

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO ACT, 2017

DISCIPLINE COMMITTEE

IN THE MATTER OF: A proposed Settlement Agreement between the Professional Conduct Committee of the Chartered Professional Accountants of Ontario and **FRED E. CLIFFORD, CPA, CA.**

TO: Mr. Fred E. Clifford, CPA, CA

AND TO: The Professional Conduct Committee

DECISION MADE JUNE 17, 2020

DECISION

After considering the submissions of the parties and the proposed Settlement Agreement itself, the Panel hereby approves the Settlement Agreement, dated June 4, 2020.

DATED at Toronto, this 17th day of June, 2020.



Randal J. Adamkowski, CPA, CA
Discipline Committee – Deputy Chair

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO
THE CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO ACT, 2017

IN THE MATTER OF: ALLEGATIONS OF PROFESSIONAL
MISCONDUCT AGAINST FRED CLIFFORD, CPA, CA,
A MEMBER OF CPA ONTARIO, BEFORE THE DISCIPLINE
COMMITTEE

SETTLEMENT AGREEMENT

**Made pursuant to Section 34 (3)(c) of the Chartered Professional
Accountants of Ontario Act, 2017, and
CPA Regulation 15-1, s.26.4**

Introduction

1. The Professional Conduct Committee (“PCC”) approved draft Allegations against Fred Clifford, CPA, CA (attached as Schedule “A”). Certain documents referred to in this Settlement Agreement are found in the attached Document Brief (“Doc”). The applicable Canadian Auditing Standards (“CAS”) sections are found in the Brief of Authorities (“Tab”).
2. The draft Allegations pertain to Mr. Clifford’s failure, as the Engagement Partner with Ernst & Young LLP (“EY”), to perform professional services in accordance with generally accepted standards of practice of the profession with respect to the audit of the consolidated financial statements of Sino-Forest Corporation (“Sino-Forest” or “the Company”) for the year ended December 31, 2010 (the “2010 Audit”).
3. The PCC and Mr. Clifford agree with the facts and conclusions set out in this Settlement Agreement for the purpose of this proceeding only, and further agree that this agreement of facts and conclusions is without prejudice to Mr. Clifford in any other proceedings of any kind, including, but without limiting the generality of the foregoing, any civil or other proceedings which may be brought by any other person, corporation, regulatory body, or agency. It is further agreed that the relevant standards are those identified in this Settlement Agreement.

Background

The Member

4. Mr. Clifford received his Bachelor of Business Administration degree in 1987 and joined Clarkson Gordon (which later became EY) as a staff accountant in 1987. He obtained his CA designation in 1989 and became a member of the Institute of Chartered Accountants of Ontario (“ICAO”) in 1989. He is also a Licensed Public Accountant.

5. He is a CPA, has remained a member in good standing of the ICAO (and CPA Ontario), and has not previously been the subject of a complaint to the PCC.
6. Mr. Clifford has been a partner at EY since 1993. He has held various management roles with EY's Assurance practice: Managing Partner, Entrepreneurial Services Practice (1996); Managing Partner, Ontario Assurance Practice (1999); Assurance People Leader (2003-2005); and Assurance Market Leader (2005-2011).
7. Mr. Clifford has extensive experience acting as audit Engagement Partner on private company and public company engagements, including approximately 20 Canadian and SEC reporting issuers. Prior to becoming the Engagement Partner for Sino-Forest, Mr. Clifford was an Engagement Partner for a private company with manufacturing operations in the People's Republic of China ("PRC") for six years, and was a Coordinating Partner/Independent Partner in respect of Sino-Forest for three years.
8. Until 2017, Mr. Clifford was a member of EY's audit practice. Mr. Clifford has not been involved in public accounting activity since he ceased conducting audits in 2017. Mr. Clifford is currently the national leader of the Financial Accounting Advisory Services practice at EY.
9. Mr. Clifford will be retiring from EY effective June 30, 2020. This retirement date is approximately three years prior to the applicable mandatory retirement date at EY. Mr. Clifford will surrender his public accounting licence upon the approval of this Settlement Agreement.

Sino-Forest

10. Sino-Forest was a company incorporated under the *Canada Business Corporations Act*. It became a reporting issuer in 1994, with its shares traded over the TSX beginning in 1995. Sino-Forest's principal business operations were located in the PRC. Sino-Forest's principal executive offices were located in Hong Kong, with its registered head office in Mississauga, Ontario. Its key officers included CEO Allen Chan, who maintained offices in mainland China and in Hong Kong, and CFO David Horsley, CA, CBV, CF, CDir.
11. Sino-Forest's operations consisted of three business segments: Plantation Fibre, Other Fibre (mainly logs imported into the PRC), and Manufacturing and Other Operations (mainly engineered wood products). The Plantation Fibre business segment consisted of "Planted Plantations" (fast growing eucalyptus trees grown from seedlings) and "Purchased Plantations" (middle-age or mature trees acquired as, and later sold as, standing timber) (collectively, Planted Plantations and Purchased Plantations are referred to as "Standing Timber"). Sino-Forest conducted the Purchased Plantations Standing Timber business in the PRC through two kinds of subsidiaries: subsidiaries incorporated in the British Virgin Islands ("BVI Subsidiaries") and subsidiaries incorporated in the PRC ("Wholly Foreign Owned Enterprises" or "WFOEs"). BVI Subsidiaries transacted with third party PRC entities, referred to as Authorized Intermediaries ("AIs").

12. By 2010, Purchased Plantations represented 711,000 hectares or 90% of the hectares managed by Sino-Forest.
13. It was ultimately revealed that Sino-Forest had engaged in a collusive fraud.

Financial History

14. Sino-Forest's ten-year financial history for years 2001-2010 reported a year-over-year increase for every income statement variable (other than gross profit margin percentage):¹

By millions, except earnings per share and share price	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Consolidated Statement of Income										
Revenue	1,923.5	1,238.2	896.0	713.9	555.5	341.3	330.9	265.7	200.7	137.3
Gross Profit	671.5	440.4	366.0	243.0	175.0	104.0	101.5	64.9	42.7	30.2
Gross Profit Margin	34.9%	35.6%	40.8%	34.0%	31.5%	30.5%	30.7%	24.4%	21.3%	22.0%
Net Income	395.4	286.4	228.6	152.3	113.5	76.2	52.8	30.2	20.6	18.6
Diluted earnings per share	1.60	1.38	1.24	0.90	0.81	0.55	0.43	0.32	0.27	0.21
Cash flow from operating activities	840.1	784.5	487.2	482.5	264.2	152.9	119.4	69.6	12.6	12.9

15. Sino-Forest's stock price increased from C\$1.19 per share as of the 2001 year-end to C\$23.29 per share as of the 2010 year-end. During this period, its reported revenues grew at a continually compounded growth rate of 29%, and its market capitalization went from C\$96 million to C\$5,723 million.
16. Between January 1, 2004 and December 31, 2010, Sino-Forest issued more than \$3 billion in debt and equity securities for cash and over \$400 million in securities for other consideration. This included the issuance of over \$1 billion in non-convertible debt.
17. By the end of December 2010, Sino-Forest had outstanding long-term debt in excess of \$1.7 billion, of which \$600 million was issued in an offering that closed on October 21, 2010.

¹ All amounts in this Settlement Agreement are in US\$, unless otherwise noted. Note: The corresponding footnote to this table in the 2010 Annual Report [Doc – #1] discloses that the results “exclude wood chips and commission operations” in 2005-2006 “but include the tax provision for tax contingency.”

18. In 2005, approximately 49% of Sino-Forest's revenues were derived from the sale of Standing Timber primarily in the PRC. 31% of revenues were derived from wood chips and approximately 20% from other wood-based products.
19. By 2010, approximately 73% of Sino-Forest's revenues were derived primarily from the sale of Standing Timber and 23% from the sale of imported wood logs. It was reported that the imported logs were purchased and then immediately sold ("Log Trading").
20. Further, as at December 31, 2010, sales from Purchased Plantations and Log Trading, primarily to AIs, made up 89% of Sino-Forest's total revenue reported in 2010, and 79% of its Standing Timber assets reported on its balance sheet. Purchased Plantation sales reported by two BVI Subsidiaries made up \$1.3 billion in sales or 69% of reported revenue in 2010 and \$635 million in consolidated income from operations, which was more than 100% of total income from operations.
21. Sino-Forest conducted its Purchased Plantation and Log Trading operations through AIs, which were domestic enterprises in the PRC. Sino-Forest's BVI Subsidiaries conducted sales and purchase transactions through the AIs.
22. The AI customers did not remit cash to the BVI Subsidiaries, but were directed to pay other AI suppliers of plantations to BVI Subsidiaries that were buying plantations. These practices were attributed by Sino-Forest to foreign currency regulations, described below.
23. Sino-Forest's evidence of the AI/BVI Subsidiary transactions involved signed contracts, a request for payment by a customer, a request to a vendor to pay, acknowledgment of payment by a vendor sent to Sino-Forest, acknowledgment sent to Sino-Forest from a customer that it had been paid, and surveys conducted by surveyors on acquisition. No other evidence was provided of cash changing hands.

