

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
(THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO)
THE CHARTERED ACCOUNTANTS ACT, 2010

DISCIPLINE COMMITTEE

IN THE MATTER OF: Allegations against **DAVID JAMES HORSLEY, CPA, CA**, under **Rule 201.1** and **Rule 202.1** of the Rules of Professional Conduct, as amended.

TO: Mr. David J. Horsley

AND TO: The Professional Conduct Committee

REASONS
(Decision and Order made August 16, 2016)

1. This tribunal of the Discipline Committee met on August 16, 2016 to hear allegations of professional misconduct brought by the Professional Conduct Committee against David James Horsley, a member.

2. Mr. Paul Farley appeared on behalf of the Professional Conduct Committee (PCC). Mr. Horsley was not represented by counsel and did not attend. Mr. Glenn Stuart attended the hearing as counsel to the Discipline Committee.

Proceeding in Mr. Horsley's absence

3. Mr. Farley filed the Affidavit of Katya Shtrachman, sworn August 15, 2016 (Exhibit 1) that deposed that the allegations had been properly sent to Mr. Horsley on May 26, 2015, and that Mr. Horsley had acknowledged receipt of Mr. Farley's correspondence and the allegations.

4. Mr. Farley filed the Affidavit of Diane Williamson, sworn August 16, 2016, (Exhibit 2) in which Ms. Williamson stated that on June 13, 2016 her assistant sent the notice of hearing to Mr. Horsley by email, for which she received confirmation of receipt and also mailed a copy by regular mail to the last known mailing address of Mr. Horsley. On August 15, 2016, an email was received by Ms. Williamson and others from Mr. Horsley, acknowledging receipt of the Notice of Hearing and noting that he would not be in attendance at the hearing and would not be represented by counsel or other agent.

5. The tribunal determined on the basis of this evidence that Mr. Horsley had received proper notice of the hearing and decided to proceed in his absence.

6. The decision of the tribunal was made known at the conclusion of the hearing on August 16, 2016, and the written Decision and Order was sent to the parties on August 18, 2016. These reasons, given pursuant to Rule 20.04 of the Rules of Practice and Procedure, include the allegations, the decision, the order, and the reasons of the tribunal for its decision and order.

Allegations

7. The following allegations were made against Mr. Horsley by the Professional Conduct Committee on May 21, 2015:

1. THAT, the said David J. Horsley, in or about the period October 1, 2005 through April 30, 2012, while employed as Senior Vice President and Chief Financial Officer of Sino-Forest Corporation, failed to maintain the good reputation of the profession and its ability to serve the public interest, contrary to Rule 201.1 of the Rules of Professional Conduct, in that he conducted himself in a fashion which contravened the Securities Act R.S.O. 1990, c. S.5 as described in the Settlement Agreement attached as "Schedule A".
2. THAT, the said David J. Horsley, in or about the period October 1, 2005 through April 30, 2012, while employed as Senior Vice President and Chief Financial Officer of Sino-Forest Corporation, failed to perform his professional services with due care, contrary to Rule 202.1 of the Rules of Professional Conduct in that he did not exercise the skill, care and diligence reasonably expected of a person in his position as described in the Settlement Agreement attached as "Schedule A".

(*document not attached)

Plea

8. A plea of not guilty to the allegations was entered on Mr. Horsley's behalf.

Background and Submissions of the PCC

9. Mr. Farley submitted that the facts in the case for the PCC are contained in Schedule A to the allegations. Mr. Horsley had signed the Settlement Agreement with the Ontario Securities Commission (OSC) as being accurate and true. Under Rule 201.2, there is a rebuttable presumption that a member has failed to maintain the good reputation of the profession and its ability to serve the public interest when the member is the subject of a matter referred to in Rule 102.1. In the case of Mr. Horsley, Rule 102.1(d) would apply as Mr. Horsley entered into a Settlement Agreement (SA) with the OSC. In his position as Senior Vice-President and Chief Financial Officer of Sino-Forest Corporation, Mr. Horsley did not exercise due care in the performance of his professional services, as required under Rule 202.1. Mr. Farley submitted that for seven years as VP and CFO, Mr. Horsley had completely abdicated his professional duties.

