INVESTIGATION REPORT

(I09-12)

on

W.H. Tang & Partners CPA Limited

in relation to the

audit of the Accounts

of

Aptus Holdings Limited (now known as Celebrate International Holdings Limited) and its subsidiaries

for the year ended 30 June 2010

Audit Investigation Board

16 October 2013

This report was adopted by the Financial Reporting Council on 29 October 2013 in accordance with section 35(3) of the Financial Reporting Council Ordinance (Cap. 588).

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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 the Rules Governing the Listing of Securities on The Growth Enterprise Market of The Stock Exchange of Hong Kong Limited 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

Acquisition	Acquisition of 100% equity interest in Casdon on 27 May 2010
AIB	Audit Investigation Board
Audit	Audit of the 2010 Financial Statements
Audit Working Papers	Working papers for the Audit
Casdon	Casdon Management Limited
Casdon Group	Casdon and its subsidiaries
Circular	A joint circular dated 22 April 2010 issued by the Company and its ultimate shareholder in relation to the Acquisition
COE	Code of Ethics for Professional Accountants
Company	Aptus Holdings Limited (now known as Celebrate International Holdings Limited) (stock code: 08212)
Convertible Bonds	Convertible bonds in the principal amount of HK$850,000,000 issued by the Company as part of the consideration for the Acquisition
Council	Financial Reporting Council
Engagement Partner	The engagement partner of the Audit
EQCR	The engagement quality control reviewer of the Audit
Glossary	Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services
Group	Company and its subsidiaries
HKAS	Hong Kong Accounting Standard
HKFRS	Hong Kong Financial Reporting Standard
HKICPA	Hong Kong Institute of Certified Public Accountants
HKSA	Hong Kong Standard on Auditing
Ordinance	Financial Reporting Council Ordinance (Cap. 588)
The Exchange	The Stock Exchange of Hong Kong Limited
Tso Au Yim & Yeung	Tso Au Yim & Yeung, legal representative of the Company

Valuer A	The independent valuer who performed the valuation of the prepaid lease payments acquired in the Acquisition as at 31 January 2010
Valuer B	The independent valuer who performed the valuation of the Convertible Bonds as at 27 May 2010
W.H. Tang	W.H. Tang & Partners CPA Limited, auditor of the 2010 Financial Statements
2010 Financial Statements	Consolidated financial statements of the Group for the year ended 30 June 2010
2011 Financial Statements	Consolidated financial statements of the Group for the year ended 30 June 2011

Executive summary

Introduction

This report is prepared under section 35 of the Ordinance and contains the findings of the investigation conducted by the AIB under section 23(1)(b) of the Ordinance in respect of the Audit by W.H. Tang. The investigation concerns the measurement of the prepaid lease payments acquired and the Convertible Bonds in relation to the Acquisition in the 2010 Financial Statements.

Background information

The Company is incorporated in the Cayman Islands and its shares are listed on the Growth Enterprise Market (stock code: 08212) of The Exchange.

The consolidated profit of the Group for the year ended 30 June 2010 was HK$129,000,000. The consolidated net assets of the Group at 30 June 2010 were HK$705,000,000 and subsequently restated to HK$621,000,000 in the 2011 Financial Statements after correcting prior period errors. Note 3 to the 2010 Financial Statements mentioned that the financial statements were prepared in accordance with HKFRSs.

The auditor's report stated that W.H. Tang conducted the Audit in accordance with HKSAs. W.H. Tang expressed an unmodified audit opinion on the 2010 Financial Statements.

Initiation of investigation

On 10 August 2012, the Council received a complaint of possible auditing irregularity in relation to the retrospective restatements as stated in note 3 to the 2011 Financial Statements, among others, the measurement of the prepaid lease payments acquired and the Convertible Bonds in relation to the Acquisition in the 2010 Financial Statements.

On 29 November 2012, the Council decided to initiate an investigation and directed the AIB to investigate the possible auditing irregularity relating to the audit of the measurement of the prepaid lease payments acquired and the Convertible Bonds in relation to the Acquisition.

Findings and conclusions of the AIB

On 27 May 2010, the Company acquired the entire interest of Casdon at the total consideration of HK$1,045,293,000, part of the consideration was settled by the issuance of the Convertible Bonds.

In the 2010 Financial Statements, the Company recognized and measured the prepaid lease payments acquired in the Acquisition with reference to their carrying amounts in the books of Casdon Group instead of the valuation prepared by Valuer A. The Company measured the Convertible Bonds at their principal amount upon initial recognition. In the 2011 Financial Statements, the Company retrospectively adjusted the 2010 Financial Statements by, among others, restating the prepaid lease payments acquired and the Convertible Bonds to their acquisition-date fair values.

The original accounting treatment in the 2010 Financial Statements as mentioned above was not in compliance with paragraphs 18 and 37 of HKFRS 3 (Revised) and paragraphs 31 and 32 of HKAS

32, for which W.H. Tang failed to identify in the Audit. W.H. Tang did not conduct the Audit in these respects in accordance with HKSAs for the reasons set out below.

Measurement of the prepaid lease payments

Planning

Judgment is required to determine whether a particular set of assets and activities acquired was a business. Reliance on the work of other experts, such as professional valuer, might be needed in the initial measurement of the assets acquired and liabilities assumed. The Circular included a property valuation report dated 22 April 2010 prepared by Valuer A on the land and buildings of the Group and Casdon Group, and included, among others, the valuation of the prepaid lease payments acquired as at 31 January 2010. W.H. Tang did not prepare an audit plan in accordance with paragraphs 13 and 14 of HKSA 300 to include the nature, timing and extent of audit procedures to be performed in relation to the Acquisition. In particular, it failed to prepare a proper audit plan to audit the measurement of the prepaid lease payments acquired to ensure that sufficient appropriate audit evidence would be obtained to reduce audit risk to an acceptably low level. In addition, W.H. Tang failed to justify the appropriateness of its risk assessment and its determination that the use of the program "Using the work of an expert (Cop06)" was "N/A".

Based on the above, W.H. Tang failed to plan the Audit with an attitude of professional skepticism in accordance with paragraph 15 of HKSA 200 (Revised) and failed to develop a proper audit plan for the Audit and document the same in accordance with paragraphs 13, 14 and 22 of HKSA 300 in this respect.

Sufficiency and appropriateness of audit evidence

Other than obtaining the oral representation from the management of Casdon and relying on the accountant's report of Casdon Group included in the Circular to substantiate the acquisition-date fair values of the prepaid lease payments acquired, there was no evidence of other audit documentation in the Audit Working Papers demonstrating:

(a) the consideration of the appropriateness in relying on the evidence obtained from the accountant's report of Casdon Group for the purpose of accounting for the Acquisition in the 2010 Financial Statements, in view of the differences in the nature of the transaction and the related accounting treatment (the acquisition of the two subsidiaries by Casdon was accounted for as an acquisition of assets and liabilities instead of a business combination);

(b) the acceptance of oral representation from the management of Casdon as audit evidence for the acquisition-date fair value of the prepaid lease payments acquired was more appropriate than the valuation report prepared by Valuer A; and

(c) written representation was obtained from the management of the Company on the reasonableness of significant assumptions in the fair value measurement of the prepaid lease payments acquired.

Based on the above, W.H. Tang failed to obtain sufficient appropriate audit evidence to support the conclusion reached in the measurement of the prepaid lease payments acquired in the Acquisition in accordance with paragraph 2 of HKSA 500 and paragraphs 3 and 63 of HKSA 545.

Documentation

Alternatively, if W.H. Tang had performed the audit procedures and obtained audit evidence for the measurement of the prepaid lease payments acquired (which the AIB disputed given the lack of any supporting document), it had failed to prepare audit documentation that provide a sufficient and appropriate record of the basis for the audit report and evidence that the Audit was performed in accordance with applicable auditing standards in these respects. Therefore, W.H. Tang failed to observe paragraphs 2 and 9 of HKSA 230.

Basis of forming audit opinion

W.H. Tang did not obtain sufficient appropriate audit evidence to support the unmodified audit opinion expressed on the 2010 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700 in this respect.

Engagement quality control review

Since the Acquisition was material to the 2010 Financial Statements, it is not unreasonable to expect that the EQCR would select the relevant audit documentation to perform the quality control review. If the EQCR had properly performed his review, the above non-compliances with financial reporting standards and auditing requirements should have been identified and addressed. Accordingly, the EQCR did not properly perform his engagement quality control review of the acquisition-date fair value measurement of the prepaid lease payments acquired in accordance with paragraphs 38 and 39 of HKSA 220.

COE

In light of the above, the Engagement Partner and the EQCR did not comply with section 130.1 of COE as they did not act diligently in accordance with the applicable technical and professional standards when providing professional services in relation to the Audit in respect of the measurement of the prepaid lease payments acquired in accordance with HKFRS 3 (Revised).

Measurement of the Convertible Bonds

Planning

The acquisition-date fair value measurement of the Convertible Bonds was inherently imprecise and based on estimates. Reliance on the work of other experts, such as professional valuer, might be needed. W.H. Tang failed to plan the Audit with an attitude of professional skepticism in accordance with paragraph 15 of HKSA 200 (Revised) and failed to develop a proper audit plan for the Audit and document the same in accordance with paragraphs 13, 14 and 22 of HKSA 300 in this respect. Such audit plan should include the nature, timing and extent of audit procedures to be performed in relation to the measurement of the Convertible Bonds to ensure that sufficient appropriate audit evidence would be obtained to reduce audit risk to an acceptably low level. Whilst

W.H. Tang regarded the valuation of the Convertible Bonds as a key risk and planned to obtain a report from a valuer in response to such risk, in other planning documents, W.H. Tang assessed the Audit as low risk and agreed that the program "Using the work of an expert (Cop06)" was "N/A", in the absence of necessary explanation in the Audit Working Papers.

Sufficiency and appropriateness of audit evidence

Other than obtaining the valuation report on the Convertible Bonds and performing certain audit procedures as documented, there was no evidence in the Audit Working Papers of the consideration made as to whether the Convertible Bonds had been measured at the acquisition-date fair values in accordance with paragraph 37 of HKFRS 3 (Revised) and accounted for in accordance with paragraphs 31 and 32 of HKAS 32. In particular, W.H. Tang failed to consider the appropriateness of (a) the Company's assumption that the principal amount of the Convertible Bonds equals their acquisition-date fair values; and (b) the valuation of the Convertible Bonds as if the embedded call option did not exist based on the Company's confirmation that it would not exercise the call option. There was also no written representation from the management of the Company on the reasonableness of significant assumptions in relation to the fair value measurement of the Convertible Bonds.

