

## **DISCUSSION OF PAST DISCIPLINARY CASES AGAINST PUBLIC ACCOUNTANTS AND PUBLIC ACCOUNTING ENTITIES**

**20 JANUARY 2012**

### **Introduction**

1. Complaints against public accountants made to ACRA are dealt with under the provisions of Part VI of the Accountants Act (Cap 2). Most of the complaints against the public accountants relate to allegations of improper or dishonourable conduct. This includes (among others) conduct involving a failure to comply with the Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (the Code). This article aims to bring to the notice of the public accountants decisions or rulings extracted from past cases dealt with by ACRA. Part I deals with issues relating to professional conduct and Part II is a summary of the decisions or rulings of two cases which were dealt with by the disciplinary committees and the orders made by the Public Accountants Oversight Committee (PAOC).

### **Part I - Issues Relating to Professional Conduct**

2. Issues relating to professional conduct which were raised in the past include:

- a. *Retention of documents when fees are not paid*

Whether a public accountant can exercise a lien over the documents of his client which are in his possession (because the client has not paid his fees) depends on the facts and circumstances of each case. Generally, it is a private matter between him and his client. However, it would be *improper* to exercise a lien over his client's accounting and other records if it would cause the company and/or its officers to breach section 199 of the Companies Act. Public accountants should seek their own legal advice if they are uncertain whether they may exercise a lien over their clients' documents and/or accounting records, or if their clients question their right to exercise a lien. In addition, public accountants may wish to refer to guidance from ICPAS under Miscellaneous Professional Statement (MPS) 7 *Ownership of Documents and Record* which discusses the issue of lien.

***b. Refusal to release audited financial statements until settlement of fees***

ACRA does not generally intervene in issues pertaining to fee arrangement, timing of billing and settlement and service delivery either between the public accountants or between public accountants and their clients as these are matters based on their contractual arrangement.

However, to avoid the situation where the deliverables are seen as being used as a lien for payment of invoices, ACRA would advise that as a matter of good practice, public accountants should set out clear payment milestones in their contractual agreement with clients and ensure that their clients understand the implication of failure to meet any of these milestones.

***c. Poaching clients of another public accountant who referred work to the public accountant***

Sometimes, a public accountant performs “outsourced” work for another public accountant. If so, the public accountant doing the “outsourced” work is acting as an agent of the public accountant who referred him the work (“principal”). An agent owes fiduciary duties towards his principal.

Occasionally, the client may ask the “agent” public accountant to take over the “outsourced” job from the “principal” public accountant. Before agreeing, the “agent” public accountant should seek the “principal” public accountant’s prior written consent as soon as possible. This is to minimise the risk of breaching his fiduciary duties to his principal. Such breach of fiduciary duties may amount to improper or dishonourable conduct depending on the facts of the case.

***d. Fee disputes***

ACRA has received complaints against public accountants of fee disputes. To reduce such risk of complaints, public accountants should consider specifying their fees in the engagement letter (with any necessary caveats) and getting their client’s written agreement to them.

***e. Independence issues***

A public accountant should avoid situations which would give rise to the impression that his integrity and objectivity might be compromised or impaired when he was performing the role as the auditor. One such situation is accepting an appointment as a director of a company which acquires the

client company (of the public accountant) shortly after the public accountant has ceased to be the auditor of that client company. This could raise question on the objectivity of the audit of the client company's financial statements which may be relied upon to determine the purchase consideration.

The public accountant is also reminded that acting as an auditor of a company in which his or her spouse is a director of the company is a breach of Paragraph 290.136 of the Code<sup>[1]</sup> as it creates a threat to independence which can only be reduced to an acceptable level by removing the individual from the assurance team.

***f. Conduct during practice reviews***

The Code imposes an obligation on public accountants to comply with relevant laws and regulations and to avoid any action that may bring disrepute to the public accounting profession. Failure to observe the Code may result in disciplinary action as provided by the Accountants Act. The Practice Monitoring Programme is established under Part V of the Accountants Act. The appointed reviewers are empowered to request and be provided with such records or documents or information relevant to the practice review. The public accountants are expected to render due assistance to the appointed reviewers during practice reviews and should avoid behaviour unbecoming of the profession such as treating appointed reviewers with disrespect by shouting and using foul language, issuing threats and harassing the appointed reviewers. Such unprofessional behaviour is not consistent with the good reputation of the accountancy profession and discredits the profession.

**Part II - Summary of Past Cases dealt with by the Disciplinary Committee**

3. The Disciplinary Committee completed inquiries of two cases on the conduct of a public accountant and a public accounting entity in 2010. A summary of each case including the background information, charges brought against the respondent, the disciplinary committee's consideration and the resulting order made by the PAOC are provided as below:

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<sup>[1]</sup> Paragraph 290.136 of the Code states that “When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level.”

## Case summary #1

### Background

4. The Respondent was convicted in the Subordinate Courts in Singapore on 3 counts of wilfully, with intent to evade tax, making false entries in his returns of income for the Years of Assessment 1995, 2001 and 2002, which are offences under section 96(1)(b) of the Income Tax Act. He was sentenced to 6 months' of imprisonment and ordered to pay penalty amounting to about S\$75,000. No appeal had been lodged by the Respondent against his conviction and sentence.
5. As the matter relates to the conviction of the public accountant of an offence that involves fraud or dishonesty, it was referred to a Disciplinary Committee (DC) for further investigation pursuant to section 41(8)(b)<sup>[2]</sup> of the Accountants Act (the Act).

### Charges

6. At the formal inquiry, two charges were brought against the Respondent in the alternative, either under section 52(1)(b) of the Act which deals with convictions in Singapore or elsewhere "*of any offence implying a defect in character which makes him unfit for his profession*"; or under section 52(1)(a) of the Act which deals with convictions in Singapore or elsewhere "*of any offence involving fraud or dishonesty or moral turpitude*".