10. Mr. Farley filed an Affidavit of Scott Porter, CPA, CA, IFA, CFF (Exhibit 3) who had been appointed as the investigator of the PCC to review the file pertaining to Mr. Horsley. Mr. Porter's report stated that Mr. Peter Wardle, legal counsel for Mr. Horsley, had advised that Mr. Horsley had entered into a SA with the OSC in June 2014, and was self-reporting the matter to CPA Ontario. Subsequent correspondence from Mr. Wardle confirmed that Mr. Horsley did not intend to contest the facts admitted to in the OSC SA. Mr. Farley submitted that the facts in the SA could be relied on by the tribunal.

11. By way of background, Mr. Farley stated that Sino-Forest was a reporting issuer in

Ontario whose common shares were listed on the Toronto Stock Exchange. From 2003 to 2010, Sino-Forest raised approximately \$3.0 billion (USD) from the issuance of equity and debt securities to investors. From June 2006 to March 2011, Sino-Forest's share price grew from \$5.75 (CAD) to \$25.30 (CAD), and by March 31, 2011, the company's market capitalization was over \$6 billion (CAD). In June 2011, the share price plummeted after a private analyst released a report making allegations of fraud against Sino-Forest.

12. In August 2011, the OSC issued an order that all trading activities of Sino-Forest cease temporarily. On the day Sino-Forest was required to file audited financial statements with the OSC, the company initiated proceedings in the courts requesting protection from its creditors. The 2011 audited financial statements were never filed with the OSC. In April 2012, the auditors of Sino-Forest resigned and in May 2012, TSX delisted the shares of Sino-Forest. In March 2013, all outstanding shares of Sino-Forest were cancelled.

13. Mr. Farley stated that Mr. Horsley was the CFO and Senior VP for Sino-Forest during the material time. Mr. Horsley had started his association with Sino-Forest in 2004 when he was appointed as an independent director on the Board, and soon after his appointment, became a member of the audit committee. Mr. Horsley was then appointed as Senior Vice-President and Chief Financial Officer (CFO) of the company effective October 10, 2005 and resigned from the Board of Directors on or about that date.

14. As CFO, Mr. Horsley was responsible for the oversight of all financial aspects of the company, and had ultimate responsibility for the integrity of Sino-Forest's financial reporting and internal controls and for ensuring that any material internal control weaknesses were properly disclosed to the investing public in accordance with the *Securities Act*.

15. Mr. Horsley did not speak or read any Chinese dialects, nor did he reside in China or Hong Kong; however, he did spend on average two weeks per quarter at Sino-Forest's offices in Hong Kong.

16. In order to fulfill his duties, Mr. Horsley needed to have requisite first-hand knowledge of the business and operating environment of Sino-Forest, including knowledge of major suppliers and customers (referred to as Authorized Intermediaries - AIs) to ensure the legitimacy of transactions. He needed to know how the Sino-Forest companies acquired their assets and generated revenue. Mr. Horsley admitted that he did not acquire the requisite knowledge of the business or its operating environment. Consequently, financial reports to the OSC were misleading, resulting in breaches of the *Securities Act* and contrary to the public interest.

17. From 2007 to 2010, Sino-Forest had reported standing timber revenue (a term used for the plantation fiber component of the company's business) totaling about \$3.6 billion, which represented 75% of its total revenue. According to the Sino-Forest Disclosure, standing timber was purchased, held and sold in two distinct subsidiary models – British Virgin Islands companies (BVI), and Wholly Foreign-Owned Enterprises (WFOE).

18. In the BVI Model, the associated cash flow took place pursuant to an offsetting arrangement whereby BVI would not directly receive or pay out cash for sales or purchases but offsetting settlement arrangements were made with AIs. Sino-Forest had no bank records to confirm that cash flow in the offsetting arrangements actually took place in the BVI Model. In 2010 for example, in terms of materiality, in the BVI Model six key suppliers accounted for 100% of the standing timber purchases, and five key customers accounted for 100% of the revenue. At December 31, 2010, the BVI Model held about 80% or \$2.5 billion in standing timber.

19. The BVI Model entered into written purchase contracts and sales contracts with AIs and most of these contracts were written in a Chinese dialect. This meant that independent confirmation of these reported cash flows was dependent on the good faith and independence of the major suppliers and major customers. Mr. Horsley did not gain the required understanding of the nature of these transactions nor did he have the knowledge to identify material non-arm's length transactions. He did not ensure the requisite documentation was obtained to establish proof of corporate ownership for its standing timber assets in the BVI Model.

20. The WFOEs were established to buy, grow and sell the standing timber. Sino-Forest entered into purchase and sale contracts with other parties in China. Cash flow from these transactions could be traced to the WFOEs' bank statements.