W.H. Tang therefore failed to obtain sufficient appropriate audit evidence to support the conclusion reached in the measurement of the Convertible Bonds in accordance with paragraph 2 of HKSA 500 and paragraphs 3 and 63 of HKSA 545.

Using the work of the valuer

W.H. Tang had placed reliance on the valuation report prepared by Valuer B. However, there was no evidence in the Audit Working Papers indicating that W.H. Tang had evaluated the professional competence and objectivity of Valuer B, and the appropriateness of the valuation report as audit evidence in relation to the acquisition-date fair values of the Convertible Bonds. Therefore, W.H. Tang failed to obtain sufficient appropriate evidence when using the work of the valuer as audit evidence in accordance with paragraphs 2, 8, 9, 11, 12 and 15 of HKSA 620.

Documentation

Alternatively, if W.H. Tang had performed the audit procedures and obtained audit evidence for the measurement of the Convertible Bonds as mentioned above (which the AIB disputed given the lack of any supporting documents), it had failed to prepare audit documentation that provided a sufficient and appropriate record of the basis for the audit report and evidence that the Audit was performed in accordance with applicable auditing standards in these respects and therefore W.H. Tang failed to observe paragraphs 2 and 9 of HKSA 230.

Basis of forming audit opinion

W.H. Tang did not obtain sufficient appropriate audit evidence to support the unmodified audit opinion expressed on the 2010 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700 in this respect.

Engagement quality control review

Since the Acquisition was material to the 2010 Financial Statements, it is not unreasonable to expect that the EQCR would select the relevant audit documentation to perform the quality control review. If the EQCR had properly performed his review, the above non-compliances with financial reporting standards and auditing requirements should have been identified and addressed. Accordingly, the EQCR did not properly perform his engagement quality control review of the acquisition-date fair value measurement of the Convertible Bonds in accordance with paragraphs 38 and 39 of HKSA 220.

COE

In light of the above, the Engagement Partner and the EQCR did not comply with section 130.1 of COE as they did not act diligently in accordance with the applicable technical and professional standards when providing professional services in relation to the Audit in respect of the measurement of the Convertible Bonds in accordance with HKFRS 3 (Revised) and HKAS 32.

Comments from W.H. Tang, the Engagement Partner and the EQCR and the corresponding response of the AIB

The draft investigation report was sent to W.H. Tang, the Engagement Partner and the EQCR for comments on 22 July 2013. W.H. Tang, the Engagement Partner and the EQCR provided their comments on the draft investigation report on 5 September 2013.

Measurement of the prepaid lease payments

Comments from W.H. Tang, the Engagement Partner and the EQCR

W.H. Tang, the Engagement Partner and the EQCR stated in their reply letters that they considered the Acquisition was a business combination and the fair values of the prepaid lease payments "should be better stated at the acquisition costs instead of the valuation amount as stated in the valuation report" because (i) the land was used for the Group's own business and not for re-sale and there was no material change in the market, (ii) the valuation report was based on the valuation of individual land instead of the whole development area, and (iii) the economic contribution of the land could contribute over HK$1,000 million to the Group in the future. Therefore, they did not rely on the valuation report.

W.H. Tang, the Engagement Partner and the EQCR also stated that:

- they had developed a proper audit plan. However, they considered that the presentation of working papers in planning should be improved to clearly express their judgments and their procedures for risky areas. They will improve their audit manual in this respect.

- they did not only rely on the oral representation but also the circular and announcement of the Company as audit evidence to form the audit opinion.

- the audit program was presented by way of audit work performed in individual file of each entity of the Group.

- they had obtained sufficient appropriate audit evidence to support the unmodified opinion.

- the EQCR had performed his engagement quality control review according to his role and responsibilities. However, they should properly document any discussion between the engagement partner and the EQCR and the audit manual will be improved in this respect.

- they had acted diligently according to the applicable technical and professional standards.

Response of the AIB

The AIB noted the comments from W.H. Tang, the Engagement Partner and the EQCR. However, it is not appropriate to include the value of the existing business and the synergy effect in determining the fair value of identifiable assets acquired in a business combination as they are regarded as part of goodwill. The prepaid lease payments in the 2010 Financial Statements were not measured at their acquisition-date fair value according to paragraph 18 of HKFRS 3 (Revised).

W.H. Tang's audit planning on the Acquisition was inadequate to support that they had planned the audit of the Acquisition and documented the same according to paragraph 15 of HKSA 200 (Revised) and paragraphs 13, 14 and 22 of HKSA 300.

W.H. Tang's audit procedures were limited to checking the land costs, legal and professional fees paid by the 11 subsidiaries of the Group of HK$23,872,246 and the consideration paid by Casdon in acquiring two wholly-owned subsidiaries. There was no evidence in the Audit Working Papers or other documentation provided by W.H. Tang to support that they had considered the nature of the transaction, the related accounting treatment and the valuation prepared by Valuer A as included in the Circular.

The AIB upholds its findings and conclusions.

Measurement of the Convertible Bonds

Comments from W.H. Tang, the Engagement Partner and the EQCR

W.H. Tang, the Engagement Partner and the EQCR stated in their reply letters that the valuation of the Convertible Bonds was determined by the underlying information including the letter of confirmation from the Company that there was no early redemption of Convertible Bonds, therefore, the call option did not exist. They considered that such confirmation was a factual factor and should be relied on in determining the fair value of the Convertible Bonds.

W.H. Tang, the Engagement Partner and the EQCR stated that:

- they had pointed out that the valuation of the Convertible Bonds was one of their concerns in the engagement during planning and they considered that they had planned the engagement according to paragraph 15 of HKSA 200 (Revised) and paragraphs 13, 14 and 22 of HKSA 300. However, they opined that the presentation of working papers in planning should be improved to clearly express their judgments and their procedures for risky areas. They will improve their audit manual in this respect.

- there was a clerical error to state "Using the work of an expert" was "N/A".

- written representation from the management of the Company regarding the reasonableness of significant assumptions relating to the fair value measurement of the Convertible Bonds was not necessary, as the assumptions were stated in the valuation report. Nevertheless, they opined that the presentation of working paper should be improved to clearly express their judgments and their consideration of audit evidence obtained. They will improve their audit manual in this respect.

- they evaluated the professional competence and objectivity of the valuer by examining the valuation report and via internet check. However, they opined that they did not state clearly their evaluation process and comment on the assumptions adopted. They will modify their audit manual to improve the documentation in using the work of an expert.

- they had obtained sufficient appropriate audit evidence to support the unmodified opinion.

- the EQCR performed his engagement quality control review according to his role and responsibilities. However, they opined that they should properly document any discussion between the engagement partner and the EQCR and the audit manual will be improved in this respect.

- they had acted diligently according to the applicable technical and professional standards.

Response of the AIB

The AIB reiterated that the recognition of the Convertible Bonds at their principal amount of HK$850 million at the date of the Acquisition in the 2010 Financial Statements was a non-compliance with paragraph 37 of HKFRS 3 (Revised).

The AIB noted the comments on the call option by W.H. Tang. However, the letter of confirmation from the Company merely reflected their intention of not exercising the call option. W.H. Tang should not accept the assumption in the valuation that the call option did not exist in the Convertible Bonds based on the Company's intention.

W.H. Tang's audit planning on the Convertible Bonds was inadequate to support that they had planned the audit of the Convertible Bonds and documented the same according to paragraph 15 of HKSA 200 (Revised) and paragraphs 13, 14 and 22 of HKSA 300.

In addition, there was no evidence in the Audit Working Papers that W.H. Tang had completed a program or checklist titled *"Using the work of an expert"*.

W.H. Tang failed to obtain sufficient appropriate evidence on the fair value measurement of the Convertible Bonds. They accepted the valuation without challenging the appropriateness on assuming that (a) the principal amount of the Convertible Bonds was their acquisition-date fair values; and (b) the call option did not exist.

The AIB upholds its findings and conclusions.

Comments from the Company

The relevant sections of the draft investigation report were also sent to the Company for comments on 22 July 2013. In its reply of 2 August 2013, the Company, represented by Tso Au Yim & Yeung, Solicitors, stated that *"We are further instructed that our client will not express any view on the Report"*.

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 Growth Enterprise Market (stock code: 08212) of The Exchange (Annex 1C). The name of the Company was changed to Hong Kong Life Group Holdings Limited on 21 October 2010 and further changed to Celebrate International Holdings Limited on 20 August 2012.

1.1.2 Note 7 to the 2010 Financial Statements (Annex 1C) disclosed that the Group was engaged in the following operations:

"Continuing operations:
(a) Trading of edible oil and mineral materials
(b) Boxes for storage of deceased cremated ashes and other ancestral properties
(c) Paper-offering businesses

Discontinued operations:
(a) Gases related
(b) Profit sharing on old field"

1.1.3 Note 31(b) to the 2010 Financial Statements (Annex 1C) disclosed that the Group acquired the entire interest in Casdon at a consideration of HK$1,045,293,000, part of the consideration was settled by the issuance of the Convertible Bonds.

1.1.4 According to the Circular (Annex 2B), Casdon Group held *"43 parcels of agricultural land in Yuen Long, New Territories, Hong Kong, with four 2-storey houses and two single-storey houses erected thereon ... Construction works have commenced to refurbish the houses for providing Boxes for storage of deceased cremated ashes and other ancestral properties and the related businesses and services."* Appendix I to the Circular further disclosed that Casdon Group *"is principally engaged in the operation and management of certain properties that provide lawful storage spaces as ancestral halls for private worship of the deceased ancestors by their descendants or a common ancestor or the members of a private institute or corporation in Hong Kong"*.

1.2 Financial information

1.2.1 The 2010 Financial Statements (Annex 1A) showed that the consolidated profit of the Group for the year ended 30 June 2010 was HK$129,000,000 and the consolidated net assets of the Group as at 30 June 2010 were HK$705,000,000. The consolidated net assets of the Group as at 30 June 2010 were restated in the 2011 Financial Statements to HK$621,000,000 after correcting prior period errors.

1.2.2 Note 3 to the 2010 Financial Statements (Annex 1A) stated that the financial statements were prepared in accordance with HKFRSs.

1.3 The Audit

1.3.1 The auditor's report stated that W.H. Tang conducted the Audit in accordance with HKSAs. W.H. Tang expressed an unmodified audit opinion on the 2010 Financial Statements.

1.3.2 A document titled "Materiality Summary" (Annex 2A) in the Audit Working Papers stated that the final materiality in relation to the Audit was HK$11,000,000.