Annual Information Form Disclosures

24. Sino-Forest's 2010 Annual Information Form (the "AIF") [Doc – #2] included the following description of Sino-Forest's business model:
 - a. Plantation operations:
 - i. Purchased Plantation model: Sino-Forest purchased trees from holders of plantation rights or collective landowners and sold the fibre either as logs or Standing Timber. After harvesting, Sino-Forest leased and replanted the land. The Purchased Plantation operations were carried out principally by the BVI Subsidiaries;
 - ii. Planted Plantation model: Sino-Forest's Planted Plantations in the PRC operated through WFOEs in the PRC, which leased suitable land on a long-term basis and applied its "scientifically advanced seedlings technology to improve tree growth"; and
 - iii. Sino-Forest engaged third parties for all field operations of both types of plantations;

- b. Log Trading operations:
- i. Sino-Forest engaged in Log Trading in the PRC and overseas, issuing invoices to AIs on a quarterly basis, with payments usually settled within 90 days of delivery;
 - ii. Sino-Forest issued letters of credit (“LCs”) for the purchase of logs, with payments usually settled within 45 to 90 days of delivery; and
 - iii. Sino-Forest’s customers and AIs were “mostly wood dealers and panel manufacturers”;
- c. AI/BVI Transactions:
- i. Sino-Forest had BVI Subsidiaries engaged in the sale of Standing Timber in the PRC through AIs;
 - ii. Under the terms of master agreements and relevant sales and purchases contracts made with the AIs, the AIs were responsible for withholding and remitting relevant PRC taxes on BVI profits that arose from authorized sales activities with the BVI Subsidiaries;
 - iii. Investments by foreign entities of cash and other assets into the PRC were highly regulated. The liquidation of investments required significant government approvals. Sino-Forest had reinvested all proceeds of PRC sales into further PRC assets and had no such approvals of its investments in Purchased Plantations; and
 - iv. The majority of Sino-Forest’s revenue and profits in the PRC were generated in the BVI Subsidiaries. The BVI Subsidiaries’ ability to remit foreign currency outside the PRC was limited. As of December 31, 2010, Sino-Forest had retained earnings of \$1.4 billion in the PRC, which were restricted.

AI/BVI Model

25. In 2010, the AI/BVI sales transactions were concentrated in four BVI Subsidiaries. Sino-Forest’s reported sales for 2010 of Standing Timber from Purchased Plantations and Log Trading were approximately \$1.7 billion, or 89% of all reported sales. Virtually all of these sales were made to AI customers identified as wood dealers in the PRC.
26. Two of the BVI Subsidiaries recorded approximately \$1.3 billion in sales of Plantation Fibre, or 69% of Sino-Forest’s total reported sales and \$635 million in consolidated “income from operations” (more than 100% of Sino-Forest’s total income from operations for 2010).
27. EY’s working papers for the 2010 Audit show that all these sales were made to six AI customers and \$1.3 billion in plantation purchases were conducted through seven AI suppliers.

28. Two other BVI Subsidiaries conducted Log Trading sales, in the amount of approximately \$353 million out of total segment sales of \$454 million. The BVI Subsidiaries dealt with 10 AI customers in the PRC and one Hong Kong-based customer. Log Trading purchases were primarily made from five Hong Kong suppliers. Hong Kong entities were not AIs.
29. The Renminbi² generated through these transactions was not “freely remittable” out of the PRC. As a result, all of the accounts receivable recorded by the BVI Subsidiaries through these transactions were settled by having AI customers directly pay Sino-Forest’s AI suppliers of new plantations (“AR/AP Offset”). These AI suppliers provided over \$1.3 billion of plantations in 2010. Sino-Forest used \$1.3 billion in receivables from other PRC customer AIs to pay for them. No cash was received or spent by Sino-Forest for these transactions. There were done by offset directed by Sino-Forest.
30. In addition, EY’s 2010 working papers identified that \$74 million in customers’ accounts receivable arising from Log Trading sales were used to offset Standing Timber payables.
31. In 2010, \$236 million of BVI Log Trading receivables were liquidated by deposit into Sino-Forest’s bank accounts, not by Sino-Forest’s customers, but by “remitting agents” (“Remitting Agents”).
32. EY’s working papers did not contain any evidence that Sino-Forest had maintained any documentation supporting the creditworthiness of its AI customers or a process for vetting approved AI customers, AI suppliers, or Log Trading suppliers.

Evidence of Ownership of Plantations

33. In 2010, the forestry sector in the PRC was governed by the Forestry Law of 1998 (the “Forestry Law”).
34. The Forestry Law stated that “individual-owned woods and individual used forest lands...shall be registered by local people’s governments...and rosters compiled and certificates issued confirming the ownership or right to use”.
35. It was noted in the AIF that Sino-Forest was required to obtain the following permits:
 - a. Plantation Rights Certificates in respect of the plantation land use rights and the ownership of planted trees for Planted Plantations;
 - b. Plantation Rights Certificates in respect of the ownership of purchased trees for Purchased Plantations;
 - c. Timber logging permits; and
 - d. Timber transportation permits.

² Renminbi is Chinese currency.

36. Sino-Forest's AIF stated that because the locations from which it purchased plantations had not fully implemented the new form of Plantation Rights Certificates, Sino-Forest had not obtained Plantation Rights Certificates, but instead obtained "confirmations" of ownership from Forestry Bureaus (the "Forestry Confirmations").
37. The AIF further disclosed that until official new form Plantation Rights Certificates were issued, there could be no assurance that Sino-Forest's "rights to our tree plantations would not be subject to dispute or challenge".
38. Sino-Forest did not have any Plantation Rights Certificates for any of the \$1.3 billion of plantations sold by its two BVI Subsidiaries in 2010, or for the \$1.4 billion of plantations acquired by other BVI Subsidiaries in 2010. Sino-Forest provided EY with Forestry Confirmations.

Harvest Permits

39. The harvesting of forests in the PRC was also subject to regulations under the Forestry Law. The Forestry Law specified that the PRC strictly controlled the annual rate of forestry felling and that the annual timber production plan could not exceed the approved annual quota for felling. The quotas were allocated to specific provinces under the 2006-2010 Five-Year Plan in place at the time in the PRC.
40. According to the Forestry Law, anyone who intended to fell timber was required to apply for a felling permit.
41. Sino-Forest publicly disclosed that it was selling harvested logs in the first three quarters of 2010. However, for the year-end audit, Sino-Forest represented to EY that harvest permits were not required because it did not sell harvested logs in 2010. Rather, it sold "standing logs" where the trees were sold still standing, but the price was based on the estimated cubic meter yield (representing the quantity of harvested logs that would be obtained from the area). Sino-Forest's year end public disclosure did not refer to "standing logs".

Certification of Internal Controls

42. The Management Discussion and Analysis ("MD&A") contained in Sino-Forest's Annual Reports for 2006 to 2010 included, as required by Canadian Securities Administrators' National Instrument 52-109, a discussion of the Company's disclosure controls and procedures and internal control over financial reporting ("ICFR").
43. Over the period of 2006 to 2010, Sino-Forest continuously disclosed ineffective ICFR arising from a failure to segregate duties relating to its purchasing, payment, sales, and receipts processes. For example, Sino-Forest's MD&A from its 2010 Annual Report stated:

The success of the Company's vision and strategy of acquiring and selling forestry plantations and access to long term supply of wood fibre in the PRC is dependent on senior management. As such, senior management plays a significant role in maintaining customer relationships, negotiating and finalizing the purchase and sale of plantation fibre contracts and the

settlement of accounts receivable and accounts payable associated with plantation fibre contracts. This concentration of authority, or lack of segregation of duties, creates risk in terms of measurement and completeness of transactions as well as the possibility of non-compliance with existing controls, either of which may lead to the possibility of inaccurate financial reporting. By taking additional steps in 2011 to address this deficiency, management will continue to monitor and work on mitigating this weakness.

2010 Audit

44. EY was the auditor for Sino-Forest for the years 1994-1999 and 2000-2004. EY was re-appointed as Sino-Forest's auditor in 2007 and audited Sino-Forest's consolidated financial statements for its fiscal years ended December 31, 2007, December 31, 2008, December 31, 2009, and December 31, 2010.
45. Mr. Clifford's involvement with Sino-Forest began around June 2007, as part of the team involved in EY's client acceptance process. Mr. Clifford acted as Coordinating Partner for EY's review of Sino-Forest's consolidated financial statements for Q3 2007 and for the December 31, 2007 year-end audit. He acted as Independent Review Partner for the quarterly reviews and year-end audits for 2008 and 2009.
46. Mr. Clifford was the Engagement Partner responsible for 2010 quarterly reviews and the 2010 Audit.