21. Although Mr. Horsley was aware that the assets and revenue in the BVI Model were more significant than that of the WFOE Model, and that the risk profiles were materially different, the risk profiles were not fully disclosed to the public.

22. Mr. Horsley admitted that he had inadequate first-hand knowledge during the material time, about the operations, legitimacy and substance of the AIs of Sino-Forest, other than what was conveyed to him by overseas management located in China. Mr. Horsley admitted that his lack of first-hand knowledge fell below what was expected of him as CFO of Sino-Forest and was contrary to the public interest.

23. Without Mr. Horsley's knowledge, employees of Sino-Forest utilized improper and misleading quarterly documentation processes in the BVI Model whereby purchase contracts were not drafted and executed until the quarter after the purported purchases were recorded in the Sino-Forest disclosure. Confirmations were also created and improperly backdated to the previous quarter by Sino-Forest. Mr. Horsley acknowledged that the purchase contracts did not constitute sufficient proof of ownership of the standing timber for public disclosure or financial reporting purposes, and that the contracts and reports did not adequately identify the location of the standing timber so that the existence of the timber could be verified or valued independently.

24. Mr. Horsley never reviewed a translation of the purchase or sales contracts, all of which were written in Cantonese, and, therefore, he was not aware if harvesting rights were recognized or not in the confirmations.

25. Mr. Horsley's failure to exercise the skill, care and diligence required of him as CFO, permitted Sino-Forest to make materially misleading disclosure contrary to the *Securities Act*. The concentration of control in the hands of overseas management facilitated the fraudulent course of conduct of BVI.

26. Although there is no indication that Mr. Horsley was aware of or participated in any fraud, he agreed that as CFO he should have applied additional diligence before accepting representations from the overseas management and certifying annual and interim filings to the OSC that were materially misleading.

27. As CFO, Mr. Horsley should have had first-hand knowledge of how Sino-Forest would acquire, hold and ultimately sell the timber. He could not have known whether the financial disclosure was accurate when it referred to the purported harvesting of timber, or whether actual harvesting took place. Mr. Horsley's failure to make enquiries contributed to the misleading

disclosure being made by Sino-Forest, contrary to the *Securities Act* and the public interest.

28. As a term of the SA with the OSC, Mr. Horsley is permanently prohibited from becoming or acting as a director or officer of an investment fund manager, registrant or promoter.

29. Mr. Farley submitted that the facts contained in the SA of the OSC contain clear, cogent and compelling evidence to prove the allegations under Rules 201.1 and 202.1, and that Mr. Horsley should be found guilty of the professional misconduct alleged. Mr. Farley submitted that Mr. Horsley exhibited a complete lack of due care and had abdicated his role as CFO of the company. Mr. Horsley entered into a SA with the OSC and in that agreement admitted his breach of the *Securities Act*.

30. Mr. Farley stated that the facts are clear and convincing in the SA with the OSC, and throughout that document Mr. Horsley admitted his failure to exercise due care in the performance of his duties as CFO.

The Decision

31. The tribunal found, on the uncontested evidence, that the allegations had been proven. After deliberating, the tribunal announced the following decision:

THAT having determined to proceed with the hearing in the absence of Mr. Horsley, being satisfied that he had proper notice of the hearing, and having entered on his behalf a plea of not guilty to the Allegations, and having seen and considered the evidence, the Discipline Committee finds David James Horsley guilty of Allegation Nos. 1 and 2 of professional misconduct.

Reasons for Decision

32. Having seen and considered the evidence provided on behalf of the PCC, the tribunal concluded that the evidence was clear, cogent and compelling and was sufficient to prove the allegations on a balance of probabilities.

33. Mr. Horsley is a well educated professional having earned a Bachelor of Arts degree, professional memberships in CPA Ontario, the Institute of Chartered Business Valuators, and designations as a corporate finance specialist and a chartered director. In spite of these qualifications he failed to discharge his professional responsibilities as CFO of Sino-Forest for over six years. Prior to joining Sino-Forest, Mr Horsley had no prior experience as an officer, director or employee of a forestry company, nor did he have any Chinese business experience.

34. During the period of the company's rapid growth, between 2005 and 2011, Mr. Horsley failed to ensure that proper internal financial controls were developed, implemented and monitored. As a result, financial reports were filed with the OSC and made available to the public, which were found to be materially misleading. He relied on the representations of senior officers of the company without considering the plausibility or veracity of their representations, and this lack of reasonable care led to filings containing material misstatement of financial data.