Section 2 Initiation of investigation

2.1 Potential auditing irregularities

2.1.1 On 10 August 2012, the Council received a complaint of possible auditing irregularity in relation to the retrospective restatements as stated in note 3 to the 2011 Financial Statements, regarding the measurement of the prepaid lease payments acquired and the Convertible Bonds in relation to the Acquisition in the 2010 Financial Statements.

2.2 Scope of the investigation

2.2.1 On 29 November 2012, the Council decided to initiate an investigation under section 23(1)(b) of the Ordinance and directed the AIB to investigate the possible auditing irregularity, and the question whether or not there is such an irregularity, arising from the Audit by W.H. Tang in respect of the measurement of the prepaid lease payments acquired and the Convertible Bonds in relation to the Acquisition.

2.3 Members of the AIB

2.3.1 The members of the AIB involved in this investigation are as follows:

(a) Dr. Kam Pok-man, Chairman (up to 31 March 2013);

(b) Mr. Chan Tak-shing*, Chairman (from 1 April 2013);

(c) Ms. Lau Wai-ling, Anna;

(d) Ms. Wong Wai-mei, Florence; and

(e) Ms. Woo Pui-yan, Joyce.

* Mr. Chan Tak-shing is the Chairman for this investigation as Mr. Mark Dickens, the Chief Executive Officer of the Council, has an interest in the matter and therefore he is not involved in the investigation.

Section 3 Process of investigation

3.1 Requirements issued

3.1.1 The AIB issued two requirements (Annexes 3C and 3E) under sections 25 and 27 of the Ordinance to W.H. Tang on 17 December 2012 and 9 January 2013 requesting:

(a) the confirmation of the Audit Working Papers included in its letter dated 19 September 2012 (Annex 3B) were the complete set of audit documentation and working papers, as defined in the Glosssary, for the audit of the measurement of the prepaid lease payments acquired and the Convertible Bonds in relation to the Acquisition in the 2010 Financial Statements;

(b) the confirmation that the information and explanations included in its letter of 19 September 2012 (Annex 3B) remained valid for the purpose of the investigation; and

(c) the location of certain audit documentation.

3.1.2 W.H. Tang provided in its letters dated 31 December 2012 and 21 January 2013 (Annexes 3D and 3F) the information and explanations requested in the requirements as described in Paragraph 3.1.1.

3.1.3 The AIB also issued two requirements (Annexes 4A and 4D) under sections 25 and 27 of the Ordinance to the Company on 20 December 2012 and 29 January 2013 requesting the production of records and documents, and explanations to written questions.

3.1.4 The Company, represented by Tso Au Yim and Yeung, provided in letters dated 18 and 25 January 2013 and 5 February 2013 (Annexes 4B, 4C and 4E) the information and explanations requested in the requirements as described in Paragraph 3.1.3.

3.2 The investigation report

3.2.1 This report is prepared under section 35 of the Ordinance and contains the findings of the investigation conducted by the AIB under section 23(1)(b) of the Ordinance in respect of the Audit by W.H. Tang.

3.2.2 The draft investigation report was sent to W.H. Tang, the Engagement Partner and the EQCR for comments on 22 July 2013. On the same date, the relevant sections of the draft investigation report were sent to the Company for comments.

3.2.3 The comments from W.H. Tang, the Engagement Partner and the EQCR contained in its reply dated 5 September 2013 (Annex 3G) were included in Sections 5.3 and 6.3 of the investigation report.

3.2.4 In its reply of 2 August 2013 (Annex 4F), the Company, represented by Tso Au Yim & Yeung, Solicitors, stated that *"We are further instructed that our client will not express any view on the Report"*.

Section 4 Relevant financial reporting, auditing, assurance and professional ethics requirements

4.1 HKFRS 3 (Revised) *Business Combinations*

4.1.1 Paragraph 2 states that *"This HKFRS applies to a transaction or other event that meets the definition of a business combination. This HKFRS does not apply to: ... (b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in HKAS 38 Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill."*

4.1.2 Paragraph 3 states that *"An entity shall determine whether a transaction or other event is a business combination by applying the definition in this HKFRS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition ..."*

4.1.3 Paragraph 18 states that *"The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values."*

4.1.4 Paragraph 37 states that *"The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer ..."*

4.2 HKAS 32 *Financial Instruments: Presentation*

4.2.1 Paragraph 31 states that *"HKAS 39 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately."*

4.2.2 Paragraph 32 states that *"Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole."*

4.3 HKAS 39 *Financial Instruments: Recognition and Measurement*

4.3.1 Paragraph AG75 states that *"The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument."*

4.4 HKSA 200 (Revised) *Objective and General Principles Governing an Audit of Financial Statement*s

4.4.1 Paragraph 15 states that *"The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated."*

4.5 HKSA 220 *Quality Control for Audits of Historical Financial Information*

4.5.1 Paragraph 38 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."

4.5.2 Paragraph 39 further states that *"An engagement quality control review ordinarily involves discussion with the engagement partner, a review of the financial information and the auditor's report, and, in particular, consideration of whether the auditor's report is appropriate. It also involves a review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions they reached ... "*

4.6 HKSA 230 *Audit Documentation*

4.6.1 Paragraph 2 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."

4.6.2 Paragraph 9 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.

4.7 HKSA 300 *Planning an Audit of Financial Statements*

4.7.1 Paragraph 13 states that *"The auditor should develop an audit plan for the audit in order to reduce audit risk to an acceptably low level."*

4.7.2 Paragraph 14 states that *"The audit plan is more detailed than the audit strategy and includes the nature, timing and extent of audit procedures to be performed by engagement team members in order to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Documentation of the audit plan also serves as a record of the proper planning and performance of the audit procedures that can be reviewed and approved prior to the performance of further audit procedures."*

4.7.3 Paragraph 22 states that "*The auditors should document the overall audit strategy and the audit plan, including any significant changes made during the audit engagement."*

4.8 HKSA 500 *Audit Evidence*

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

4.9 HKSA 545 *Auditing Fair Value Measurements and Disclosures*

4.9.1 Paragraph 3 states that *"The auditor should obtain sufficient appropriate audit evidence that fair value measurements and disclosures are in accordance with the entity's applicable financial reporting framework."*

4.9.2 Paragraph 63 states that *"The auditor should obtain written representations from management regarding the reasonableness of significant assumptions, including whether they appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity where relevant to the fair value measurements or disclosures."*

4.10 HKSA 620 *Using the Work of an Expert*

4.10.1 Paragraph 2 states that *"When using the work performed by an expert, the auditor should obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit."*

4.10.2 Paragraph 8 states that *"When planning to use the work of an expert, the auditor should evaluate the professional competence of the expert. This will involve considering the expert's:*

(a) Professional certification or licensing by, or membership in, an appropriate professional body; and

(b) Experience and reputation in the field in which the auditor is seeking audit evidence."

4.10.3 Paragraph 9 states that *"The auditor should evaluate the objectivity of the expert."*

4.10.4 Paragraph 11 states that *"The auditor should obtain sufficient appropriate audit evidence that the scope of the expert's work is adequate for the purposes of the audit. Audit evidence may be obtained through a review of the terms of reference which are often set out in written instructions from the entity to the expert. Such instructions to the expert may cover matters such as the following:*

- *The objectives and scope of the expert's work.*
- *A general outline as to the specific matters the auditor expects the expert's report to cover.*
- *The intended use by the auditor of the expert's work, including the possible communication to third parties of the expert's identity and extent of involvement.*
- *The extent of the expert's access to appropriate records and files.*
- *Clarification of the expert's relationship with the entity, if any.*
- *Confidentiality of the entity's information.*
- *Information regarding the assumptions and methods intended to be used by the expert and their consistency with those used in prior periods.*

In the event that these matters are not clearly set out in written instructions to the expert, the auditor may need to communicate with the expert directly to obtain audit evidence in this regard. In obtaining an understanding of the entity, the auditor also considers whether to include the expert during the engagement team's discussion of the susceptibility of the entity's financial statements to material misstatement."

4.10.5 Paragraph 12 states that *"The auditor should evaluate the appropriateness of the expert's work as audit evidence regarding the assertion being considered. This will involve evaluation of whether the substance of the expert's findings is properly reflected in the financial statements or supports the assertions, and consideration of:*

- *Source data used;*

- *Assumptions and methods used and their consistency with prior periods; and*
- *Results of the expert's work in the light of the auditor's overall knowledge of the business and of the results of other audit procedures."*

4.10.6 Paragraph 15 states that *"If the results of the expert's work do not provide sufficient appropriate audit evidence or if the results are not consistent with other audit evidence, the auditor should resolve the matter. This may involve discussions with the entity and the expert, applying additional audit procedures, including possibly engaging another expert, or modifying the auditor's report."*

4.11 HKSA 700 *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*

4.11.1 Paragraph 11 states that *"The auditor should evaluate the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the financial statements."*

4.11.2 Paragraph 13 further states that *"Forming an opinion as to whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework involves evaluating whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework for particular classes of transactions, account balances and disclosures. This evaluation includes considering whether, in the context of the applicable financial reporting framework: (a) The accounting policies selected and applied are consistent with the financial reporting framework and are appropriate in the circumstances; (b) The accounting estimates made by management are reasonable in the circumstances; (c) The information presented in the financial statements, including accounting policies, is relevant, reliable, comparable and understandable; and (d) The financial statements provide sufficient disclosures to enable users to understand the effect of material transactions and events on the information conveyed in the financial statements, for example, in the case of financial statements prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs), the entity's financial position, financial performance and cash flows."*

4.12 Section 130 of COE *Professional Competence and Due Care*

4.12.1 Section 130.1 states that *"The principle of professional competence and due care imposes the following obligations on professional accountants:*

(a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and

(b) To act diligently in accordance with applicable technical and professional standards when providing professional services."

Section 5 Measurement of the prepaid lease payments

5.1 Findings of fact

5.1.1 Background information

5.1.1.1 Note 31(b) to the 2010 Financial Statements (Annex 1A) disclosed that *"For the year ended 30 June 2010, the Group acquired 100% equity interest in Casdon at a consideration of approximately HK$1,045,293,000."* Among the net asset acquired, the Group recognized the prepaid lease payments acquired at the fair value of HK$143,872,000.