Events Following the 2010 Audit

Muddy Waters Report

47. On June 2, 2011, Muddy Waters LLC ("Muddy Waters")³ published a report in which it put a "strong sell" recommendation on Sino-Forest, and estimated its target price to be in the range of C\$1.00/share, a substantial discount from the C\$20 range in which Sino-Forest shares had then been trading. The Muddy Waters report alleged that Sino-Forest was a "Ponzi scheme".
48. On June 3, 2011, the board of directors of Sino-Forest announced the establishment of an Independent Committee to investigate the allegations in the Muddy Waters report.
49. On June 14, 2011 and August 15, 2011, Sino-Forest announced that EY had advised that they were unable to complete the review of the Company's Q1 and Q2 financial statements, respectively.
50. Sino-Forest published its Q1 2011 interim report on June 3, 2011 and its Q2 2011 interim report on August 15, 2011, despite EY not having completed any review engagement reports. Sino-Forest did not publish any further financial statements.

³ Muddy Waters is an investment-based firm that conducts investigative research and also takes investment positions in the companies it researches, often as a short-seller.

51. On August 26, 2011, the Ontario Securities Commission (“OSC”) issued a cease trade order in respect of Sino-Forest’s stock, which at the time had been trading at C\$4.81/share.
52. On December 12, 2011, Sino-Forest announced that it was not in a position to release its Q3 2011 financial statements and cautioned that, “[t]he circumstances that could cause the Company to be unable to release the Q3 Results also could impact the Company’s historic financial statements.”
53. On January 10, 2012, Sino-Forest issued a press release stating that, “[t]he Company cautions that the Company’s historic financial statements and related audit reports should not be relied upon.”
54. Sino-Forest’s Independent Committee released interim reports on August 11, 2011 and November 15, 2011. Ultimately, the Independent Committee’s final report was released on January 31, 2012. The Independent Committee was not able to confirm that Sino-Forest held Standing Timber assets of approximately \$2.9 billion in the PRC, as reported in its audited financial statements as at December 31, 2010. Further, the Independent Committee could not verify that Sino-Forest’s largest suppliers and customers (i.e. the AIs) transacted at arm’s-length with the Company.
55. EY did not withdraw its unqualified audit report on the consolidated financial statements of Sino-Forest for the year ended December 31, 2010.
56. EY resigned as auditor of Sino-Forest on April 4, 2012.

The CCAA Proceedings and the Class Proceedings

57. On March 30, 2012, Sino-Forest filed for protection under the *Companies’ Creditors Arrangement Act* (“CCAA”).
58. Ultimately, pursuant to a Plan of Arrangement approved in the CCAA proceeding, Sino-Forest’s Standing Timber assets were transferred to a new entity, Emerald Plantation Holdings Limited (“Emerald Holdings”), and ascribed a nil value for the purposes of creditors. These transferred assets had a recorded value on Sino-Forest’s consolidated financial statements as at December 31, 2010 of \$2.9 billion.
59. In June and July 2011, class action proceedings were commenced against Sino-Forest, its officers and directors, its auditors, its underwriters, and several other parties.
60. EY settled the class action proceedings as against it for C\$117 million as an element of the CCAA Plan of Arrangement, where EY obtained a release of all claims against EY as an element of the Sino-Forest CCAA Plan of Arrangement (the “Plan”).

OSC Proceedings – Sino-Forest

61. On June 8, 2011, Sino-Forest announced an investigation by the OSC.

62. On May 22, 2012, the OSC issued a Notice of Hearing and Statement of Allegations against Sino-Forest and six members of its executive management team. OSC Staff alleged, among other things, that Sino-Forest and its former senior executives had engaged in a fraudulent scheme that inflated the assets and revenue of Sino-Forest, and that Sino-Forest had made materially misleading statements in public disclosures and to its auditors.
63. Mr. Horsley, former CFO of Sino-Forest, entered into a Settlement Agreement with OSC Staff which was approved by the OSC on July 21, 2014. Therein, he admitted to failing in his duties as the CFO for Sino-Forest. Among other things, he was permanently barred from acting as a director or officer of any public company or OSC registrant.
64. The OSC held a hearing which took place over 188 days starting on September 2, 2014 and ending on May 12, 2016.
65. Mr. Clifford testified during those proceedings.
66. On July 13, 2017, the OSC issued its Reasons and Decision regarding the OSC's allegations against Sino-Forest and certain of its former executives. The OSC found that Sino-Forest and certain former executives had, in some material respects, misled and deceived the Board of Directors, auditors and investors and had committed fraud related to reported Standing Timber holdings.

OSC Settlement – EY

67. On December 3, 2012, the OSC issued a Notice of Hearing and Statement of Allegations against EY, alleging that EY's 2007 to 2010 audits of Sino-Forest were not conducted in accordance with Generally Accepted Auditing Standards ("GAAS"). It was alleged in the Statement of Allegations that EY did not obtain sufficient appropriate audit evidence of the ownership and existence of Standing Timber assets reported by Sino-Forest.
68. In September 2014, the OSC approved a no-contest settlement wherein EY neither admitted nor denied the facts or conclusions of Staff of the Commission in the proceeding against EY. EY agreed to make a voluntary payment of C\$6.5 million in settlement of the Sino-Forest OSC proceeding on a no contest basis. Mr. Clifford was not a party to the OSC proceedings.
69. In the OSC/EY Settlement Agreement, OSC Staff acknowledged that they did not allege, and found no evidence of, dishonest conduct by EY.

Other Proceedings

Cosimo Borrelli, in his capacity as trustee of the SFC Litigation Trust v. Allen Tak Yuen Chan

70. A civil action was commenced in April 2014 by the Trustee under the Plan of Arrangement⁴ against Allen Chan, former Chairman and CEO of Sino-Forest. The claim was for C\$2.63 billion for fraud, breach of fiduciary duty, and negligence. On March 14, 2018, a decision was rendered by the Ontario Superior Court of Justice in which it was found that:

[939] It has been proved, on a balance of probabilities, that Sino-Forest did not own BVI standing timber assets worth anything close to \$2.9 billion. It has also been proved on a balance of probabilities that Sino-Forest's BVI standing timber and wood log trading operations were not bona fide and were not conducted with arm's-length counterparties. Mr. Chan directed a massive fraud, in breach of his fiduciary duties to the company, in which he caused Sino-Forest to misrepresent its assets (it did not own 520,000 ha of BVI standing timber) and their value (the BVI standing timber "asset" had no value).

71. Damages were assessed against Mr. Chan in the amount of C\$2,627,478,000.

CPA Ontario Proceedings against Mr. Horsley (former CFO of Sino-Forest)

72. The Discipline Committee issued a Decision and Order against Mr. Horsley, the former CFO of Sino-Forest, on August 16, 2016.
73. The Discipline Committee found, amongst other things, that Mr. Horsley did not discharge his professional duties to Sino-Forest and the investing public, and that his misconduct occurred over a sustained period of more than six years.
74. Mr. Horsley's membership in CPA Ontario was revoked by the Discipline Committee on August 16, 2016 for failure to maintain the reputation of the profession on the basis of the admissions made in his OSC settlement.

The Complaint

75. On January 26, 2015, CPA Ontario Staff advised Mr. Clifford that a review into the audit of Sino-Forest had been commenced and requested a response from Mr. Clifford. Mr. Clifford's response, dated April 24, 2015, is reproduced at Doc – #3.
76. On January 12, 2016, the PCC appointed Mr. Peter Chant, FCPA, FCA, to inquire into the standards of practice and professional conduct of Mr. Clifford with respect to his role as Engagement Partner for the 2010 Audit. Mr. Chant was assisted by co-investigator, Jodie Wolkoff, CPA, CA, DIFA, CBV, CFF.

⁴ Sino-Forest's rights of action were assigned to the SFC Litigation Trust. Cosimo Borrelli was appointed by Sino-Forest's secured debt holders as the Litigation Trustee.

