 5.1.3.1 in respect of the [Subsidiary] Review, had been performed by [Subsidiary Group Auditor] in relation to the [Subsidiary] Audit:

(a) Review of credit notes in relation to trade receivables;
(b) Review of impairment assessment on trade receivables to determine if it was in accordance with the requirements in HKAS 39 *Financial Instruments: Recognition and Measurement*;
(c) Review of operating lease commitments; and
(d) Review of sales in addition to gross profit margin.

5.1.3.5 [Legal Representative] replied (Annex 4L) that *"Our client cannot now recall what exact auditing works have been performed by [Subsidiary Group Auditor] in respect of the specific aspects as stated in your said requirement under 1(b). In so far as your requirement under 1(b)(1) and (2) is concerned, since our client is not able to recall the exact audit works performed by [Subsidiary Group Auditor], our client is not in the position to give its reply to the two specific questions. However, our client would say that, according to its usual practice in such auditing works, our client should have*

reviewed and/or discussed such specific issues with the audit in charge from [Subsidiary Group Auditor] and thereafter arrived at our clients' view in the report."

5.1.3.6 The AIB also requested [Auditor] (Annex 4K) to explain how it resolved the outstanding matters in relation to the [Subsidiary] Review and how they were reflected in the Audit Working Papers.

5.1.3.7 [Legal Representative] replied (Annex 4L) that *"Again, as you have rightly observed, our client did not record or reflect the audit works performed in the audit working papers. However, according to the recollection of the engagement team of our client, enquiries and discussion had been made with the audit-in-charge of [Subsidiary Group Auditor] during our client's review on [Subsidiary Group Auditor]'s auditing working papers."*

5.1.3.8 The AIB further requested [Auditor] (Annex 4K) to advise whether there were other missing documents which the firm could not locate but contained the nature, timing and extent of audit procedures performed and the conclusion reached on the [Subsidiary] Review.

5.1.3.9 [Legal Representative] confirmed (Annex 4L) that *"There are no other missing documents."*

5.2 Relevant auditing and assurance requirements

5.2.1 Paragraph 2 of HKSA 230 states that *"The auditor should prepare, on a timely basis, audit documentation that provides:*

(a) A sufficient and appropriate record of the basis for the auditor's report; and
(b) Evidence that the audit was performed in accordance with HKSAs and applicable legal and regulatory requirements."

5.2.2 Paragraph 9 of HKSA 230 states that *"The auditor should prepare the audit documentation so as to enable an experienced auditor, having no previous connection with the audit, to understand:*

(a) The nature, timing, and extent of the audit procedures performed to comply with HKSAs and applicable legal and regulatory requirements;
(b) The results of the audit procedures and the audit evidence obtained; and
(c) Significant matters arising during the audit and the conclusions reached thereon."

5.2.3 Paragraph 23 of HKSA 230 further states that *"In documenting the nature, timing and extent of audit procedures performed, the auditor should record:*

(a) Who performed the audit work and the date such work was completed; and
(b) Who reviewed the audit work performed and the date and extent of such review."

5.2.4 Paragraph 18 of SAS 510 states that *"The principal auditors would document in their audit working papers the components whose financial information was audited by the*

other auditors, their significance to the financial statements of the entity as a whole, the names of the other auditors and any conclusions reached that individual components are immaterial. The principal auditors would also document the procedures performed and the conclusions reached. For example, working papers of the other auditors that have been reviewed would be identified and the results of discussions with the other auditors would be recorded. ....”

5.3 Views of the AIB

5.3.1 The AIB is of the view that [Auditor] did not properly document the nature, timing and extent of the audit procedures performed and the conclusion reached on the [Subsidiary] Review in accordance with paragraphs 2, 9 and 23 of HKSA 230 and paragraph 18 of SAS 510.

5.4 Comments on draft investigation report from [Auditor]

5.4.1 In the letter dated 9 March 2011 (Annex 4P), [Legal Representative], on behalf of [Auditor], suggested the following changes to the wordings in Paragraph 5.3.1:

“... that [Auditor] did not properly document the nature, timing and extent of <u>part of</u> the audit procedures performed and the conclusion reached on the [Subsidiary] Review in <u>strict</u> accordance with paragraphs 2, 9 and 23 of HKSA 230 and paragraph 18 of SAS 510”.

5.5 Response of the AIB to comments from [Auditor]

5.5.1 The AIB considers that the wordings in Paragraph 5.3.1 are appropriate and no change is necessary.

5.6 Comments on draft investigation report from the Company

5.6.1 The Company did not provide any comment on this section.

Section 6 Engagement quality control review

6.1 Findings of fact

6.1.1 Background information

6.1.1.1 The complainant questioned whether [Auditor] had performed engagement quality control review before it issued the auditor's report on the Relevant Financial Statements.