5.1.1.2 Note 3(i) to the 2011 Financial Statements (Annex 1B) stated that *"During the course of* [the Acquisition]*, the Group determined the fair value of the prepaid lease payments owned by* [Casdon Group] *as at 27 May 2010 based on the consideration paid by Casdon in acquiring 11 companies holding the pieces of land (the "Land Companies"), together with the original acquisition costs of the land incurred by individual Land Companies. Subsequent to the date of the financial statements for the year ended 30 June 2010, the Directors had obtained a valuation report issued by an independent surveyor regarding the fair values of the identifiable assets and liabilities of* [Casdon Group] *as at 27 May 2010. As mentioned in this valuation report, the fair value of the prepaid lease payments should be HK$25,465,000 at 27 May 2010. Accordingly, the Directors considered the fair value of the prepaid lease payments at the date of* [the Acquisition] *was overstated and the corresponding goodwill arised* (sic) *from* [the Acquisition] *was understated."*

5.1.1.3 According to the Circular (Annex 2B), among the assets acquired in the Acquisition were 37 parcels of agricultural land in Yuen Long, New Territories, Hong Kong, with four two-storey houses and two single-storey houses erected thereon. As stated in the Circular, construction work had commenced to refurbish the houses for providing boxes for storage of deceased cremated ashes and other ancestral properties, and the related businesses and services.

5.1.1.4 The complainant alleged that there was a non-compliance with paragraph 18 of HKFRS 3 (Revised) (Paragraph 4.1.3) in the 2010 Financial Statements for not measuring the prepaid lease payments acquired in the Acquisition at their acquisition-date fair values.

5.1.1.5 Given the above possible non-compliance, the complainant alleged that W.H. Tang had not planned and performed the Audit in accordance with the applicable HKSAs, and had not formed an appropriate auditor's opinion on the 2010 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700 (Paragraphs 4.11.1 and 4.11.2).

5.1.2 Review of Audit Working Papers

5.1.2.1 In a document titled "Planning Memorandum – Year end 30 Jun 10" (Annex 2C), W.H. Tang mentioned the Acquisition under "Background information" and identified the related "*impairment test on goodwill*" as one of the key risks.

5.1.2.2 In a document titled "Appendix E Engagement Acceptance/Continuance Risk Tolerance Worksheet" (Annex 2D), W.H. Tang classified the risk factor "Involvement of other auditors/specialists" as *"Low Risk"* due to *"Limited specialist involvement required"*. In the same document, W.H. Tang also stated that *"Based on the above assessment this client should be considered: Low Risk"*.

5.1.2.3 In a document titled "AUDIT PLANNING CHECKLIST" (Annex 2E), W.H. Tang marked item 8.13: "*Where the work of an expert is to be relied upon concerning: the valuation of assets; the determination of quantities; the application of specialised techniques to determine amounts ... complete the optional program 'Using the work of an expert' (Cop06)*" as *"N/A"*.

5.1.2.4 The document titled "CASDON MANAGEMENT LIMITED – Consolidated properties under development and prepaid land leases – As at 30 June 2010" (Annex 2F) showed that the "Prepaid land leases – Land cost" of HK$143,872,230 was made up of "land cost" of HK$23,872,246 and a consolidation adjustment of HK$119,999,984 (Annex 2H).

5.1.2.5 According to a document titled "CASDON MANAGEMENT LIMITED – Consolidated properties under development– As at 30 June 2010" (Annex 2G), the "land cost" of HK$23,872,246 represented the aggregate of *"land costs*" and "*legal and professional fee*" paid by 11 subsidiaries of Casdon Group in acquiring the lands in Yuen Long.

5.1.2.6 In the same document that consisted the lead schedules of "Properties under development" of the 11 subsidiaries (Annex 2G), W.H. Tang stated that:

"<u>Audit work</u>

1. Analytical review
2. Obtain or prepare the breakdown
3. Detail testing
   a. Check to sales and purchase agreement
   b. Check to assignment
   c. Perform land search
   d. Check the supporting document for the direct cost
   e. Agree amount with ledger

<u>Analytical review</u>
1. Properties under development represents the land held by the Company that together with the land held by other companies in the Group for the business of the provision of boxes for storage of deceased cremated ashes and other ancestral properties in Hong Kong."

...

<u>Conclusion</u>
From the audit work carried out I confirm that:
- *the work has been performed in accordance with the audit programme.*

- *the work performed and the results obtained have been adequately documented.*
- *all necessary information has been collected for the presentation and disclosure in the financial statements.*
- *sufficient appropriate evidence has been obtained to support the audit conclusion reached.*
- *in my opinion* [prepaid lease payments] *are fairly stated.*

5.1.2.7 According to a document titled "Casdon Management Limited – Period from 12.3.2009 to 30.6.2010 – Interest in subsidiaries" (Annex 2I), Casdon acquired two wholly owned subsidiaries which indirectly held leasehold land in Yuen Long at the consideration of HK$120,000,000. W.H. Tang checked the details of these acquisitions against the sale and purchase agreement of these two subsidiaries. It is implicit in a document titled "Casdon Management Limited – Consolidated financial statements – as at 27 May 2010" (Annex 2H), the elimination of Casdon's investment in these two wholly owned subsidiaries with their equity resulted in the consolidation adjustment of HK$119,999,984 (Paragraph 5.1.2.4).

5.1.2.8 In a document titled "Evaluation of fair value adjustment 30 June 10" (Annex 2J), W.H. Tang stated that:

"By examining the documents for the acquisition of land owned subsidiaries by Casdon Management Limited, we noted that Casdon acquired 100% equity interests in [a company] *and* [another company] *at a consideration of HK$60,000,000 and HK$60,000,000 respectively and Casdon accounted for the acquisition costs as land costs in the consolidated financial statements instead of goodwill. And we noted that this was the mainly difference between the valuation report by the value regarding the land costs. By discussing with the director of Casdon,* [name of the director], *he stated that the costs was for acquisition of assets, so that it was accounted for in the land costs of* [property, plant and equipment].

By considering the following issues, we are satisfied that there was no fair value adjustment regarding the [properties under development and prepaid lease payments] *in the* [Acquisition]*:*

1. *Refer to the accountant's report of Casdon Management Limited for the period from 12 March 2009 (date of incorporation) to 30 November 2009, the report stated that the value of* [properties under development and prepaid lease payments] *was approximately HK$147,920,000* [HK$147,922,000 according to the accountant's report of Casdon Group] *and this amount included the consideration in acquiring* [a company] *and* [another company]. *As mentioned by* [the director of Casdon]*, the acquisition costs was deemed to acquire the assets so that the reporting accountants reported the amount in the* [properties under development and prepaid lease payments] *accordingly.*

2. *Business of Casdon Management Limited is engaged to provide Box for ancestor and the property is the main asset for generating of revenue. By considering the fair value of the assets, we considered the financial contributions of the assets in*

the business instead of the resale value by breakdown the lands into pieces. In this regard, we considered that the acquisition costs and construction costs become the fair value of the [properties under development and prepaid lease payments]. *"*(sic)

5.1.2.9 The properties under development, which included the construction costs (properties under development) and the land cost (the prepaid lease payments), increased from HK$147,922,000 (Paragraph 5.1.2.8) at 30 November 2009 to HK$157,774,000 as at 27 May 2010 (being the aggregate of the properties under development of HK$13,902,000 and the prepaid lease payments acquired of HK$143,872,000 (Paragraph 5.1.1.1)).

5.1.2.10 A property valuation report dated 22 April 2010 prepared by Valuer A (Annex 2K) was included in the Circular, in which the prepaid lease payments acquired were valued at HK$25,465,000 as at 31 January 2010.

5.1.2.11 The representation letter from the management of the Company (Annex 2L) did not include any matters relating to the fair value measurement of the assets and the prepaid lease payments acquired in the Acquisition.

5.1.2.12 In a document titled "Partner Completion – Initial" dated 10 September 2010 (Annex 2M), both the engagement partner and the second partner signed below the following questions and statement:

"1. Have we obtained sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion?

…

5. Has sufficient work been undertaken to reduce audit risk to an acceptably low level that is consistent with the audit objectives?

…

10. Has an engagement quality control review been undertaken where required by HKICPA's Code of Ethics for Professional Accountants, HSQC1 or the firm's procedures?

…

12. Have all matters been documented that are important in providing audit evidence to:

- support the audit opinion; and
- confirm that the audit was carried out in accordance with HKSAs?

…

I authorise the issue of the accounts for approval".

5.1.2.13 In a document titled "Partner Completion – Final" dated 10 September 2010 (Annex 2N), the engagement partner signed but the designated space for the second partner to sign-off and the date of the review were left blank after the following statement:

"I am satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued."

5.1.3 *Information and explanation provided by W.H. Tang and the Company*

5.1.3.1 W.H. Tang confirmed in its letter of 31 December 2012 (Annex 3D) that the records and documents provided on 19 September 2012 were the complete set of audit documentation and working papers, as defined in the Glossary, in the audit of the measurement of the prepaid lease payments acquired in the Acquisition.

5.1.3.2 On 9 January 2013 (Annex 3E), W.H. Tang was requested to identify its audit documentation in relation to how it satisfied that the acquisition-date fair values of the prepaid lease payments acquired of HK$143,872,000 (Paragraph 5.1.1.1) were properly determined in compliance with paragraph 18 of HKFRS 3 (Revised) (Paragraph 4.1.3).

5.1.3.3 W.H. Tang stated in its reply letter dated 21 January 2013 (Annex 3F) that *"In evaluating the fair values of the prepaid lease payments ("PLP") of HK$143,872,000 ... were properly determined in compliance with paragraph 18 of HKFRS3 or not, we considered the following factors:*

(i) The ... PLP is used for the development of ancestor ashes box business and not for re-sale, so that we considered that the fair values of the ... PLP was determined by using the acquisition costs instead of market values for re-sale. After recognition, the ... PLP are stated at cost, less depreciation and impairment loss, if any.

(ii) We also make reference to the accountant's report of Casdon Management Limited issued on 22 April 2010 [Paragraph 5.1.2.8]*, the PUD recorded was approximately to HK$147,922,000 (PLP included) and we discussed with the management of our client about the accounting treatment and his reply was that the acquisition was mainly for the assets to develop of the ancestor ashes box and the fair value of PUD* [including prepaid lease payments] *acquired was considered to be its acquisition costs and construction costs.*

In view of the above, we stated the evaluating of fair value adjustments under index B-3300 [Paragraph 5.1.2.8] *in our consolidation file of Aptus Holdings Limited and the acquisition costs of ... PLP was performed in audit file for the subsidiaries of Aptus Holdings Limited."*

5.1.3.4 On 20 December 2012 (Annex 4A), the AIB asked the Company to explain how the acquisition-date fair values of the prepaid lease payments acquired were determined and why the value of HK$25,465,000 as shown in the valuation report prepared by Valuer A (Paragraph 5.1.2.10) was not used as the acquisition-date fair values for the prepaid lease payments acquired.

