

NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS ACT 1996

IN THE MATTER of the New Zealand Institute of Chartered Accountants Act 1996 and the Rules made thereunder

AND

IN THE MATTER of **BYRON JOHN WATSON PEARSON**, Chartered Accountant, of Ashburton

**DETERMINATION OF THE DISCIPLINARY TRIBUNAL OF THE NEW ZEALAND
INSTITUTE OF CHARTERED ACCOUNTANTS
24 November 2010**

Hearing: 24 November 2010

Tribunal: Mr RJO Hoare (Chairman), Prof D Macdonald, Mr P Scott and Ms A Hauk-Willis (lay member)

Legal Assessor: Mr B Corkill QC

Counsel: Mr T Sissons
Mr R Raymond and Mr G Pearson for Mr Pearson

The hearing was held in public. The member was in attendance and represented by counsel. The charges and particulars were amended with the consent of the member. The member admitted the amended particulars and pleaded guilty to the amended charges.

The amended charges and amended particulars were as follows:

FIRST CHARGE

- (1) In performing the audit of the financial statements of South Canterbury Finance Limited for the six months ended 31 December 2008, you breached Rule 11 of the Code of Ethics by failing to comply with Auditing Standards which require auditors to plan and perform the audit with an attitude of professional scepticism.

Particulars

In breach of paragraph 50 of AS-100 *Objectives of and General Principles Governing an Audit*, you failed to perform the audit with an attitude of professional scepticism, in that you accepted assertions from South Canterbury Finance Limited's management that no collective provision for doubtful debts was required, when there was information available to you which indicated that a collective provision and/or a discount to future cash flows expected from some larger debtors was warranted.

SECOND CHARGE

- (2) In performing the audit of the financial statements of South Canterbury Finance Limited for the six months ended 31 December 2008 you breached Rule 11 of the Code of Ethics by failing to comply with Auditing Standards which require you to: (a) assess whether the aggregate of uncorrected misstatements that have been identified during the audit is material; (b) evaluate sample results; and (c) document your findings.

Particulars

- (a) In breach of paragraph 19 of AS-304 - *Audit Materiality* you failed to assess whether the aggregate of uncorrected misstatements relating to potential provisions required on individual loans that were identified during the audit was material; and/or
- (b) In breach of paragraph 36(b) of AS 506 – *Audit Sampling* you failed to project the uncorrected misstatements relating to potential provisions required on individual loans over the population of the loan book and to consider the effect of that projection on the collectability of the loan book; and/or
- (c) In breach of paragraph 8 of AS-204 – *Documentation* you failed to document the audit procedures performed in relation to uncorrected misstatements, the results of the audit procedures and the conclusions drawn from the audit evidence obtained.

THIRD CHARGE

- (3) In performing the audit of the financial statements of South Canterbury Finance Limited for the six months ended 31 December 2008 you breached Rule 11 of the Code of Ethics by failing to comply with Auditing Standards which require you to document matters important in providing evidence to support the audit opinion and evidence that the audit was carried out in accordance with the Auditing Standards.

Particulars

In breach of paragraph 8 of AS-204 – *Documentation*, you:

- (a) Failed to document your conclusions in relation to the recognition and valuation of the hedging asset of \$48m disclosed in note 12 of the financial statements; and/or
- (b) Failed to document your conclusions as to whether the swap transactions referred to in two letters from BNZ dated 1 April 2008 were appropriately reflected in the financial statements as at 31 December 2008; and/or
- (c) Failed to adequately document the basis for concluding that related party transactions did not breach the 35% exposure threshold referred to in clause 16.1(d) of the South Canterbury Finance Limited Trust Deed.

FOURTH CHARGE

- (4) In performing the audit of the financial statements of South Canterbury Finance Limited for the six months ended 31 December 2008 you breached Rule 11 of the Code of Ethics by failing to comply with Auditing Standards which require auditors to satisfy themselves that identified related party transactions have been properly disclosed.

Particulars

In breach of paragraph 18 of AS-510 – *Related Parties* you failed to satisfy yourself that the related party transactions detailed at note 24 of the financial statements had been properly disclosed when the note did not disclose the amount of the transactions between Hornchurch Limited and South Canterbury Finance Limited, as required by paragraph 17(a) of NZIAS 24 – *Related Party Disclosures*.

FIFTH CHARGE

- (5) In signing an unqualified audit opinion on the South Canterbury Finance Limited financial statements for the six months ended 31 December 2008 you breached Rule 9 of the Code of Ethics by failing to exercise due care and diligence in relation to your assessment of the financial statements of the company.