Generally Accepted Auditing Standards in 2010

77. The standards for auditing applicable to the 2010 Audit are described by GAAS. In 2010, GAAS, as they existed in Canada relating to the conduct of an audit of a public company and other professional auditing matters, were published in the Assurance section of the Canadian Institute of Chartered Accountants Handbook.
78. The text of GAAS as it existed in 2010 included CAS 200, a general standard entitled “Overall objectives of the independent auditor and the conduct of an audit in accordance with Canadian Auditing Standards”, and a series of more focused standards.
79. GAAS requires auditors to obtain reasonable assurance that the audited entity’s financial statements are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is achieved when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to a low level and to provide a reasonable basis to support the content of the audit report.
80. The audit process consists to a great extent of identifying areas of the financial statements that are at risk of misstatement and designing and carrying out procedures that reduce the risk of undetected misstatement to an acceptably low level in the circumstances.
81. Further, as set out below, GAAS requires auditors to plan and perform their audits using professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. Professional skepticism requires a questioning attitude which is alert to conditions which may indicate a possible misstatement due to error or fraud. Professional skepticism requires an auditor to conduct a critical assessment of the audit evidence.
82. Excerpts from CAS 200 specify the following guidance:
 11. In conducting an audit of financial statements, the overall objectives of the auditor are:
 - (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
 - (b) To report on the financial statements, and communicate as required by the CASs, in accordance with the auditor’s findings.
 - [...]
 17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low

level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A28-A52)

83. CAS 200.13(m) defines reasonable assurance as: “[i]n the context of an audit of financial statements, a high, but not absolute, level of assurance.”
84. CAS 200 describes the sufficiency and appropriateness of audit evidence as being interrelated, as follows:

A28. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor and, therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

A29. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

A30. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

85. CAS 200 discusses both the inherent limitations of an audit and the evidence that must be obtained in performing an audit:

A52. Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial

statements may not be detected, even though the audit is properly planned and performed in accordance with CASs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with CASs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. Whether the auditor has performed an audit in accordance with CASs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

86. Pursuant to CAS 200.18-23, compliance with CAS is not optional.

Failure to Maintain Professional Standards

The Audit of the Consolidated Financial Statements of Sino-Forest for the year ended December 31, 2010

87. The financial statements for Sino-Forest for the year ended December 31, 2010, together with the Auditor's Report, which Mr. Clifford, as Engagement Partner, authorized to be signed by EY, and issued on March 14, 2011. EY issued an unqualified opinion for the 2010 Audit.

Particular (a) – Failure to Properly Plan the Audit

88. The purpose of audit planning procedures is to identify the risk of material misstatement due to fraud or error. These risks, in turn, affect the choice of appropriate substantive procedures to be performed during the audit.
89. The standards applicable to the planning procedures for audits are set out in CAS 315 and 240. CAS 315.3 states: “[t]he objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.”
90. CAS 300.5 requires that the Engagement Partner and other key members of the engagement team be involved in planning the audit, including planning and participating in the discussion among engagement team members.
91. CAS 315.5-315.8, CAS 315.11, and CAS 240.16-24 set out specific risk assessment procedures required to be carried out in the planning phase of an audit.
92. By the time of and/or during the client retention/continuance process for the 2010 Audit, the audit team was, or became, aware of the following fraud risk factors, many of which are consistent with fraud risk factors specifically identified in CAS 240 and CAS 315:

- a. Sino-Forest had not filed its required tax returns for its AI/BVI Subsidiaries transactions in the PRC and Hong Kong;
- b. While AI customers were reportedly contractually obligated to pay all “relevant taxes” on behalf of the BVI entities, there was no evidence that the AI customers had paid those taxes for the benefit of the BVI entities;
- c. Despite advising EY in 2007 that it wanted to resolve tax matters arising from the activities of the BVI Subsidiaries and using WFOEs for sales of plantations, Sino-Forest had not made much progress in this matter by 2010;
- d. Sino-Forest stated that it had the option of requesting that its AI customers in the PRC settle receivables by payments of cash to Sino-Forest’s BVI Subsidiaries in the PRC, but there was no evidence that this was the case, or of Sino-Forest ever having done so;
- e. There was a risk in respect of the authenticity of transactions due to the above-noted offsetting settlement mechanism for BVI Standing Timber transactions in the PRC;
- f. Sino-Forest had failed to address known weaknesses in its internal controls for over five years relating to a lack of segregation of duties in Sino-Forest’s Purchased Plantation and Log Trading operations, including that:
 - i. For Purchased Plantations, one senior member of management (Alfred Hung) was responsible for the entire AI settlement process. No evidence of bilateral transactions, such as cancelled cheques or bank transfer vouchers, supporting such purported payments was ever provided by a customer or a supplier;
 - ii. For Log Trading operations, cash deposits on the bank statements did not contain detailed information about the customer making the deposit and, as a result, settlement of accounts receivable could not be traced directly from the available documentation. One senior member of Sino-Forest’s management team (Mr. Hung) was responsible for identifying the customers for each unreconciled receipt without written evidence from the customer to substantiate the source of the payment; and
 - iii. For Log Trading operations, there were also control deficiencies for payment processes. Payments for purchases of logs were made without any observation by Sino-Forest of the receipt or delivery of the logs. Confirmation of the receipt of the payment by the supplier was provided solely by the data on the confirmations prepared by Sino-Forest and sent to the supplier and returned to EY as part of the year-end audit. In a 2008 review of internal control documentation, EY had identified that disbursements subject to those controls constituted a risk that funds could be distributed for other than corporate purposes;
- g. In 2010, a retired EY Assurance partner had reported to the audit team that a business contact in the PRC had unofficially raised concern about the authenticity of the plantation sales/purchase transactions between the Company and the AIs; and

- h. Mr. Horsley had stated, when interviewed by EY, that the key fraud risk for Sino-Forest was the amount of cash held in bank accounts in Hong Kong.
93. As part of its planning analytics for the 2010 Audit, EY was required to identify high risk audit areas and to highlight expected and unexpected changes within Sino-Forest's operations in order to identify risks of material misstatement [see Doc – #4].
94. EY's audit team identified the following specific fraud risks in planning for the 2010 Audit [Doc – #5]:
- a. "Improper revenue recognition": overstating revenues by early revenue recognition;
 - b. "Management incentive": incentive to report "strong results for future financing and to meet debt covenant requirements in relation to long term debts. As well, management bonus is based on earnings";
 - c. "Standing Timber transactions with AIs": the Company purchases and sells Standing Timber through AIs. There is a risk that the AIs were unidentified related parties and would give management an opportunity to manipulate sales and standing timber assets. Transactions with AIs are settled through accounts receivable and accounts payable settlements and pose additional risks to the occurrence, completeness, and measurement of these transactions. Other risks include: a) Risk of fictitious sales and purchase transactions; b) Risk that the Company does not legally own the Standing Timber; and c) Risk that the Company is not complying with local laws and regulations related to ownership/environmental obligations;
 - d. "Lack of segregation of duties": "[c]oncentration of authority from a few senior management members in plantation sales and purchase cycles, including the A/R and A/P settlement with plantation contracts"; and
 - e. "Related party transactions": "Company has complex structure so related parties may not be easily identified." These "give management opportunities to manipulate assets, liabilities, revenue and expenses."
95. The audit team identified a fraud risk relating to AIs, including that they may be unidentified related parties, fictitious companies, or have unwritten agreements with the Company.
96. To address the fraud risks identified by the audit team, EY designated the 2010 Audit as a close monitoring engagement.
97. The audit team planned various audit procedures in relation to 20 AIs in the PRC and five Hong Kong Log Trading suppliers. The planned procedures were designed to address the identified risks and included:
- a. A company information search report on all significant Suppliers and Customer AIs for Purchased Plantations and Log Trading to verify the existence of the AI's operations and identify any undisclosed related parties of the Company;
 - b. A Hong Kong directorship search on senior management of Sino-Forest to identify any undisclosed related parties;

- c. In person interviews with significant and new AIs to assess the validity and existence of the AI operations; and
 - d. Obtaining a continuity schedule for each AI, reconciling the opening and closing receivable/payable balance, and performing the following:
 - i. Sending confirmations to each AI to confirm opening and closing balances (account receivable or accounts payable) and all transactions that occurred during the year (sales or purchases); and
 - ii. Agreeing significant purchases to contracts, payment instructions from the Company to the AI (along with the AI's acknowledgement that payment was sent/received) and Forestry Confirmations on the respective purchase transactions.
98. The results of the audit procedures conducted, and their implications on the sufficiency and appropriateness of the audit evidence obtained, are addressed below.
99. Certain fraud risks were, however, not identified by the audit team and therefore appropriate responses to those risks were not developed or considered in the planning of the 2010 Audit.
100. The fraud risks associated with cash holdings identified in the interview with Mr. Horsley were not identified by EY in its planning documentation. This risk was therefore not included in the planning of the 2010 Audit. Mr. Clifford agrees that it ought to have been.
101. The audit team did not identify a gap in documentation relating to the liquidation of Log Trading receivables made by Remitting Agents, rather than customers (as described below). The consequence of this gap in documentation was that remittances made by Remitting Agents could not be traced to the customer on whose behalf they were purportedly made. Mr. Clifford agrees that this risk ought to have been addressed in the planning of the 2010 Audit.
102. In the five years between 2005 and 2009, Sino-Forest's reported revenue grew by 397% and growth rates in reported revenues averaged 41% per year. This was considerably in excess of the industry's growth rate. This unexpected growth in Sino-Forest's reported revenues, as compared to industry growth, was not identified as a fraud risk by the audit team. Mr. Clifford agrees that it should have been.
103. Further, the audit team considered attending at the Forestry Bureau to confirm the procedure for issuing Forestry Confirmations as a substantive procedure to address known fraud risks associated with the ownership and existence of Purchased Plantations and the AI/BVI Model. This visit was discouraged by Sino-Forest and the audit team ultimately did not perform this procedure. Mr. Clifford agrees that it should have been performed as contemplated.