5.1.3.5 In its reply letter of 18 January 2013 (Annex 4B), the Company, represented by Tso Au Yim & Yeung, stated that *"... the prepaid lease payments of HK$143,873,000* [HK$143,872,000] *... represented the carrying amounts of the prepaid lease* *payments … as reflected in the books and records of Casdon Management Limited and its subsidiaries as at 27 May 2010 (the "date of Acquisition").*

The then management of the Group determined the fair value of the prepaid lease payments owned by Casdon Management Limited and its subsidiaries (the "Casdon Group") as at the date of Acquisition based on the consideration paid [of HK$120,000,000] [Paragraph 5.1.2.7] *by Casdon Management Limited in acquiring 11 companies holding the pieces of land (the "Land Companies") together with the original acquisition costs of the land* [land cost of HK$23,872,246] [Paragraph 5.1.2.5] *incurred by individual Land Companies prior to the Acquisition. As a result, the then management of the Company did not rely on the figure of HK$25,465,000 of the capital value in existing state as at 31 January 2010 appearing in the circular of the Company dated 22 April 2010.*[Paragraph 5.1.2.10]*"*

5.1.3.6 In the same reply letter, the Company further stated that *"Subsequent to the date of the financial statements for the year ended 30 June 2010, following a change of auditor for the Group, the then management of the Company obtained a valuation report issued by an independent surveyor regarding the fair values of the identifiable assets and liabilities of Casdon Group as at the date of Acquisition and the fair value of the prepaid lease payments at the date of Acquisition was overstated and the corresponding goodwill arisen from the Acquisition was understated. As a result, corresponding adjustment was made by the Group in its financial statements for the year ended 30 June 2011."* The prepaid lease payments acquired were restated at HK$25,465,000 at the date of the Acquisition (Paragraph 5.1.1.2).

5.2 Conclusions of the AIB

5.2.1 Paragraph 3 of HKFRS 3 (Revised) (Paragraph 4.1.2) requires an entity to determine whether a transaction or other event is a business combination by applying the definition in the standard. HKFRS 3 (Revised) defines business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. HKFRS 3 (Revised) further defines a business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

5.2.2 Whether an acquired set of activities and assets is a business can lead to different accounting results. For business combination, paragraph 18 of HKFRS 3 (Revised) (Paragraph 4.1.3) states that *"The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values."*

5.2.3 On the contrary, if the asset or a group of assets acquired is not a business, HKFRS 3 (Revised) does not apply. The entity should account for such transaction as an asset acquisition by allocating the cost of purchase consideration between the individual identifiable assets and liabilities in the acquiree based on their relative fair values at the date of purchase. Such transaction or event does not give rise to goodwill (Paragraph 4.1.1).

Accounting non-compliance

5.2.4 The Acquisition was a business combination because:

(a) note 31(b) to the 2010 Financial Statements (Paragraph 5.1.1.1) stated that the Group acquired 100% equity interest in Casdon, which indicated that the Company obtained control of Casdon;

(b) according to the Circular, construction work had commenced to refurbish the houses for providing boxes for storage of deceased cremated ashes and other ancestral properties, and the related businesses and services (Paragraph 5.1.1.3);

(c) the Circular (Annex 2B) disclosed that *"The Aptus Directors have also taken into account of … the aforesaid prospect of the business of providing spaces for storage of deceased cremated ashes and other ancestral properties is positive given the growing demand and shortage of supply in Hong Kong … the Acquisition represents an opportunity for Aptus to tap into the Business …"*; and

(d) the chairman's statement to the 2010 annual report (Annex 1A) stated that *"The Board believes that the prospects of the newly acquired business of providing spaces for storage of deceased cremated ashes and other ancestral properties is positive given the growing demand and shortage of supply in Hong Kong. Based on the growing need, we are confident that the business will provide solid and long-term contribution to the Group's revenue"*.

5.2.5 According to paragraph 18 of HKFRS 3 (Revised) (Paragraph 4.1.3), the prepaid lease payments acquired in the Acquisition should have been measured at their acquisition-date fair values. However, the Company measured the prepaid lease payments acquired in the Acquisition with reference to their carrying amounts in the books and records of Casdon (Paragraph 5.1.3.5) when preparing the 2010 Financial Statements.

5.2.6 Based on the above, there is a non-compliance with paragraph 18 of HKFRS 3 (Revised) (Paragraph 4.1.3) for not measuring the prepaid lease payments acquired in the Acquisition at their acquisition-date fair values in the 2010 Financial Statements. The acquisition-date fair values of the prepaid lease payments acquired in the Acquisition should have been HK$25,465,000 instead of HK$143,872,000 based on the Company's reply (Paragraph 5.1.3.6).

Auditing irregularities

5.2.7 Based on the review of the Audit Working Papers and explanations provided, W.H. Tang failed to address the above non-compliance and did not conduct the Audit in accordance with HKSAs, the details of which are set out in the following paragraphs.

Planning

5.2.8 Judgment is required to determine whether a particular set of assets and activities acquired was a business. Reliance on the work of other experts, such as professional valuer, might be needed in the initial measurement of the assets acquired and the liabilities assumed.

5.2.9 Appendix VIII to the Circular (Annex 2B) is a property valuation report dated 22 April 2010 prepared by Valuer A on the land and buildings of the Group and Casdon Group, including the valuation of the prepaid lease payments acquired in the Acquisition valued as at 31 January 2010.

5.2.10 The planning memorandum prepared by W.H. Tang (Annex 2C) did not include the nature, timing and extent of audit procedures to be performed in relation to the Acquisition. In particular, it failed to prepare a proper audit plan to audit the measurement of the prepaid lease payments acquired to ensure that sufficient appropriate audit evidence would be obtained to reduce audit risk (i.e. the risk to express an inappropriate audit opinion when the financial statements were materially misstated) to an acceptably low level in accordance with paragraphs 13 and 14 of HKSA 300 (Paragraphs 4.7.1 and 4.7.2).

5.2.11 In addition, W.H. Tang failed to justify the appropriateness of its risk assessment and its determination that the use of the program "Using the work of an expert (Cop06)" was "N/A" (Paragraph 5.1.2.3).

5.2.12 Therefore, W.H. Tang failed to plan the Audit with an attitude of professional skepticism in this respect in accordance with paragraph 15 of HKSA 200 (Revised) (Paragraph 4.4.1) and failed to develop a proper audit plan and document the same in accordance with paragraphs 13, 14 and 22 of HKSA 300 (Paragraphs 4.7.1 to 4.7.3).

Sufficiency and appropriateness of audit evidence

5.2.13 W.H. Tang relied on the oral representation from the management of Casdon and the accountant's report of Casdon Group included in the Circular as audit evidence in concluding that the initial measurement of the prepaid lease payments acquired in the Acquisition was in compliance with HKFRS 3 (Revised) (Paragraphs 5.1.2.8 and 5.1.3.3). There was no evidence in the Audit Working Papers demonstrating:

(a) the consideration of the appropriateness in relying on the evidence obtained from the accountant's report of Casdon Group for the purpose of accounting for the Acquisition in the 2010 Financial Statements, in view of the differences in the nature of the transaction and the related accounting treatment. According to the accountant's report of Casdon Group as included in the Circular, Casdon acquired the two subsidiaries on 24 November 2009 at a consideration of HK$120,000,000. Casdon accounted for this transaction as *"Acquisition of assets and liabilities through acquisition of subsidiaries"* and allocated the consideration of HK$120,000,000 to the net assets acquired;

(b) the acceptance of oral representation from the management of Casdon (Paragraph 5.1.2.8) as audit evidence for the acquisition-date fair value of the prepaid lease payments acquired was more appropriate than the valuation report prepared by Valuer A; and

(c) that the written representation obtained from the management of the Company included the reasonableness of significant assumptions in the fair value measurement of the prepaid lease payments acquired (Paragraph 5.1.2.11).

5.2.14 Based on the above, W.H. Tang failed to obtain sufficient appropriate audit evidence in relation to the measurement of the prepaid lease payments acquired in the Acquisition in accordance with paragraph 2 of HKSA 500 (Paragraph 4.8.1) and paragraphs 3 and 63 of HKSA 545 (Paragraphs 4.9.1 and 4.9.2).

Documentation

5.2.15 Under the conclusion section of a document titled "CASDON MANAGEMENT LIMITED – Consolidated properties under development and prepaid land leases – As at 30 June 2010" (Annex 2G), W.H. Tang stated that "the work has been performed in accordance with the audit programme" (Paragraph 5.1.2.6). However, the AIB noted that there was no such audit programme in the Audit Working Papers.

5.2.16 Alternatively, if W.H. Tang had performed the audit procedures and obtained audit evidence as set out in Paragraphs 5.2.11 to 5.2.15 (which the AIB disputes given the lack of any supporting document), it had failed to prepare audit documentation that provide a sufficient and appropriate record of the basis for the audit report and evidence that the Audit was performed in accordance with applicable auditing standards in these respects. Therefore, W.H. Tang failed to observe paragraphs 2 and 9 of HKSA 230 (Paragraphs 4.6.1 and 4.6.2).

Basis of forming audit opinion

5.2.17 In light of the matters set out in Paragraphs 5.2.7 to 5.2.16, W.H. Tang did not obtain sufficient appropriate audit evidence to support the conclusions reached in the measurement of the prepaid lease payment acquired in the Acquisition and for the unmodified audit opinion expressed on the 2010 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700 (Paragraphs 4.11.1 and 4.11.2).

Engagement quality control review

5.2.18 By signing the "Partner Completion – Initial" form (Paragraph 5.1.2.12), the EQCR indicated that he was satisfied with the audit evidence obtained and procedures performed by the audit team and that the 2010 Financial Statements were prepared in accordance with HKFRSs and the Audit was performed in accordance with HKSAs.

5.2.19 On the basis of the findings in this section, and given the Acquisition was material to the 2010 Financial Statements, it is not unreasonable to expect that the EQCR would select the relevant audit documentation to perform the quality control review. If the EQCR had properly performed his review, in particular, in response to those questions asked in the relevant working paper (Paragraph 5.1.2.12), the non-compliances with the financial reporting standards and auditing requirements as mentioned above (Paragraphs 5.2.7 to 5.2.16) should have been identified and addressed. Accordingly, the EQCR did not properly perform his engagement quality control review of the acquisition-date fair value measurement of the prepaid lease payments acquired in the Acquisition in accordance with paragraphs 38 and 39 of HKSA 220 (Paragraphs 4.5.1 and 4.5.2).