Particulars

The audit opinion asserted that the financial statements complied with generally accepted accounting practice in New Zealand when the financial statements:

- (a) Recorded the figures of \$114,485,000 as interest received in the income statement and cash flow statement, which did not take into account any adjustments for capitalised interest; and/or
- (b) Failed to include the element of capitalised interest included in the interest received figure of \$114,485,000 as a non cash item in note 3 of the financial statements.

DECISION

This case involves a widely known public issuer, South Canterbury Finance, and involves issues of public accountability, and the standing and reputation of the profession and the Institute.

The member lacked the required depth of experience and expertise of auditing in the finance industry, and the professional skepticism, to undertake an audit of the nature and complexity of South Canterbury Finance. This was exacerbated by the prevailing economic circumstances.

The above charges essentially relate to the member's following deficiencies:

- his lack of professional scepticism and experience in reviewing loan values in an environment where there had been a substantial and rapid decline in asset values;
- his failure to adequately document the audit process and his findings, including aggregating the unadjusted misstatements; and
- his failure to identify disclosure deficiencies within the financial statements where they would have been identified under normal audit circumstances.

The member informed the Tribunal that he had attempted, without success, to obtain the assistance of an independent New Zealand based auditor to act as the second partner reviewer on the audit.

The Tribunal accepts the member's assurance that he has no intention of auditing a financial institution in future.

Counsel for the member questioned the costs sought by the Professional Conduct Committee on the grounds that:

- there should be no GST payable (refer below);
- there should be no inclusion of Institute staff costs;
- there is precedent from other Tribunals whose considerations start at 50% of actual costs.

The Tribunal considers that there is no difference between the Institute's costs incurred in a specific investigation, regardless of whether they are incurred by an external consultant or an Institute staff member.

Historically the Tribunal has started with 100% of costs, noting that the Institute already bears the cost of abandoned investigations and costs up to the Professional Conduct Committee's decision to hold a Final Determination.

The reasons why the Tribunal might award less than full costs include:

- charges, particulars and evidence not proven and/or withdrawn;
- excessive or unnecessary expenses incurred; and
- demonstrated evidence of hardship i.e. inability to pay.

The Tribunal finds that none of these mitigating circumstances apply in this case.

Member's counsel asserted that the Institute was incorrect in charging GST on costs awarded by the Tribunal. As the GST registered entity it is for the Institute to determine what GST if any should be charged and the Tribunal make no findings in this regard.

PENALTY

Pursuant to Rule 21.31 (k) of the Rules of the New Zealand Institute of Chartered Accountants the Disciplinary Tribunal ordered that **Byron John Watson Pearson** be censured.

Pursuant to Rule 21.31 (n) of the Rules of the New Zealand Institute of Chartered Accountants the Disciplinary Tribunal ordered that **Byron John Watson Pearson** not undertake the audit of an issuer as defined in section 4 of the Financial Reporting Act 1993 for a period of five years from the date of this decision, save that he may continue to audit Company A, Company B, Company C and Company D on the condition that a pre-signing external quality control review be carried out by a member approved by the New Zealand Institute of Chartered Accountants.

COSTS

Pursuant to Rule 21.33 of the Rules of the New Zealand Institute of Chartered Accountants the Disciplinary Tribunal ordered that **Byron John Watson Pearson** pay to the Institute the sum of \$38,000 (plus GST if any) in respect of the costs and expenses of the hearing before the Disciplinary Tribunal, the investigation by the Professional Conduct Committee and the cost of publicity.

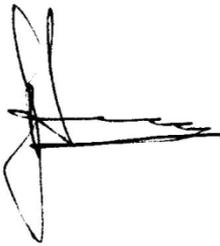
PUBLICATION

In accordance with Rule 21.35 of the Rules of the New Zealand Institute of Chartered Accountants the decision of the Disciplinary Tribunal shall be published on the Institute's website, in the Chartered Accountants Journal and the Christchurch Press with mention of the member's name and locality.

RIGHT OF APPEAL

Pursuant to Rule 21.41 of the Rules of the New Zealand Institute of Chartered Accountants which were in force at the time of the original notice of complaint, the member may, not later than 14 days after the notification of this Tribunal to the member of the exercise of its powers, appeal in writing to the Appeals Council of the Institute against the decision.

No decision other than the direction as to publicity shall take effect while the member remains entitled to appeal, or while any such appeal by the member awaits determination by the Appeals Council.

A handwritten signature in black ink, appearing to read 'R J O Hoare'. The signature is stylized with a large, looped initial 'R' and a horizontal line extending to the right.

R J O Hoare
Chairman
Disciplinary Tribunal