104. Mr. Clifford admits that, in the manner described herein, he failed to comply with the requirements of CAS 315 and CAS 240 in evaluating the risks of fraud and developing appropriate responses to those risks.

Particulars (b), (c), (d), (e) and (f) – Revenue, Accounts Receivable, Cost of Sales and Accounts Payable and Accrued Liabilities, Timber Holdings and Log Trading

105. EY's planned audit procedures to address the fraud risks associated with Sino-Forest's use of AIs were detailed in the audit working paper – AI Procedures Memo [Doc – #6]. The audit team identified the following fraud risk associated with the AI/BVI Model: "AIs may be unidentified related parties, fictitious companies or have unwritten agreements with the Company."
106. Mr. Clifford reviewed and approved the list of audit risks that the audit team identified and the procedures developed to address them in the 2010 Audit.
107. These procedures were EY's response to the risks of misstatement for the asset identified on the 2010 balance sheet as Timber Holdings in the amount of \$3.1 billion. They related to:
- a. The sales, revenues, cost of goods sold, receivables, payables, and timber holding assets of the two BVI Subsidiaries that sold Standing Timber in 2010, and the 16 entities that purchased plantation assets; and
 - b. The sales and costs of goods sold and accounts receivable associated with the two Log Trading BVI Subsidiaries.
108. In particular:
- a. Sino-Forest reported revenues of \$1,923 million for year ended December 31, 2010 and recorded accounts receivable of \$636 million as at December 31, 2010;
 - b. Revenue from sales of Standing Timber amounted to \$1,401 million;
 - c. Revenue from Log Trading amounted to \$451 million;
 - d. Sino-Forest reported timber holdings at historical cost of \$3,122 million as at December 31, 2010; and
 - e. Sino-Forest's reported cost of sales of \$1,252 million for year ended December 31, 2010 and recorded accounts payable and accrued liabilities of \$500 million as at December 31, 2010.

Relevant GAAS

109. According to CAS 315, EY's substantive audit procedures should have been derived from its understanding of Sino-Forest's controls. CAS 240.27 identifies the same requirement as CAS 315 for assessed risks of material misstatement due to fraud.

110. CAS 330 sets out a process for identifying audit procedures that address significant risks at the assertion level. This includes a requirement for tests of details when only substantive procedures are used to test significant risks. Risks of misstatement due to fraud are considered to be significant risks.

111. CAS 330.6, 330.21, 330.26, and 330.27 state:

6. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (Ref: Para. A4-A8)

[...]

21. If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Ref: Para. A53)

[...]

26. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. (Ref: Para. A62)

27. If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements.

112. CAS 330.28 states that the audit documentation is required to include a linkage between the assessed risks and the results of procedures performed to address those risks:

28. The auditor shall include in the audit documentation:

- a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing, and extent of the further audit procedures performed;
- b) The linkage of those procedures with the assessed risks at the assertion level; and
- c) The results of the audit procedures, including the conclusions where these are not otherwise clear. (Ref: Para. A63)

AI/BVI Entities – Procedures Summary

113. Sino-Forest's transactions with AIs were conducted through:
- a. Two operating BVI Subsidiaries, with operations in the PRC, that sold Purchased Plantations;
 - b. 16 BVI Subsidiaries, with operations in the PRC, that only purchased and held Purchased Plantations; and
 - c. Two BVI Subsidiaries, with operations in Hong Kong, that only dealt with Log Trading.
114. EY performed procedures on 20 AIs in the PRC and five Hong Kong Log Trading suppliers. These entities produced more than 100%⁵ of Sino-Forest's consolidated income from operations and the related timber holding assets were in excess of 50% of consolidated assets.
115. EY's conclusion after performing the procedures set out in the AI Results Memo was that "EY noted no significant issues and believes that the related risks were addressed appropriately." [Doc – #7]

AI Procedures: Company Information Searches, In-Person Interviews, and Site Investigations

Company Information Searches

116. CAS 230 includes a specific documentation requirement if the auditor has identified information that is inconsistent with the auditor's final conclusion regarding a significant matter. CAS 240.14 specifies that where inquiries that are made of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.
117. The auditor is required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. When designing and performing audit procedures, the auditor must consider the relevance and reliability of the information to be used as audit evidence. [CAS 500.6-CAS 500.7]
118. When using information provided by the entity under audit, the auditor is required to evaluate whether information is sufficiently reliable for the auditor's purposes, including obtaining audit evidence about the accuracy and completeness of information, and evaluating whether the information is sufficiently precise and detailed. [CAS 500.9]
119. Obtaining audit evidence from different sources, or evidence of a different nature, may indicate that an individual piece of audit evidence is not reliable, such as when there is an inconsistency. [CAS 500.A57]
120. EY's procedure to address the existence of AIs and to determine if they were related to Sino-Forest was to "[c]omplete a company information search report on all significant and

⁵ More than 100% because there were losses from other operations.

new Customer/Supplier AIs for purchased plantations to verify the existence of AIs' operations and assess if their owners and directors are related parties of the Company" and to "[c]omplete a company information search report on all significant Suppliers and Customers AIs for imported wood logs to verify the existence of the AIs' operations and assess if their owners and directors are related parties of the Company." [Doc – #6]

121. In total, EY retained Commercial Business Information Limited ("CBI") to conduct company searches for 13 Purchased Plantation customers and suppliers and 12 Log Trading entities.⁶
122. CBI provided EY with two sets of Company Search Reports (the "Company Search Reports") with respect to the Purchased Plantation AIs. When EY ordered the first set of Company Search Reports, EY did not provide CBI with addresses, but only names of the AIs. CBI could not locate six of 13 of the Purchased Plantation AIs using corporate registration and other research sources given this information. [Doc – #8].
123. In an internal email sent February 4, 2011 to Mr. Clifford and others, the independent partner on the Sino-Forest 2010 Audit stated that he had some thoughts about what EY could do to understand whether "these are clerical errors of some sort and to dig a bit deeper now that there is potentially a little "smoke". Despite follow up inquiries in the ensuing days, the 2010 Audit file contains no documentation regarding the Company Search Reports and does not address how the above anomalies were resolved. [Doc – #9]
124. When EY ordered the second set of Company Search Reports, EY provided CBI with addresses for the AIs, which had been provided by Sino-Forest. The CBI findings were summarized on an EY schedule which indicated that six of the seven entities listed "could not be located at the given addresses". The available CBI reports identified the following anomalies in the follow-up searches:
 - a. **JT:** CBI found a different named company at the given address. Contact was made via phone call and the respondent advised that he had not heard of the subject;
 - b. **NT:** The address provided was in another room of the same building as JT. Building management had never heard of the subject. The local representative said that the given room did not exist in the building. The address provided by Sino-Forest management was new in 2010 and the search could not locate the company at the new address;
 - c. **GDW:** The address provided was the site of a brewery; and
 - d. **YW:** The company's representative told CBI that it was affiliated with a subsidiary of Sino-Forest, and its sole shareholder had been a contractor for a subsidiary of Sino-Forest during or before 2007. Further, according to a separate spreadsheet, the legal representative of the company had the same name as the sole shareholder of another new AI in 2010.

⁶ There are two AIs, JX and ZQ, that were involved in Plantations and Log Trading.

125. None of the CBI Company Search Reports were archived in EY's working papers.
126. According to EY's working papers, one of the 10 Log Trading customer AIs for which results were obtained was not registered with the State Administration of Industry and Commerce [Doc – #7].
127. CBI encountered issues locating and/or obtaining information on six of seven of the PRC Log Trading customers for which it conducted searches. EY did not document in its working papers the manner in which these anomalies were resolved.
128. In addition, CBI could not find any registration records or "any other relevant information" for RE and FP, two Hong Kong based Log Trading suppliers that supplied over \$114 million (approximately 34%) of Log Trading purchases in 2010. EY determined not to engage CBI pursuant to its offer to conduct a site visit at the addresses provided [Doc – #11]. EY did not document in its working papers the manner in which these anomalies were resolved. However, the results of the A/P confirmations sent to these entities were included in other EY working papers, as set out below.
129. The accounts receivable for Log Trading customer entities were paid by Remitting Agents. The Remitting Agents did not identify the company for which they were making the payment. Other than the returned confirmations from Log Trading customers, there was no evidence supporting the existence of the Log Trading customers.

