



COURT ORDERS EY TO PRODUCE ACCOUNTING RECORDS TO SFC

Introduction

The Court of First Instance (the **Court**) has ordered Ernst & Young (**EY**) to produce to the Securities and Futures Commission (**SFC**) specified accounting records relating to its work as the reporting accountant and auditor on the failed listing application of Standard Water Limited (**Standard Water**). The order relates to EY's failure to comply with nine separate notices seeking production of these documents as part of an SFC investigation into the failed listing issued by the SFC under s183 of the Securities and Futures Ordinance (**SFO**).¹

EY had previously refused to hand over the records as requested, claiming that it was prevented from doing so by restrictions under PRC law. It claimed that according to a joint statement issued by PRC authorities on 20 October 2009, accounting records and audit working papers may be the subject of claims of state secrecy under PRC law and that it would therefore require the consent of relevant Mainland authorities to hand over accounting records to the SFC, even if the records are kept in Hong Kong.

Case background

Standard Water applied for listing to the Stock Exchange of Hong Kong (**SEHK**) in November 2009. Although the engagement contract was entered into by EY, the field work for the audit was conducted by its Mainland joint venture partner, Ernst & Young Hua Ming (**EYHM**). In March 2010, EY

suddenly informed the SEHK of its resignation as reporting accountants and auditors of Standard Water upon discovery of inconsistencies in documentation provided by the company. Shortly afterwards, Standard Water withdrew its listing application. The SFC then started an investigation into whether any market misconduct or offences under sections 277, 298 and 384 SFO (the civil and criminal offences for disclosure of false or misleading information) had been committed in relation to the listing application.

The SFC commenced proceedings² against EY in 2012 to compel production of the accounting records after EY failed to produce them. The SFC also sought assistance from the relevant Mainland authority to compel EYHM to produce the documents. EYHM also failed to produce the documents.



¹ Under s 183 of the SFO, the SFC is empowered to request information from persons whom it believes may have information relevant to an investigation.

² The SFC invoked s 185 of the SFO, which empowers the Court to inquire into the circumstances of non-compliance and to order compliance with the SFC's request if it is satisfied that the person does not have any reasonable excuse for not complying.

Court order to produce accounting records

The Court order for EY to produce the accounting records was handed down on 23 May 2014. EY's argument that it was prevented from producing the documents by PRC state secrecy laws was rejected by the Court; the Hon Mr. Justice Ng described the argument as "a complete red herring". Both PRC law experts agreed that the relevant regulation "does not impose a *blanket* prohibition on cross-border transmission of audit working papers to overseas securities regulatory authorities – such transmission is permissible if prior approval from the relevant government departments has been obtained". The court found that whether the audit working papers constituted State or commercial secrets depended entirely on their contents. The papers were not however produced to the court and had not been seen by the PRC law experts: the court thus concluded that EY could not establish to the court's satisfaction that the papers contained State or commercial secrets which would prohibit their transmission to EY in Hong Kong. Since the relationship between EY and EYHM was one of principal and agent, EYHM had "a duty to produce to EY all books and documents ... relating to the audit field work".

The court ordered EY to produce the relevant documents to the SFC within 28 days (or within such other period as agreed between the parties) and to pay the SFC's costs.

companies and would require them instead to team up with one of the top 100 Mainland accounting firms who would conduct the audit. The international firm will however be required to sign off on the accounts and take responsibility for any auditing failures of the Mainland partner. The rules will also require strict compliance with PRC State secrets laws and prohibit audit papers from being taken out of the Mainland.



Concerns over Ministry of Finance reforms

The ruling in the EY case has led to concerns that the Ministry of Finance will speed up implementation of planned reforms to prohibit Hong Kong and other international accountants from working on the Mainland. The proposed rules would prohibit international firms from sending staff to audit Mainland

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