35. As a result of its investigation of Sino-Forest, the OSC determined that during the relevant time period, Mr. Horsley, as CFO and Senior Vice-President, was obliged to acquire the requisite knowledge of the operations of Sino-Forest to be able to certify to the OSC that

various internal control and other operating procedures were in place to ensure the financial information and other reporting requirements were, in all material respects, accurate and presented fairly the financial position and results of operations of the company. Mr. Horsley agreed that he did not have the requisite knowledge and did not monitor the effectiveness of the controls and procedures to ensure the accuracy of the company's reports. Mr. Horsley failed to exercise due professional care and diligence in his capacity as CFO.

36. The OSC found that Mr. Horsley did not explore the details as to how business was conducted and, therefore, he did not know the basics of the company's business cycle, nor was he aware that material transactions were being improperly recorded. Mr. Horsley failed to ensure that business activities were recorded properly in the accounts of the company over a long period of time, thereby failing to discharge his professional obligations to the company, the OSC and investors.

37. Mr. Horsley certified the Management Discussion and Analysis information annually; however, he agreed with the OSC that he did not do the requisite review and enquiry required to prepare the report. As a result, material weaknesses in internal financial controls and procedures and the impact of these weaknesses on Sino-Forest's financial reporting were not properly reported to the OSC or investors. Corporate information filed with the OSC and available to investors was materially misleading.

38. Mr. Horsley admitted that in order to report on the procedures and controls in place to enable him report on corporate and financial matters to the OSC and stakeholders he must have a detailed knowledge of the business, how business was conducted, how sales and purchases were made, and how assets were acquired, accounted for and safeguarded. In summary, he was required to understand and monitor the whole business cycle of the company and its subsidiaries. He was required to understand how Sino-Forest conducted its business in sufficient detail to enable him to assess the risks associated with the conduct of Sino-Forest's business, and he failed to do so.

39. The tribunal found that Mr. Horsley's actions, considered in all of these circumstances, undermined the good reputation of the profession and therefore constituted professional misconduct.

Sanction

40. Mr. Farley filed no additional evidence on sanction. Mr. Farley, on behalf of the PCC, submitted that an appropriate sanction in this matter would be the following: a written reprimand from the chair of the tribunal; a fine in the amount of \$75,000; suspension of membership for a period of two years, and full publicity, including publication in *The Globe and Mail* with the costs of the newspaper publication being borne by Mr. Horsley. The PCC also sought an order for costs equal to approximately two-thirds of the costs incurred in the investigation and prosecution of these allegations.

41. Mr. Farley submitted that Mr. Horsley, who was in a position of trust in a publicly traded company, avoided his responsibilities and closed his eyes to what went on in the company. The sanctions proposed by the PCC appropriately deal with the principles of general and specific deterrence. There is no suggestion of fraud on the part of Mr. Horsley, but the sanctions must address the seriousness of the misconduct.

42. Mr. Farley stated that the aggravating factors included the following: while Mr. Horsley was the CFO of Sino-Forest for a period of seven years, there was a major audit failure; he did not perform his duties in a competent manner and did not take steps to perform due diligence; and, Mr. Horsley failed to attend the discipline hearing and face his peers.

43. Mr. Farley stated that the mitigating factors included that Mr. Horsley cooperated with the OSC and entered into an agreement, thereby owning up to his actions. In addition, he has already suffered financially through the OSC and civil litigation with costs of approximately \$700,000.

44. Mr. Farley submitted that there are no other precedent cases involving fraud within a company where the CFO ignored his responsibilities over an extended period of time. Mr. Farley distributed the *Barrington, Power and Russo* case, noting that this involved a fraud within a company where the auditors failed to obtain sufficient audit evidence.

45. Mr. Farley submitted that the fine recommended of \$75,000 will act as a general deterrent to other members.

46. Mr. Farley filed a Costs Outline (Exhibit 4) showing the costs were approximately \$10,000 as an investigation had not been necessary in this case. The PCC was seeking two-thirds of this amount.