6.1.2 Review of the Audit Working Papers

6.1.2.1 There was no documentation in the Audit Working Papers which indicated the completion of an engagement quality control review before the issuance of the auditor's report on the Relevant Financial Statements.

6.1.3 Information and explanation provided by [Auditor]

6.1.3.1 On 8 June 2010, the AIB requested [Auditor] to advise the following in relation to engagement quality control review for the 2008 Audit (Annex 4H):

(a) name of the engagement quality control reviewer and his rank;

(b) whether significant matters had been discussed with the engagement quality control reviewer;

(c) whether the engagement quality control review was completed before the issuance of the auditor's report on the Relevant Financial Statements; and

(d) time spent by the engagement quality control reviewer on the review.

6.1.3.2 [Legal Representative] replied on behalf of [Auditor] on 9 July 2010 (Annex 4I) that *" ... our director, was the engagement quality control reviewer"*. The reply also stated that *"According to the engagement quality control review worksheet (Appendix 7), ... No significant matter was noted in the review record."* A copy of the "Engagement Quality Control Review Worksheet" was provided in the reply.

6.1.3.3 The AIB noted that the engagement quality control reviewer checked the following questions in the "Engagement Quality Control Review Worksheet":

"2. As the EQC [Engagement Quality Control] *Reviewer, were you:*

...

b) Consulted on significant planning issues?

c) Consulted during the engagement on major issues?

…

3. Is there evidence of adequate work and documentation for:

a) Significant financial statement areas?

b) Significant management estimates?

…

5. Were difficult and contentious matters:

a) Adequately documented?

…

c) Appropriately resolved?

…

13. Have all review points on the file (including those of the EQC Reviewer) been cleared satisfactorily and working papers corrected as appropriate?…"

6.1.3.4 According to the "Engagement Quality Control Review Worksheet", the engagement quality control reviewer stated that *"Based on my review of the engagement file, discussions with engagement personnel and the responses to my review comments, I am satisfied that the engagement report can be released."*

6.1.3.5 In response to the question raised in Paragraph 6.1.3.1(c), [Legal Representative] replied (Annex 4I) that *"According to the engagement quality control review worksheet, the engagement quality control review was completed before the issuance of the auditor's report on the Relevant Financial Statements."*

6.1.3.6 [Legal Representative], on behalf of [Auditor], also advised (Annex 4I) that *"As the engagement quality control review is regarded as our quality control procedures, the review report is not included in the audit working papers."*

6.1.3.7 [Legal Representative], on behalf of [Auditor], further advised (Annex 4I) that *"According to the engagement quality control review worksheet … which was inspected by HKICPA's in May 2009, the review was started on 15 April 2009 and issues were discussed with the engagement personnel on 18 April 2009. There is no other record which can show the actual time spent by the engagement quality control reviewer on the review."*

6.2 Relevant auditing and assurance requirements

6.2.1 Paragraph 5 of HKSA 220 provides the definition of "engagement quality control review" and "engagement quality control reviewer",

"(b) "Engagement quality control review" – a process designed to provide an objective evaluation, before the auditor's report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the auditor's report;

(c) "Engagement quality control reviewer" – a partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the auditor's report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the auditor's report".

6.2.2 Paragraph 36 of HKSA 220 states that *"For audits of financial statements of listed entities, the engagement partner should:*

(a) Determine that an engagement quality control reviewer has been appointed;

(b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and

(c) Not issue the auditor's report until the completion of the engagement quality control review."

6.2.3 Paragraph 38 of HKSA 220 further states that *"An engagement quality control review should include an objective evaluation of:*

(a) The significant judgments made by the engagement team; and

(b) The conclusions reached in formulating the auditor's report."

6.3 Views of the AIB

6.3.1 The AIB could not locate the "Engagement Quality Control Review Worksheet" in the Audit Working Papers. Based on the copy subsequently provided by [Auditor], it was completed and signed by the engagement quality control reviewer on 18 April 2009 which was before the issuance of the auditor's report on the Relevant Financial Statements on 20 April 2009.

6.3.2 The AIB is of the view that there is no evidence indicating that [Auditor] did not complete the engagement quality control review for the audit of the Relevant Financial Statements as required under HKSA 220.

6.4 Comments on draft investigation report from [Auditor]

6.4.1 [Auditor] did not provide any comment on this section.

6.5 Comments on draft investigation report from the Company

6.5.1 The Company did not provide any comment on this section.