AI Interviews and Site Investigations

130. To address the fraud risks related to the validity and existence of Purchased Plantations AIs and their operations, EY adopted the following two audit procedures [Doc – #6]:
 - a. Conducted in person interviews with significant and new AIs; and
 - b. Arranged a site investigation (performed by a third party) at the address of the AIs provided by management.
131. EY did not carry out these procedures for Log Trading AIs.
132. JM, the audit partner for the 2010 Audit, conducted five interviews with four AI suppliers and one AI customer for the 2010 Audit. Mr. Hung arranged all of the interviews and accompanied EY to all of the interviews. [Doc – #10]
133. To further substantiate the existence of the AIs at the addresses provided by management, EY ordered "Site Investigation Reports" from CBI. EY obtained nine Site Investigation Reports from CBI. None of the Site Investigation Reports were retained in EY's audit working papers.
134. EY's working papers did not identify any significant anomalies from the Site Investigation Reports for five AIs and JM did not note any anomalies in respect of the AI interviews she conducted.

135. However, when the Site Investigation Reports are compared with JM's memo summarizing the results of the AI interviews, the following anomalies are evident, none of which were noted in EY's working papers:
- a. **NT:** CBI attended at three given addresses. At two addresses, the AI was not found. At the third address where audit confirmations were also sent, CBI was informed that NT was a subsidiary of the company which leased the space. JM conducted her interview at a hotel office, but also attended this third address and confirmed with the receptionist that it was NT's mailing address;
 - b. **JT:** CBI could not locate the subject company at the address provided (which was the same building as NT). CBI was informed that the premises were leased to another company. When JM visited the same address, she noted that the office area was shared with an affiliate of JT;
 - c. **DCJ:** CBI was unable to find the company at the address provided. However, CBI did find a sign bearing the company name at a different address [Doc – #12]. While CBI visited this AI in Hunan Province, when JM visited DCJ with Mr. Hung she noted that her visit had been in Guangxi Province. JM's memo stated that EY verified that the office JM visited was the same mailing address used for sending confirmations. Seven accounts payable confirmations were sent to the given Hunan address where CBI could not locate the AI and returned in completed form [Doc – #13]; and
 - d. **JS:** JM conducted an interview at JS' location which she stated was in Jiangxi Province. This was the same address where CBI found the company. JM noted that this was not the same address that was used for sending confirmations. JM was advised during her interview that the mailing address provided by Sino-Forest was JS' offices in the prior year. JM stated that she hand-delivered a copy of at least one confirmation during the interview. Three confirmations were returned without exception.
136. The Site Investigation Reports for the three sites that JM did not visit reported the following anomalies, which were not documented in EY's working papers:
- a. **ZQ:** CBI could not find any signs bearing the subject company name. Further, no one in the area had heard of ZQ. Four accounts receivable confirmations were sent to the given address and were returned without exception;
 - b. **JX:** CBI attended at two given addresses. One address was a residential community and the subject could not be found there. CBI found the company at the second address provided. Three accounts payable and one accounts receivable confirmation were sent to the first residential address and were returned without exception; and
 - c. **GDW:** The address provided by Sino-Forest was a hotel and the company was not found at the hotel. CBI made inquiries and found the company at a new location provided (but no specific address was given). JM did not visit this AI. An accounts payable confirmation was sent to the hotel address and was returned without exception. It is not documented by CBI or EY when the move took place, how the company was located without a specific address, or why Sino-Forest did not have an updated address in its records.

137. There were additional deficiencies in the audit evidence concerning the AI interviews, including:
- a. JM's AI interview memo [Doc – #10] did not discuss how the AI entities were chosen for interview. For example, JM initially chose six AIs to interview, but she ultimately did not visit three of these AIs. One of the entities chosen initially, but not interviewed, was ZQ. As noted above, CBI could not locate ZQ during its site visit. EY's working papers do not address why JM did not interview ZQ given CBI's search results, although four audit confirmations were sent and returned by the company;
 - b. A second list of AIs to interview was created by JM and sent to Mr. Hung. This list contained seven AIs where CBI had difficulties locating the AIs or had other issues. From this list, JM did not interview two of the listed AIs. EY's working papers did not address why JM did not interview these AIs given CBI's search results;
 - c. Mr. Hung provided EY with the addresses for sending confirmations and he arranged the interviews; and
 - d. Mr. Hung accompanied JM to every interview. Mr. Hung had the list of questions that JM was going to ask the AIs. The EY working papers did not document any consideration of the implications of the fact that Mr. Hung, the person at the nexus of the lack of segregation of duties (an internal control weakness), provided the addresses, arranged the interviews, and attended all interviews.
138. Mr. Clifford admits that, in evaluating the results of these procedures, in the manner set out herein, he failed to exercise a sufficient and appropriate amount of professional skepticism, that the appropriateness and sufficiency of the audit evidence and the risk of the audit should have been reconsidered in light of anomalous results from the procedures, and that he failed to ensure that sufficient appropriate audit evidence was obtained and maintained.

AI Customer and AI Supplier Confirmations

139. EY's planned procedure to test the opening and closing balances and to confirm all transactions associated with the AI/BVI Model was to send confirmations to each AI to confirm accounts receivable and accounts payable opening and closing balances, and all transactions that occurred during the year (sales or purchase).
140. The purpose of the procedure was to obtain evidence supporting the amounts recorded as sales, purchases, payments, and offsets in the accounts of the BVI Subsidiaries.

Results – AI Customer and AI Supplier Confirmations

141. EY conducted confirmation procedures on all customers and suppliers of the BVI Subsidiaries selling Purchased Plantations to, and buying Purchased Plantations from, AIs. The confirmation procedures were also conducted on the sales of logs to AIs by the two Log Trading BVI Subsidiaries, and on their purchases of logs from Hong Kong non-AI entities. Among the entities included in the confirmation procedures were a Hong Kong customer and two Hong Kong suppliers that had not been part of the company search procedures or the site visit procedures.

142. EY's recorded results in respect of the confirmations were:
- a. For BVI Purchased Plantations customer AIs, all sales and offsets recorded were confirmed without exception in 11 instances;
 - b. For BVI Purchased Plantations supplier entities, all purchases and all payments by offset were confirmed without exception in 24 instances;
 - c. For Log Trading sales, all sales and payments received from Remitting Agents were confirmed without exception in 17 instances; and
 - d. For Log Trading purchases, only the accounts payable balances were confirmed in 12 instances. The purchase transactions were not included on the Log Trading payable confirmations, although the procedure as stated in the AI Procedures Memo (and in other planning documents) was to confirm all transactions, not just balances.
143. EY's conclusion for each of the accounts receivable and accounts payable balances was that no exceptions had been noted based on the audit work performed. [Doc – #7]
144. Mr. Clifford admits that the 100% return rate and the 0% error rate, in combination with the factors discussed above and below, should have raised significant doubt about the validity of the confirmation process.
145. Further, the following information, obtained by EY through the CBI site investigation procedures, ought to have raised doubts about the reliability of the confirmations received:
- a. **JX:** JX, an AI, returned four confirmations. The confirmations were sent to a residential address and the apartment was occupied by a couple. The address where CBI located JX was not the address used for sending the confirmations. The confirmations indicated that JX had been paid by five different AIs;
 - b. **ZQ:** ZQ, an AI, had returned four confirmations. As noted above, CBI could not find ZQ at the address to which the confirmations were sent, or at any address provided by Sino-Forest. JM did not visit this AI. As a customer of plantations, ZQ had confirmed that it had made payments to suppliers of 12 BVI Subsidiaries. As a customer of logs, ZQ confirmed that it had made payments to suppliers of five BVI Subsidiaries;
 - c. **DCJ:** DCJ, an AI, returned seven confirmations as a supplier of plantations [Doc – #13]. The confirmations were sent to "Cadre Sanitorium, Dao County". CBI was unable to find the company at the address on the confirmation, although CBI did find a sign bearing the company name at a different address. As noted above, JM's visit had been in a different province than CBI indicated, and from where confirmations were sent. As a supplier of plantations to seven different BVI Subsidiaries, DCJ confirmed that it had been paid by eight AI customers of Sino-Forest involving 64 different transactions;
 - d. **FP:** FP was a Hong Kong company (and not an AI). Two accounts payable confirmations were received from FP. The addresses used on the confirmations were the same addresses provided by EY to CBI. As noted above, CBI was unable to locate

FP at these addresses and could not find its registration information in Hong Kong. Further, these confirmations of accounts payable only included the balances, one of which was nil, as Log Trading suppliers were paid with LCs on delivery. No details of the dates or amounts of purchases were supplied in the confirmation by Sino-Forest;

- e. **RE:** RE was a Hong Kong company (and not an AI). Two accounts payable confirmations were received from RE. The addresses used on the confirmations were the same addresses provided by EY to CBI. CBI had informed EY that no registration could be found for RE, nor could it be found at the address to which Sino-Forest had addressed the confirmations. Further, these confirmations of accounts payable only included the balance at year-end of nil. No details of the dates or amounts of purchases were supplied in the confirmation by Sino-Forest; and
- f. **JT:** JT was an AI supplier of plantations. EY received two accounts payable confirmations from JT. The addresses on the confirmations were the same as the address visited by CBI. CBI reported the space was rented by another entity. JT reported that it had been paid by six different AI customers for one account, and by five different customers for another.