COE

5.2.20 In light of the above, the Engagement Partner and the EQCR did not comply with section 130.1 of COE (Paragraph 4.12.1) as they did not act diligently in accordance with the applicable technical and professional standards when providing professional services in relation to the Audit in respect of the measurement of the prepaid lease payments acquired in accordance with HKFRS 3 (Revised).

5.3 Comments from W.H. Tang, the Engagement Partner and the EQCR

5.3.1 W.H. Tang, the Engagement Partner and the EQCR in their reply letters dated 5 September 2013 (Annex 3G), stated that:

"Accounting non-compliance

As we noted that the Company acquired Casdon Management Limited and its subsidiaries (Casdon) on 27 May 2010 and the acquisition of Casdon was a business combination … As explained in our previous letter, Casdon acquired 2 lots of lands at a consideration of approximately of HK$120,000,000 and the books and records of Casdon recorded a prepaid lease payment of approximately of HK$143,872,000 … By assessing the fair values of prepaid lease payments, we considered that the following factors:

1. *the usage of the land;*
2. *the synergy effect in grouping the land in a large area for development;*
3. *the economic contribution of the land to the business of the Group;*
4. *Casdon acquired the property under development (include prepaid lease payments) from individual third parties around half year ago and there was no material change in the market afterwards and it is similar to the principle of HKFRS 13 "Fair Value Measurement"; and*
5. *Accountant's report issued in the circular of the Company dated 22 April 2010 stated that the property under development was amounted to approximately HK$147,922,000*

As the land was used for its own business use and not for re-sale and the valuation report was based on the valuation of individual land instead of the whole development area. In addition, the economic contribution of the land could contribute over HK$1,000 million to the Group in the future, we considered that the fair values of the prepaid lease payments should be better stated at the acquisition costs instead of the valuation stated at the valuation report.

As stated in the above, we considered that the fair values of prepaid lease payments were not relied on the valuation from the valuer.

Moreover, we believed that our judgement may over considerate in taking into account too many factors in determining the fair value of prepaid lease payments.

Auditing irregularities

Planning

As the completion of the acquisition was on 27 May 2010 and the financial year end of the Company was on 30 June 2010 (one months later on the date of completion), we planned to perform our audit procedures in relation to the acquisition in our annual audit file. In this regard, audit file of Casdon included 2 columns, one column was for the balance as at 27 May 2010 and the other column was for the balance as at 30 June 2010 …

In our planning, we also pointed out the risk area (goodwill and valuation of convertible bonds) which we concerned that it may cause the financial statements to be materially misstated.

Therefore, refer to our planning memorandum, we considered that we developed a proper audit plan and documents in the engagement in accordance with paragraph 15 of HKSA 200 (Revised) and paragraph 13,14 and 22 of HKSA 300.

Moreover, we consider that our presentation of working paper in planning should be modified to express clearly our judgement and elaborate our procedures for risk areas in the planning stage. WH Tang will improve its audit manual to ensure the improvement in the futures.

Sufficiency and appropriateness of audit evidence

Please be noted that we are not only relied on the oral representation from the management as our audit evidence. We also considered the circular and announcement of the Company published in the past and after due carefully to consider that the available evidence is enough or not to form our audit opinion.

As we considered that we have obtained other documentation as audit evidence to prove the oral representation from the management (e.g. consolidated worksheet prepared by the Company and approved by the management, circular issued by the Company), we considered that oral representation was not necessary to be obtained.

Documentation

… The audit programme to verify the properties under development and prepaid land leases was stated in individual audit file of each entity of the Group. In this regard, we considered that we had prepared audit documentation that provide a sufficient and

appropriate record of the basis for the audit report and evidence that the engagement was performed in accordance with applicable auditing standards in these respects.

Basis of forming audit opinion

In light of the matters set out in the above, we considered that we obtained sufficient appropriate audit evidence to support the conclusions reached in the measurement of the prepaid lease payments acquired in the acquisition and for the unmodified opinion … Please be noted that our opinion was formed based on the underlying audit evidence available to us, if we adopted the finding in the Report [the Investigation Report]*, we believe that our opinion is required to be modified.*

Engagement quality control review

… As EQCR of the engagement, [the EQCR] *performed his engagement quality control review in accordance with the role and responsibilities …In completion of the EQCR worksheet,* [the EQCR] *also discussed with the engagement partner …* [the EQCR] *and then based on the underlying information and concluded that the engagement report was issued.*

Moreover, we considered that except for the EQCR worksheet, any discussion between the engagement partner and EQCR should be properly documented and recorded in the audit file for supporting. Our audit manual will be modified to improve the engagement quality control process in the future.

COE

… in preparing our audit engagement, engagement partner and EQCR are acted diligently in accordance with the applicable technical and professional standards …"

5.4 Response of the AIB to comments from W.H. Tang, the Engagement Partner and the EQCR

<u>*Accounting non-compliance*</u>

5.4.1 The AIB noted the comments from W.H. Tang, the Engagement Partner and the EQCR. However, as stated in Paragraphs 5.2.5 and 5.2.6, failure to measure the prepaid lease payments at their acquisition-date fair value was a non-compliance with paragraph 18 of HKFRS 3 (Revised).

5.4.2 Paragraphs BC312 to BC318 of the Basis for Conclusions accompanying HKFRS 3 (Revised) provide explanation of the recognition and measurement of goodwill. In particular, Paragraph BC316 specifies that "the third component" and "the fourth component" (as detailed below extracted from Paragraph BC313) are considered collectively as "core goodwill".

"Component 3 - The fair value of the going concern element of the acquiree's existing

business. The going concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from other benefits (such as factors related to market imperfections, including the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors).

"Component 4 - The fair value of the expected synergies and other benefits from combining the acquirer's and acquiree's net assets and businesses. Those synergies and other benefits are unique to each combination, and different combinations would produce different synergies and, hence, different values."

5.4.3 Based on the above, it is not appropriate to include the value of the existing business and the synergy effect (Paragraph 5.3.1) in determining the fair value of the identifiable assets acquired in a business combination as they are regarded as part of goodwill.

5.4.4 In respect of HKFRS 13 *Fair Value Measurement* as mentioned in their reply letters (Paragraph 5.3.1), the AIB noted that HKFRS 13 was issued by the HKICPA in June 2011 and effective for financial statements with accounting periods beginning on or after 1 January 2013. Therefore, it was not applicable to the 2010 Financial Statements.

Auditing irregularities

5.4.5 W.H. Tang's audit planning on the Acquisition was limited to the documentation as set out in Paragraphs 5.1.2.1 to 5.1.2.3. There was no evidence in the Audit Working Papers or other documentation provided by W.H. Tang to support that they had planned the audit of the Acquisition and documented the same according to paragraph 15 of HKSA 200 (Revised) (Paragraph 4.4.1) and paragraphs 13, 14 and 22 of HKSA 300 (Paragraphs 4.7.1 to 4.7.3).

5.4.6 As set out in Paragraphs 5.1.2.6 to 5.1.2.8, W.H. Tang's audit procedures were limited to checking the land costs, legal and professional fees paid by the 11 subsidiaries of the Group of HK$23,872,246 and the consideration paid by Casdon in acquiring two wholly-owned subsidiaries. There was no evidence in the Audit Working Papers or other documentation provided by W.H. Tang to support that they had considered the nature of the transaction, the related accounting treatment (Paragraph 5.2.13) and the valuation prepared by Valuer A as included in the Circular.

5.4.7 The AIB upholds its conclusions as set out in Section 5.2.

5.5 Comments from the Company

5.5.1 In its reply of 2 August 2013 (Annex 4F), the Company, represented by Tso Au Yim & Yeung, Solicitors, stated that *"We are further instructed that our client will not express any view on the Report"*.

Section 6 Measurement of the Convertible Bonds

6.1 Findings of fact

6.1.1 Background information

6.1.1.1 Note 31(b) to the 2010 Financial Statements (Annex 1A) disclosed that the Company issued convertible bonds as part of the consideration for the Acquisition. Note 28(b) to the 2010 Financial Statements (Annex 1A) further disclosed that:

"On 27 May 2010, the Company issued convertible bonds with a principal amount of HK$850 million as part of the consideration to acquire Casdon (the "Casdon Bonds"). The Casdon Bonds were denominated in Hong Kong dollar, unsecured, transferrable and interest-free. The Casdon Bonds entitled the holders thereof to convert the Casdon Bonds, in whole or in part, into ordinary shares of the Company at a conversion price of HK$0.25 per share during the period from the date of issue to 27 May 2016 (the "Maturity Date"). The Company also has the option to redeem all or any of the outstanding Casdon Bonds at any time prior to the Maturity Date, at par.

The Casdon Bonds contained 2 components, namely liability component and equity component. The effective interest rate for the liability component is 12.97% per annum ..."

6.1.1.2 Note 3(ii) to the 2011 Financial Statements (Annex 1B) stated that:

"The Group issued convertible bonds as part of the considerations of the [Acquisition]. *The Group first determined the fair value of the liability component, and the equity component was assigned the residual amount after deducting the fair value of the liability component from the principal amount of the convertible bonds.*

In accordance with HKFRS 3 Business Combination, the consideration transferred in a business combination shall be measured at fair value. The Group has discovered the above errors and accordingly remeasured the equity component at fair value at the date of [the Acquisition]*."*

6.1.1.3 The differences between the amounts of the two components of the Convertible Bonds originally recognized in the 2010 Financial Statements and those amounts restated in the 2011 Financial Statements are summarized as follows:

	Recognized in the 2010 Financial Statements	Restated in the 2011 Financial Statements	Difference
	HK$'000	HK$'000	HK$'000
Liability component	409,915[(a)]	409,915[(b)]	-
Equity component	440,085[(a)]	356,280[(b)]	83,805
	850,000[(a)]	766,195[(b)]	83,805

(a) Extracted from note 28(b) to the 2010 Financial Statements (Annex 1A)

(b) Extracted from notes 33 and 37(b) to the 2011 Financial Statements respectively (Annex 1B)

6.1.1.4 The complainant alleged that there was a non-compliance with paragraph 37 of HKFRS 3 (Revised) (Paragraph 4.1.4) in the 2010 Financial Statements for not measuring the Convertible Bonds at the acquisition-date fair values.

6.1.1.5 Given the above possible non-compliance, the complainant alleged that W.H. Tang had not planned and performed the Audit in accordance with the applicable HKSAs, and had not formed an appropriate auditor's opinion on the 2010 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700 (Paragraphs 4.11.1 and 4.11.2).