Order

47. After deliberating, the tribunal made the following order:

IT IS ORDERED in respect of the Allegations:

1. THAT Mr. Horsley be reprimanded in writing by the Chair of the hearing.
2. THAT Mr. Horsley be and he is hereby fined the sum of \$75,000, to be remitted to the Chartered Professional Accountants of Ontario ("CPA Ontario") within one (1) month from the date this Decision and Order is made.
3. THAT Mr. Horsley's membership in CPA Ontario be and it is hereby revoked.
4. THAT notice of this Decision and Order, disclosing Mr. Horsley's name, be given in the form and manner determined by the Discipline Committee:
 - (a) to all members of CPA Ontario; and
 - (b) to all provincial bodies;and shall be made available to the public.
5. THAT notice of the revocation of membership, disclosing Mr. Horsley's name, be given by publication on the CPA Ontario website and in *The Globe and Mail* and the *Financial Post*. All costs associated with the publication shall be borne by Mr. Horsley and shall be in addition to any other costs ordered by the committee.
6. THAT Mr. Horsley surrender all certificates issued by CPA Ontario or its

predecessor, including any membership certificate granting the Chartered Accountant (CA) and Chartered Professional Accountant (CPA) designation, to the Adjudicative Tribunals Secretary within ten (10) days from the date this Decision and Order is made.

IT IS FURTHER ORDERED:

7. THAT Mr. Horsley be and he is hereby charged costs fixed at \$7,000, to be remitted to CPA Ontario within one (1) month from the date this Decision and Order is made.

Reasons for Sanctions

48. In ordering the sanctions, the tribunal took into consideration several aggravating and mitigating factors.

49. The most serious aggravating factor was that Mr. Horsley did not discharge his professional duties to his employer and the investing public with the competence expected of a CPA. This was a major financial collapse of a public company, and Mr. Horsley's professional misconduct occurred over a sustained period of nearly seven years. Mr. Horsley did not attend this discipline hearing, suggesting indifference to the allegations laid against him.

50. Mitigating factors were that Mr. Horsley reported to CPA Ontario that he was being investigated by the OSC and kept CPA Ontario apprised of those proceedings. In 2011, Mr. Horsley recognized that a Hong Kong based CFO would be better for the company and tendered his resignation; however, the Board requested that he withdraw his resignation, which he did. Mr. Horsley was not aware of, nor did he participate in, any of the fraud alleged against Sino-Forest or overseas management, nor was he aware of any improper relationships between Sino-Forest, its employees or purported external companies. He was not aware of the backdating of documents. He cooperated with OSC's investigation and signed a Settlement Agreement which became the basis of these allegations. He agreed with the findings of the OSC as documented in the Agreement. He cooperated with the PCC's investigator.

51. A written reprimand is meant to stress to Mr. Horsley that his professional conduct over the relevant period of his employment was unacceptable and not to be tolerated.

52. The fine of \$75,000 is significant and serves as a specific deterrent to emphasize to Mr. Horsley that his professional misconduct was unacceptable. It serves as a general deterrent to show the public and other members of the profession that CPA Ontario is serious in maintaining the high standards the public expects of CPAs. As there was no submission from Mr. Horsley as to the time to be permitted to pay the fine, one month to pay was found to be appropriate.

53. The PCC submitted that a suspension of Mr. Horsley's membership for two years was appropriate, and, when questioned by a tribunal member, the PCC reaffirmed its submission. The tribunal disagreed and determined that, given the severity of the consequences of his misconduct, revocation of his membership was the only appropriate sanction. Revocation was required to explicitly communicate to the public and the profession that the abdication by a CPA of his professional responsibilities over a prolonged period, which resulted in significant injury to the public interest, could not be reconciled with that person's continued membership in the profession.

54. There were no submissions regarding any rare or unusual circumstances which would justify the withholding of full publication of Mr. Horsley's name and circumstances leading to the revocation of his membership. Accordingly, in keeping with CPA Ontario's transparency policy regarding disciplinary matters, and to serve as a general deterrent, publicity was ordered.

Costs

55. The tribunal recognized that costs were kept to a minimum because of Mr. Horsley's cooperation and that the PCC's case was based on the OSC Settlement Agreement which was agreed to by Mr. Horsley. The disciplinary process is part of the activities of the regulatory authority of CPA Ontario over its members, and CPA Ontario should bear some of the cost of the hearing. The tribunal agreed with the PCC's submission and awarded costs to CPA Ontario of \$7,000, and Mr. Horsley was given one month to remit these costs.

DATED AT TORONTO THIS 19TH DAY OF JANUARY, 2017
BY ORDER OF THE DISCIPLINE COMMITTEE



A.D. NICHOLS, FCPA, FCA – DEPUTY CHAIR
DISCIPLINE COMMITTEE

MEMBERS OF THE TRIBUNAL:

A.R. DAVIDSON, CPA, CA
R. FUNG, CPA, CMA
C. KENWELL (PUBLIC REPRESENTATIVE)
P.J. VAILLANCOURT, CPA, CGA