146. In summary, EY received confirmations from customers and suppliers where CBI had identified anomalies in locating the entities, as follows:

Company Name	ST/LT ⁷	A/R or A/P	# of Confirmations Sent	Total Transactions USD
JT	ST	A/P	2	117,195,852
GDW	ST	A/P	1	55,599,904
YW	ST	A/P	4	221,899,557
JX	ST	A/P	3	216,560,815
DCJ	ST	A/P	7	269,577,775
NT	ST	A/R	2	267,503,987
ZQ	ST	A/R	2	282,915,726
FP	LT	A/P	2	72,854,260
RE	LT	A/P	2	41,600,634
JX	LT	A/R	1	7,517,307
ZQ	LT	A/R	2	44,512,561

147. These confirmations were the only evidence received directly from third parties with respect to purchases and sales in respect of the AI/BVI Model.

148. The results of the CBI reports indicated that, for over 20 of the 69 confirmations EY sent on behalf of Sino-Forest, the businesses could not be located at the given address, or indicated

⁷ ST is Standing Timber. LT is Log Trading.

other anomalies, as described above. The addresses at which the businesses could not be located were all provided by Sino-Forest.

149. Moreover, as set out above, CBI's search results raised doubts about the existence of RE and FP (i.e. registration and location). The receipt of confirmations from these entities therefore should have highlighted the possibility that payments were being made to fictitious vendors and increased the skepticism applied by Mr. Clifford and the audit team in assessing the audit evidence. [Doc – #11]
150. Further, the accounts payable confirmations related to SWT and SFR did not confirm the purchase transactions, but only the accounts payable balance. As a result, they did not provide any external evidence of the occurrence of Log Trading purchase transactions for vendors in respect of which there was no evidence of the validity of their address. The purchases were for over \$336 million in 2010.
151. EY's working papers show that the LCs were drawn down in the amount of each Log Trading purchase. Since cash was ultimately used to pay the LCs, this meant that Sino-Forest disbursed cash for log trades for which the evidence raised doubt about the authenticity of the suppliers.
152. EY's working papers did not identify any concerns related to the confirmation procedure [Doc – #7].
153. Mr. Clifford admits that he did not ensure that the audit team maintained sufficient professional skepticism in:
 - a. Evaluating the results of the company searches, the AI Interviews, and site investigations for both Purchased Plantations and Log Trading; and
 - b. Evaluating the implications of a 100% response rate with no exceptions from AI customers and AI supplier confirmations, particularly in light of the results for the other procedures.
154. Mr. Clifford further admits that the confirmation procedure results ought to have been considered in conjunction with the results of the company searches, AI interviews, and site investigations in evaluating the sufficiency and appropriateness of the audit evidence and, in particular, the authenticity of the AIs.
155. Mr. Clifford admits that he failed to ensure that he and the audit team considered the relevance and reliability of the audit evidence obtained through the conduct of these procedures, contrary to CAS 500.6, 500.9, and 500.11.

Reconciling Log Trading Receivables

156. EY's procedure to address the identified risks of misstatement of accounts receivable resulting from Log Trading operations was to obtain a continuity schedule of each AI customer reconciling the opening and closing receivable balances and conduct specified procedures [Doc – #6].

Relevant GAAS

157. GAAS requires a test of details of all significant accounts for which a substantive approach is taken. Specifically, CAS 330.21 states that "...when the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details." CAS 315.25-26 and 315.A107 contain additional direction on this point.

Results – Reconciling Log Trading Receivables

158. The working papers for the 2010 Audit indicated 149 instances of cash deposits made by Remitting Agents to SWT and SFR (the BVI Subsidiaries that engaged in Log Trading) to liquidate \$236 million of receivables.
159. The allocation of specific remittances to customer accounts was made by Mr. Hung. There is no record of any system or example of any document used by Mr. Hung to make such allocations in the working papers for the 2010 Audit.
160. EY used Sino-Forest's vouchers to test the particulars supporting individual accounting entries. These vouchers identified a receivable corresponding to each remittance advice received. However, while it was possible to trace the data on the voucher to a remittance advice received from the bank, it was not possible to test the data relating to specific remittance receipts to data on the vouchers that identified specific customers. Bank advices did not identify the customers to whom the remittance related, rather they only identified the Remitting Agent, who was not the customer.
161. The allocation of the credit entry to a customer's receivable made in the voucher could not be substantiated.
162. In 149 instances of purported cash deposits EY recorded that it completed the procedure (tracing a credit from a cash deposit recorded in a customer account) to address the risks of fictitious customers/transactions. EY did not note any unusual findings from this procedure. However, it was not actually possible to definitively trace deposits to the applicable customers given the available documentation.
163. Further, of the 149 remittance payments, Mr. Clifford failed to ensure that 116 of the remittance transactions that ended in "000" were tested. The use of transactions ending in round numbers such as "000" is a known fraud indicator (and was identified as such by EY). The remittances did not match the quantum of any invoice issued to any customer.

Procedure – Costs of Plantations Sold

164. EY's procedure to test the risk of inappropriate accounting in respect of the cost of the plantations sold was to inspect the tracking system prepared by the Company's forest management department and compare the areas sold and remaining areas to the respective accounting records at year-end [Doc – #6].

165. EY was aware that Sino-Forest did not have a formal forestry management system in place. EY did not perform a procedure it had identified as necessary to obtain reasonable assurance that the cost of goods sold was not misstated.
166. Given the failure to inspect the forestry management system, there could be no reasonable assurance that integrity could be attributed to the outputs of it as provided by management.
167. Mr. Clifford was aware that this procedure was not performed and did not ensure that an alternative procedure was implemented by the audit team. He admits that he should have done so.

Failure to Ensure Sufficient Appropriate Audit Evidence – AI/BVI Model

168. Mr. Clifford admits that, in the manner described herein, he did not ensure that the results of the substantive procedures conducted with respect to the AI/BVI Model were properly evaluated or documented, and that he failed to ensure that additional audit procedures were implemented when doing so would have been appropriate.
169. Accordingly, Mr. Clifford admits that he failed to obtain sufficient appropriate audit evidence for the 2010 Audit to support:
 - a. The Consolidated Statements of Income & Retained Earnings item “Revenue \$1,923,536”;
 - b. The Consolidated Statements of Income & Retained Earnings item “Cost of sales \$1,252,023,000”;
 - c. The Consolidated Balance Sheets item “Timber Holdings \$3,122,517,000”;
 - d. The Consolidated Balance Sheets item “Accounts Receivable (note 4) \$636,626,000”; and
 - e. The Consolidated Balance Sheets item “Accounts payable and accrued liabilities (note 18) \$499,854,000.”

Particular (g) – Failure to Exercise Sufficient Appropriate Professional Skepticism

170. “Professional skepticism” is defined in CAS 200 as: “[a]n attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.”
171. An auditor is required to plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. [CAS 200.15]
172. Further, on the requirement to exercise professional skepticism, CAS 200.A18-20 state:
 - A18. Professional skepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to those required by the CASs.

A19. Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

A20. Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example, in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

173. On accepting documents as genuine, CAS 200.A21 states:

A21. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), the CASs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

174. On believing management's representations, CAS 200.A22 states:

A22. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged

with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less-than-persuasive audit evidence when obtaining reasonable assurance.