6.1.2 Review of Audit Working Papers

6.1.2.1 A document titled "Planning Memorandum – Year end 30 Jun 10" (Annex 2C) stated that: *"Key risks and responses at financial statement level - As Aptus acquired Casdon Group on 27 May 2010, we consider that the following is the key risks at financial statements level ... valuation of convertible bonds (Response: Report from valuer will be obtained for recognition of convertible bonds)"*.

6.1.2.2 In a document titled "Appendix E Engagement Acceptance/Continuance Risk Tolerance Worksheet" (Annex 2D), W.H. Tang classified the risk factor "Involvement of other auditor/specialists" as *"Low Risk*" due to *"Limited specialist involvement required"*. In the same document, W.H. Tang also stated that *"Based on the above assessment this client should be considered: Low Risk"*.

6.1.2.3 In a document titled "AUDIT PLANNING CHECKLIST" (Annex 2E), W.H. Tang marked the item 8.13: *"Where the work of an expert is to be relied upon concerning: the valuation of assets; the determination of quantities; the application of specialised techniques to determine amounts ... complete the optional program 'Using the work of an expert' (Cop06)"*as *"N/A"*.

6.1.2.4 According to a document titled "Audit Highlights – Period: 30 June 2010" (Annex 2O), *"... Convertible bonds for the year ended 30 June 2010 represent convertible bonds of principal value of HK$850,000,000 issued for the acquisition of Casdon Group.*

Referred to the valuer's report, the convertible bond is split into liability component of HK$409,915,000 and equity component of HK$440,085,000 [Paragraph 6.1.1.3]*."*

6.1.2.5 In a document titled "CONVERTIBLE BONDS - period: 30 JUNE 2010" (Annex 2P), W.H. Tang documented the following audit procedures in relation to the Convertible Bonds:

" ... Audit work:

1) *Examine to nature of account*
2) *Obtain bond purchase agreement*
3) *Extract to announcement from HKEX* [The Exchange]
4) *Examine to bank deposit*
5) *Cross check to finance cost of reasonable interest rate*

RESULTS:

Analytical review:

Compared to last year figure, the convertible bonds was decreased by ... because the [Convertible Bonds] *b/f* [brought forward] *was released and a new convertible bond with different value was issued during the year.*

Detail testing:

... Under HKAS32 Financial instruments: Disclosure and Presentation, compound financial instruments will have both a liability and an equity component. It requires the components to be split into different parts, with each part accounted for and presented separately as financial liabilities or equity instruments. Obtain the assumption of fair value of convertible bonds.

...

Conclusion: *From the audit work carried out we confirm that:*

- *the work has been performed in accordance with the audit work.*
- *the work performed and the results obtained have been adequately documented.*
- *all necessary information has been collected for the presentation and disclosure in the financial statements.*
- *sufficient appropriate evidence has been obtained to support the audit conclusion reached.*
- *in my opinion convertible bond are fairly stated."* (sic)

6.1.2.6 In a document titled "Convertible bonds for the year ended 30 June 2010" (Annex 2Q), W.H. Tang further stated that *"... New convertible bonds with principal amount of HK$850,000,000 was* (sic) *issued as part of consideration for acquired 100% equity* *interest in Casdon Management Limited on 27 May 2010. Refer to valuation report <B-1500BA> from* [Valuer B]*, the* [Convertible Bonds] *was split into liability component and equity component …"*

6.1.2.7 A copy of the valuation report prepared by Valuer B (Annex 2R) was included in the Audit Working Papers. According to the first paragraph of the valuation report, Valuer B was engaged by the Company to carry out a valuation of the Convertible Bonds and *"The purpose of this report is to provide our opinion on the market value of the Convertibles with reference to the terms and conditions as instructed by the Company. We understand this valuation is required for accounting purposes under the requirement of Hong Kong Financial Reporting Standards."*

6.1.2.8 The valuation report prepared by Valuer B (Annex 2R) further stated that *"Our appraisal has been carried out on a market value basis. Market value is defined as the estimated amount for which an asset should exchange between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeable, prudently and without compulsion".*

6.1.2.9 It was noted from the valuation report that the debt component of the Convertible Bonds was determined by the present value of the bond's cash flows discounted at the required yield. Valuer B further stated in the report that (Annex 2R) *"… the functional currency is same as the debt currency, the conversion ratio is fixed during the conversion period and the underlying shares represent the Company's shares. Given the aforesaid conditions can be satisfied, the Convertibles may be accounted under the ~~Under the~~ HKAS 32–Financial Instruments: Disclosure and Presentation. Under the HKAS 32 Financial Instruments: Disclosure and Presentation, Convertibles is considered as hybrid securities consisted of debt and equity component. The debt component will be determined first. The balancing amount, which given by <u>netting off debt component from the principal amount</u>, is allocated to the equity component."*(underline added)

6.1.2.10 The valuation report further stated that (Annex 2R) *"With reference to the structure of the Convertibles, it can be observed that there exists an embedded derivative (the "Issuer call option") which falls under the governance of the HKAS 39 Financial Instruments: Measurement and Recognition. However, we have been advised by the Company that the Convertible bond will not be redeemed till maturity … Under this circumstances, the Issuer call option will have no economic value to the Company. As such, the Convertibles will be valued as if the Issuer call option does not exist."*

6.1.2.11 In a document titled "Letter of Confirmation" for the year ended 30 June 2010 (Annex 2S), the Company confirmed that *"We, Aptus Holdings Limited, hereby confirm that the outstanding amount of HK$520,000,000 convertible bond issued on 27 May 2010 will not be redeemed during the next six years from 30 June 2010 until the date of maturity."*

6.1.2.12 The representation letter from the management of the Company (Annex 2L) in the Audit Working Papers did not include any matters relating to the fair value measurement of the Convertible Bonds.

6.1.3 Information and explanation provided by W.H. Tang

6.1.3.1 In its letter dated 31 December 2012 (Annex 3D), W.H. Tang confirmed that the records and documents provided on 19 September 2012 were the complete set of audit documentation and working papers, as defined in the Glossary, in the audit of the measurement of the Convertible Bonds in relation to the Acquisition in the Audit.

6.1.3.2 On 9 January 2013 (Annex 3E), W.H. Tang was further requested to identify its audit documentation in relation to how it satisfied that the Convertible Bonds were accounted for in compliance with paragraph 37 of HKFRS 3 (Revised) (Paragraph 4.1.4) and paragraphs 31 and 32 of HKAS 32 (Paragraphs 4.2.1 and 4.2.2).

6.1.3.3 W.H. Tang stated in its reply letter dated 21 January 2013 (Annex 3F) that *"... the valuation report of convertible bonds clearly stated that: "Our valuation requires consideration of all relevant information that helps to conclude the value of the debt and the equity components of the Convertibles ..." As convertible bonds was split into liability component and equity component and we considered that the fair value of convertible bonds as at the date of acquisition is equal to the total fair value of liability component plus equity component of the convertible bonds in accordance with paragraph*[s] *31 and 32 of HKAS 32. <u>By obtaining assumptions of fair value of convertible bonds as at 27 May 2010 (date of acquisition), we considered that the fair value of convertible bonds was measured in accordance with HKAS 32 and HKAS 39</u> ... By reviewing the assumptions of the valuer in preparing the valuation report, we considered that the assumptions were reasonable and proper in determining the valuation of convertible bonds and we attached the valuation report as supporting documents."*(underline added)

6.2 Conclusions of the AIB

6.2.1 Paragraph 37 of HKFRS 3 (Revised) (Paragraph 4.1.4) requires the acquirer to measure the consideration transferred in a business combination at the acquisition-date fair value.

6.2.2 According to the terms of the Convertible Bonds, they contained three components:

(a) a debt component (i.e. a financial liability represented the Company's contractual obligation to repay the outstanding principal, if not converted);

(b) an equity component (i.e. a written option granting the Convertible Bond holder the right, for a specific period of time, to convert the outstanding principal into a fixed number of the Company's ordinary shares at the stated convertible price); and

(c) a derivative (i.e. a call option granting the Company a right to early redeem the outstanding principal of the Convertible Bonds at par).

6.2.3 According to paragraphs 31 and 32 of HKAS 32 (Paragraphs 4.2.1 and 4.2.2), the fair value of the call option should be included in the liability component, assuming the call option was not accounted for separately, while the equity component should be determined by deducting the fair value of the liability component (including the fair value of the call option) from the fair value of the Convertible Bonds.

Accounting non-compliance

6.2.4 The Company recognized the Convertible Bonds at the principal amount in the 2010 Financial Statements, instead of the acquisition-date fair value, and determined the value of the equity component by deducting the fair value of the liability component from the principal amount of the Convertible Bonds (Paragraphs 6.1.1.2 and 6.1.1.3). Based on the advice of the Company that it would not exercise the call option until maturity, Valuer B determined the fair value of the liability component of the Convertible Bonds as if the call option did not exist (Paragraph 6.1.2.10), which the AIB disagreed. According to AG75 of HKAS 39 (Paragraph 4.3.1), entity specific factor should be relied on as little as possible in determining fair value.

6.2.5 The AIB concluded that the initial measurement of the Convertible Bonds as mentioned in the preceding paragraph was not in compliance with paragraph 37 of HKFRS 3 (Revised) (Paragraph 4.1.4) and paragraphs 31 and 32 of HKAS 32 (Paragraphs 4.2.1 and 4.2.2).

Auditing irregularities

6.2.6 W.H. Tang relied on the valuation report prepared by Valuer B as audit evidence and concurred with the relevant accounting treatment of the Company (Paragraphs 6.1.2.4 and 6.1.2.6). Based on the review of the Audit Working Papers and explanations provided, W.H. Tang did not conduct the Audit in relation to the Convertible Bonds in accordance with HKSAs, the details of which are set out in the following paragraphs.

Planning

6.2.7 The acquisition-date fair value measurement of the Convertible Bonds was inherently imprecise and based on estimates. Reliance on the work of other experts might be needed, such as professional valuer.

6.2.8 W.H. Tang failed to plan the Audit with an attitude of professional skepticism in this respect in accordance with paragraph 15 of HKSA 200 (Revised) (Paragraph 4.4.1) and failed to develop a proper audit plan for the Audit and document the same in this respect in accordance with paragraphs 13, 14 and 22 of HKSA 300 (Paragraphs 4.7.1 to 4.7.3) on the basis that:

(a) it has not prepared an audit plan (which should include the nature, timing and extent of audit procedures to be performed) in relation to the measurement of the Convertible Bonds to ensure that sufficient appropriate audit evidence would be obtained to reduce audit risk (i.e. the risk to express an inappropriate audit opinion when the financial statements were materially misstated) to an acceptably low level; and

(b) whilst it regarded the valuation of the Convertible Bonds as a key risk and planned to obtain a report from a valuer in response to such risk (Paragraph 6.1.2.1), in other planning documents (Paragraph 6.1.2.2), W.H. Tang assessed the Audit as low risk and agreed that the program "Using the work of an expert (Cop06)" was "N/A" (Paragraph 6.1.2.3) in the absence of necessary explanation in the Audit Working Papers.