### Consideration

7. The DC was of the view that the charge under section 52(1)(a) had been established in that the Respondent had been convicted in Singapore of offences involving dishonesty and fraud within the meaning of section 52(1)(a) of the Act.

### Decision

8. The PAOC ordered that the Respondent's registration as a public accountant be cancelled and disbursement costs be recovered from the Respondent.

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<sup>[2]</sup> Section 41(8)(b) of the Accountants Act states that "*On the completion of a review under this section, the Registrar shall in a case where the complaint or information relates to the conviction (whether in Singapore or elsewhere) of the public accountant, accounting corporation, accounting firm or accounting LLP concerned of an offence that —*

*(i) involves fraud or dishonesty; or*

*(ii) implies a defect in character which makes the public accountant concerned unfit for his profession,*

*recommend to the Oversight Committee to refer the matter to a Disciplinary Committee for a formal inquiry*".

**Case summary #2**

**Background**

9. The Respondent was the auditor of a company (which was in the business of operating a pub) for three financial years (FY) ended 31 December 2001, 2002 and 2003. During the relevant years, the company's finance manager misappropriated over S\$1 million through teeming and lading. She delayed banking in cash on the day of sales into the company's bank account, and instead used the cash for her benefit. To make up for the resulting shortfall, she banked in an equivalent amount of cash subsequently which the company had collected from later sales. However, the Respondent still issued unqualified audit reports for the company's financial statements for FY2001 and FY2002. The audit for FY2003 was started but not completed as the company had appointed new auditors in place of the Respondent.
10. The company filed a civil suit claim against the Respondent in the High Court. Ultimately, the Court of Appeal ruled that the Respondent had been negligent in conducting its audit. In arriving at its decision, the Court of Appeal held that statutory auditors had a duty to be alive to the possible existence of fraud and to discharge their obligations with reasonable care. Yet, the Respondent had not recognised from "striking facts" that something was amiss. For example, there appeared to be a significant increase in cash sales (supposedly not yet deposited into the company's bank account and still remaining on the company's premises) to about \$672,000/- at FY ended 2003 compared to around \$148,000/- for FY ended 2001 and approximately \$160,000/- for FY ended 2002. In addition, this \$672,000 comprised 68 cash sale (CFS) items. But the company banked in its cash sales twice a week. Hence, there should have been at most 4 CFS items (i.e. 4 days worth of cash sales) at FY ended 2003. Nevertheless, the Respondent neither raised these issues with the company's management nor took any further steps to investigate them. But the Court of Appeal also found the company to have been contributorily negligent and reduced the damages which the Respondent had to pay to the company by 50%.
11. The company lodged a complaint against the Respondent to the Registrar of Public Accountants. The matter was referred to a Complaints Committee which recommended that the case be referred to a DC for a formal inquiry.

Charges

12. The charges formulated against the Respondent in the proceedings before the DC were, in respect of the FY2002 audit, that:
- a. the Respondent failed to communicate material weaknesses in the design or operation of the accounting and internal control systems of the company which came or ought to have come to its attention and therefore failed to comply with *SSA 6 Risk Assessments and Internal Control*; and
  - b. the Respondent did not perform the audit with an attitude of professional scepticism commensurate with the risks present or at all and have therefore failed to comply with *SSA 240 The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements*; and

by reason of the above the Respondent had omitted to do something which, if omitted to be done by a public accountant, would be regarded as being improper conduct that would bring the profession of public accountancy into disrepute within the meaning of section 53(1)(b) of the Accountants Act.

Consideration

13. The DC found that the two charges filed by ACRA against the Respondent have been fully substantiated. In making its recommendations, the DC, amongst other things, took into account the following:
- a. The fact the finance manager could misappropriate such a significant sum of money clearly meant there were control weaknesses within the company.
  - b. For a basically cash business like that of the company, 10 days' of revenue from sales not banked-in as at 31 December 2002<sup>[3]</sup> (which the Respondent was aware of) constituted weaknesses in control that the Respondent should have communicated to the company's management.
  - c. The use of purely substantive procedures without performing any test of controls does not remove the need for auditors to communicate material weaknesses that they become aware of to the company's management.
  - d. The term "uncredited lodgements" (contrary to the Respondent's view of the term) normally refers to cheque deposited into the bank account but not yet cleared by the bank and would appear on the bank reconciliation statement as

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<sup>[3]</sup> Based on the Respondent's view that "uncredited lodgements" meant money not yet deposited into the bank.

outstanding deposit. Money received but not banked-in should have been included as part of cash balance and should not have appeared on the bank reconciliation statement. The fact that money received was accounted for as outstanding “uncredited lodgements” should have caused the Respondent to exercise greater professional scepticism in its approach to the audit of cash and bank balances.

- e. The Respondent had adopted the approach of auditing the money received but not banked-in in the same manner as cheques deposited but not cleared by tracing these amounts to clearance in subsequent bank statements. A more appropriate audit approach would be to count the money received but not banked-in and by performing such a cash count, any missing amount could have been detected.

#### Decision

14. The PAOC ordered the Respondent to ensure that, for a period of 12 months, the work of the public accountant responsible for the audit of the company, be reviewed by another public accountant before he signs off on any audit engagement and to pay costs and expenses of and incidental to the disciplinary proceedings against it.

#### Conclusion

15. In conclusion, ACRA would like to remind public accountants of the need to not only comply with the legal and regulatory requirements of the profession but also to conduct themselves professionally when dealing with their clients and other third parties and to avoid improper conduct that would bring the profession of public accountancy into disrepute.