Sufficiency and appropriateness of audit evidence

6.2.9 Other than obtaining the valuation report on the Convertible Bonds and performing certain audit procedures as documented (Paragraph 6.1.2.5), there was no evidence in the Audit Working Papers in relation to:

(a) the consideration of whether the Convertible Bonds had been measured at the acquisition-date fair values in compliance with paragraph 37 of HKFRS 3 (Revised) (Paragraph 4.1.4) and accounted for in accordance with paragraphs 31 and 32 of HKAS 32 (Paragraphs 4.2.1 and 4.2.2), in particular, the appropriateness of the Company's assumption that the principal amount of the Convertible Bonds equals their acquisition-date fair values;

(b) the consideration of whether the basis of valuation (i.e the embedded call option of the Convertible Bonds did not exist) was in compliance with paragraph AG75 of HKAS 39 (Paragraph 4.3.1) (Paragraphs 6.1.2.10 and 6.1.2.11); and

(c) written representation from the management of the Company regarding the reasonableness of significant assumptions in relation to the fair value measurement of the Convertible Bonds (Paragraph 6.1.2.12).

6.2.10 Therefore, W.H. Tang failed to obtain sufficient appropriate audit evidence to support the conclusion reached in the measurement of the Convertible Bonds in accordance with paragraph 2 of HKSA 500 (Paragraph 4.8.1) and paragraphs 3 and 63 of HKSA 545 (Paragraphs 4.9.1 and 4.9.2).

Using the work of the valuer

6.2.11 The AIB noted that W.H. Tang had placed reliance on the valuation report prepared by Valuer B (Paragraphs 6.1.2.4, 6.1.2.6 and 6.1.3.3). However, there was no evidence in the Audit Working Papers indicating that W.H. Tang had evaluated the professional competence and objectivity of Valuer B, and the appropriateness of the valuation report as audit evidence in relation to the acquisition-date fair value measurement of the Convertible Bonds.

6.2.12 Therefore, W.H. Tang failed to obtain sufficient appropriate audit evidence when using the work of Valuer B as audit evidence in accordance with paragraphs 2, 8, 9, 11, 12 and 15 of HKSA 620 (Paragraphs 4.10.1 to 4.10.6).

Documentation

6.2.13 Alternatively, had W.H. Tang performed the audit procedures and obtained audit evidence as set out in Paragraphs 6.2.6 to 6.2.12 (which the AIB disputed given the lack of audit documentation), W.H. Tang failed to prepare audit documentation that provided a sufficient and appropriate record of the basis for the audit report and evidence that the Audit was performed in accordance with applicable auditing standards in these respects and therefore W.H. Tang failed to observe paragraphs 2 and 9 of HKSA 230 (Paragraphs 4.6.1 and 4.6.2).

Basis of forming audit opinion

6.2.14 In view of the matters set out in Paragraphs 6.2.5 to 6.2.13, W.H. Tang did not obtain sufficient appropriate audit evidence to support the conclusions reached in the measurement of the Convertible Bonds and for the unmodified audit opinion expressed on the 2010 Financial Statements in accordance with paragraphs 11 and 13 of HKSA 700 (Paragraphs 4.11.1 and 4.11.2).

Engagement quality control review

6.2.15 On the basis of the findings in this section, and given the Acquisition was material to the 2010 Financial Statements, it is not unreasonable to expect that the EQCR would select the relevant audit documentation to perform the quality control review. If the EQCR had properly performed his review (Paragraph 5.2.21), in particular, in response to each of the questions asked in the relevant working paper (Paragraph 5.1.2.12), the non-compliances with the financial reporting standards and auditing requirements as mentioned above (Paragraphs 6.2.5 to 6.2.13) should have been identified and addressed. Accordingly, the EQCR did not properly perform his engagement quality control review of the acquisition-date fair value measurement of the Convertible Bonds in accordance with paragraphs 38 and 39 of HKSA 220 (Paragraphs 4.5.1 and 4.5.2).

COE

6.2.16 In light of the above, the Engagement Partner and the EQCR did not comply with section 130.1 of COE (Paragraph 4.12.1) as they did not act diligently in accordance with the applicable technical and professional standards when providing professional services in relation to the Audit in respect of the measurement of the Convertible Bonds in accordance with HKFRS 3 (Revised) and HKAS 32.

6.3 Comments from W.H. Tang, the Engagement Partner and the EQCR

6.3.1 W.H. Tang, the Engagement Partner and the EQCR in their reply letters dated 5 September 2013 (Annex 3G), stated that:

"<u>Accounting non-compliance</u>

... the valuation of convertible bonds was determined by the underlying information available to the valuer, it included the letter of confirmation from the Company to confirm that there is no early redemption of convertible bonds until the day of maturity. In this regard, it was considered that call option did not exist in this scenario. We

considered that the confirmation of the Company was a factual factor should be relied on in determining the fair value of convertible bonds and considered that the initial measurement of the convertible bonds was in compliance with paragraph 37 of HKFRS 3 (Revised) and paragraphs 31 and 32 of HKAS 32.

<u>Auditing irregularities</u>

Planning

As mentioned in our planning memorandum, we also point out that the valuation of convertible bonds was one of our concerns in the engagement and subject to review the valuation report prepared by an independent professional valuer. Therefore, we considered that we plan the engagement in accordance with paragraph 15 of HKSA 200 (Revised) and paragraph 13, 14 and 22 of HKSA 300.

Moreover, we consider that our presentation of working paper in planning should be modified to express clearly our judgement and elaborate our procedures for risk areas in the planning stage. WH Tang will improve its audit manual to ensure the improvement in the futures.

In our audit programme, we considered that there was a clerical error to state "Using the work of an expert" was "N/A".

Sufficiency and appropriateness of audit evidence

As the valuation report of convertible bonds from the valuer was clearly stated that the date of valuation was 27 May 2010 (date of completion of acquisition) and we reviewed the assumptions of valuation reports and satisfied that the principal amounts of the convertible bonds equal their acquisition-date fair values … by obtaining the letter of confirmation from the Company and valuation report from the valuer, we considered that written representation from the management of the Company regarding the reasonableness of significant assumptions in relation to the fair value measurement of the convertible bonds was not necessary.

In this regard, we considered that we obtained sufficient appropriate evidence to support our conclusion reached in the measurement of the convertible bonds in accordance with paragraph 2 of HKSA 500 and paragraph 3 and 63 of HKSA 545.

Moreover, we consider that our presentation of working paper should be modified to express clearly our judgement and elaborate our consideration in obtaining audit evidence. WH Tang will improve its audit manual to ensure the improvement in the futures.

Using the work of expert

… Please be noted that by examining the valuation report, we included to evaluate the professional competence and objectivity of the valuer. We checked the professional competence of the valuer via internet and the objectivity of the valuer was clearly

stated in the valuation report. But we considered that we did not clearly state our evaluation process and comment on the assumptions adopted. Therefore, our audit manuals will be modified to improve the documentation in using the work of an expert.

Documentation

… we considered that a brief documentation was required to state clearly for our audit work performed in complying with the requirements of HKAS 230.

Basis of forming audit opinion

In light of the matters set out in the above, we considered that we obtained sufficient appropriate audit evidence to support the conclusions reached in the measurement of the prepaid lease payments acquired [Convertible Bonds issued] *… and for the unmodified opinion … Please be noted that our opinion was formed based on the underlying audit evidence available to us, if we adopted the finding in the Report* [the Investigation Report]*, we believe that our opinion is required to be modified.*

Engagement quality control review

As EQCR of the engagement, [the EQCR] *performed his engagement quality control review in accordance with the role and responsibilities … In completion of the EQCR worksheet,* [the EQCR] *also discussed with the engagement partner …* [the EQCR] *and then based on the underlying information and concluded that the engagement report was issued.*

Moreover, we considered that except for the EQCR worksheet, any discussion between the engagement partner and EQCR should be properly documented and recorded in the audit file for supporting. Our audit manual will be modified to improve the engagement quality control process in the future.

COE

… in preparing our audit engagement, engagement partner and EQCR are acted diligently in accordance with the applicable technical and professional standards …"

6.4 Response of the AIB to comments from W.H. Tang, the Engagement Partner and the EQCR

<u>Accounting non-compliance</u>

6.4.1 The AIB reiterated that recognition of the Convertible Bonds at their principal amount of HK$850 million at the date of the Acquisition in the 2010 Financial Statements (Paragraph 6.1.1.1) was a non-compliance with paragraph 37 of HKFRS 3 (Revised) (Paragraph 6.2.1) as they were not issued for cash at par.

6.4.2 The AIB noted the comments on the call option as stated in Paragraph 6.3.1. However, the letter of confirmation from the Company merely reflected their intention of not exercising the call option. W.H. Tang should not accept the assumption in the valuation that the call option did not exist in the Convertible Bonds based on the Company's intention.

6.4.3 The AIB upholds its conclusion as set out in Section 6.2.

<u>Auditing irregularities</u>

6.4.4 W.H. Tang's audit planning on the Convertible Bonds was limited to the documentation as set out in Paragraphs 6.1.2 1 to 6.1.2.3. There was no evidence in the Audit Working Papers or other documentation provided by W.H. Tang to support that they had planned the audit of the Convertible Bonds and documented the same according to paragraph 15 of HKSA 200 (Revised) (Paragraph 4.4.1) and paragraphs 13, 14 and 22 of HKSA 300 (Paragraph 4.7.1 to 4.7.3).

In addition, there was no evidence in the Audit Working Papers that W.H. Tang had completed a program or checklist titled *"Using the work of an expert"*.

6.4.5 W.H. Tang accepted the valuation without challenging the appropriateness on assuming that (a) the principal amount of the Convertible Bonds was their acquisition-date fair values (Paragraph 6.1.3.3); and (b) the call option did not exist (Paragraphs 6.1.2.11 and 6.3.1).

6.4.6 The AIB upholds its conclusions as set out in Section 6.2.

6.5 Comments from the Company

6.5.1 In its reply of 2 August 2013(Annex 4F), the Company, represented by Tso Au Yim & Yeung, Solicitors, stated that *"We are further instructed that our client will not express any view on the Report"*.