175. Mr. Clifford admits that he failed to exercise and failed to ensure that a sufficient level of professional skepticism was exercised in evaluating, both individually and cumulatively, the results, sufficiency, relevance, and reliability of the substantive audit procedures undertaken to address the fraud risks associated with the AI/BVI Model and in considering circumstances that suggested the need for additional audit procedures to be performed.
176. In particular, Mr. Clifford admits that he failed to ensure that a sufficient level of professional skepticism was exercised in respect of:
- a. Anomalies encountered in the company search results and site investigations [CAS 500.7-9 and CAS 500.A27];
 - b. Evaluating the results of the AI interviews (conducted and not conducted) for both Purchased Plantations and Log Trading;
 - c. Evaluating the evidence obtained from AI customer and AI supplier confirmations (received with a 100% return rate and a 0% error rate, despite irregularities identified in the Company Search Reports, site investigations, and AI interviews);
 - d. Evaluating the sufficiency, relevance, and reliability of the audit evidence as to the existence and ownership of Purchased and Planted Plantations, including by:
 - i. Relying upon prior legal opinions issued for purposes other than the 2010 Audit;
 - ii. Relying upon a telephone conversation with EY PRC in-house counsel as a “consultation with an expert” when doing so was not in accordance with GAAS [CAS 620.09, CAS 620.10, CAS 620.12, CSQC 1.34], for a documented telephone discussion;
 - iii. Relying upon site surveys which did not provide a sufficient level of detail to identify the precise location of trees purportedly owned by Sino-Forest [Doc – #14];
 - iv. Relying upon qualified information contained in valuation reports of Sino-Forest’s timber holdings and other assets from 2004-2009 prepared by Poyry, an international forestry consulting company;
 - v. Relying upon the results of a single site visit to a Planted Plantation as evidence of the existence and ownership of Purchased Plantations; and
 - vi. Accepting and relying upon Forestry Confirmations which were not confirmed directly with the issuer of the Forestry Confirmations (i.e. the Forestry Bureaus);

- e. The absence of harvesting permits for approximately 11 million m³ of logs sold as Standing Timber. Sino-Forest's disclosures in previous quarters had disclosed harvesting by Sino-Forest;
- f. The implications of Poyry's 2007 and 2009 reports concerning harvesting restrictions on Sino-Forest's assertions regarding the existence and ownership of Standing Timber;
- g. The implications of Sino-Forest's failure to maintain a formal forestry management system;
- h. The fraud risks and implications on the auditability of Sino-Forest's accounts and transaction streams in respect of Log Trading, including:
 - i. The use of Remitting Agents who were not customers to liquidate accounts receivable;
 - ii. Sino-Forest's policy of paying for Log Trading purchases immediately through interest bearing LCs, but providing customers 60-90 days to pay without interest or penalty; and
 - iii. The fact that remittances were often in round numbers when customer accounts were not, and remittances did not exactly match any invoice and were often split between more than one customer;
- i. The implications of Sino-Forest's failure to file tax returns on the business it carried out in the PRC or in Hong Kong; and
- j. The assumptions supporting the tax provision made by Sino-Forest on restricted retained earnings of \$1.4 billion on which Sino-Forest had not paid taxes.

Particular (k) – Presentation and Disclosure of Consolidated Statements of Cash Flows

177. CAS 330.24 and 330.A59 include the following requirement:

- 24. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework. (Ref: Para. A59)

[...]

- A59. Evaluating the overall presentation of the financial statements, including the related disclosures, relates to whether the individual financial statements are presented in a manner that reflects the appropriate classification and description of financial information, and the form, arrangement, and content of the financial statements and their appended notes. This includes, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

178. Handbook (“HB”) section 1540.06 defines cash flows as inflows and outflows of cash and cash equivalents. Examples of cash flows, provided in HB section 1540.16, are cash receipts from sale of goods, cash payments to suppliers, and cash payments to and on behalf of employees.
179. As described above, pursuant to the AI/BVI Subsidiaries Model, Sino-Forest directed AI customers to pay its AI suppliers instead of receiving and paying those amounts itself. Sino-Forest treated these non-cash transactions as cash transactions.
180. Sino-Forest considered the offsets of \$1,108 million and \$74 million, from AI customers to the AI suppliers as cash inflows and outflows relating to Standing Timber and Log Trading receivables and payables of Sino-Forest, respectively.
181. Sino-Forest used \$336 million of trust receipt import loans from banks to settle payables for purchased logs imported under LCs.
182. Given the non-cash nature of the offset transactions, the appropriate presentation of Sino-Forest’s 2010 statement of cash flows, taking into account the use of trust receipt import loans in respect of Log Trading purchases, would have been as follows:

(US\$ millions)	Operating activities	Investing activities	Financing activities
Cash Flows as reported	\$840	\$(1,403)	\$681
BVI Receivables not paid in cash	(1,108)	1,108	
Log Trading Receivables offset	(74)	74	
Log Trading Purchases paid for by Import Loans	336		(336)
Adjusted cash flows in accordance with GAAP	(6)	(221)	335

183. As set out above, Sino-Forest’s reported cash flows from operating activities of \$840 million in 2010. The net amount of the adjustments for the non-cash offset transactions would have been \$846 million, eliminating all cash flows from operating activities.
184. EY’s working papers do not note consideration of the definition of cash or cash equivalents as defined in HB section 1540.06 and do not contain any documentation supporting the classification of these highly unusual offset transactions as cash flows reported on Sino-Forest’s cash flow statement.

185. Mr. Clifford admits that he failed as required by GAAS to ensure the correct presentation and disclosure of Sino-Forest's Consolidated Statement of Cash Flows items: (a) "Cash flows from operating activities and continuing operations \$840,085,000;" (b) "Cash flows used in investing activities \$(1,403,067,000);" and (c) "Cash flows from financing activities \$680,743,000".

Particular (i) – Risk of Material Misstatement Due to Fraud or Error

186. As set out above, GAAS requires auditors to obtain reasonable assurance that the entity's financial statements are free from material misstatement, whether due to fraud or error. In order to do so, auditors are required to identify areas of the financial statements that are at risk of misstatement, and to design and carry out procedures that reduce the risk of undetected misstatement to an acceptably low level in the circumstances.
187. CAS 240 "expands on how CAS 315 and CAS 330 are to be applied in relation to risks of material misstatement due to fraud" [CAS 240.1]. Particular guidance is included in CAS 240, CAS 315, and CAS 330, as set out above notably and as follows:
- When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit [CAS 240.12];
 - An auditor is required to treat assessed risks of material misstatement due to fraud as significant risks and obtain an understanding of the entity's related controls, including control activities, relevant to such risks [CAS 240.16];
 - The audit shall evaluate whether the selection and application of accounting policies, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings [CAS 240.29(b)];
 - Irrespective of the auditor's assessment of the risk of management override of controls, the auditor is required to design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments [CAS 240.32];
 - Misappropriation of an entity's assets can involve management, who may accomplish misappropriation in ways including "[c]ausing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees)" [CAS 240.A5]; and
 - When an auditor believes that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible procedures to investigate further may include

confirming directly with the third party, or using an expert to assess the document's authenticity [CAS 240.A9].

188. Specific fraud risk factors identified in Appendix 1 to CAS 240 include:

- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult “substance over form” questions;
- Use of business intermediaries for which there appears to be no clear business justification; and
- Where the monitoring of management is not effective as a result of:
 - Domination of management by a single person or small group (in a non owner-managed business) without compensating controls; and
 - Oversight by those charged with governance over the financial reporting process and internal controls is not effective.

189. As set out herein, these enumerated fraud risk factors, and others, were present in Sino-Forest's business and operations and were known, or should have been known, to Mr. Clifford and the audit team, particularly in respect of the AI/BVI Model and the Log Trading receivables process.

190. Mr. Clifford admits that, in the manner set out herein, he failed to appropriately consider and audit, and failed to ensure that the EY 2010 audit team appropriately considered and audited, the risks of material misstatement due to fraud or error, despite the presence of numerous fraud factors, contrary to the requirements of CAS 240, CAS 315, and CAS 330.

Particular (j) – Control Over External Bank Confirmations

191. CAS 505.7(d) states that: “[w]hen using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including: (d) sending the requests, including follow-up requests when applicable, to the confirming party.”

192. Sino-Forest reported cash and cash equivalent balances of \$1,223 million as at December 31, 2010. For WFOE entities located in the PRC, confirmations representing \$171 million of bank balances and other items (i.e. contingent liabilities, LCs, and other off-balance sheet financial commitments) were sent out not by EY, but by local subsidiaries of Sino-Forest. The confirmation responses were sent by the banks directly to EY [Doc – #15].

193. Mr. Clifford admits that he failed to ensure that EY maintained control over external bank confirmation requests, contrary to the requirements of CAS 505.7(d). Accordingly, the risks intended to be addressed by this standard audit procedure were not addressed.

Particular (I) – Insufficient Documentation

194. CAS 230.8 states:

The auditor shall prepare audit documentation that is sufficient 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 the CASs and applicable legal and regulatory requirements; and (b) the results of the audit procedures performed, and the audit evidence obtained.

195. As set out herein, the Company Search Reports and Site Investigation Reports were not maintained in EY's working papers for the 2010 Audit.

196. There was no information in EYs working papers that indicated that anomalous results of the Company Search Reports, the Site Investigation Reports, and AI interviews conducted (and not conducted) were taken into consideration in the course of the audit.

197. Mr. Clifford admits that, in the matter set out herein, he failed to maintain and failed to ensure that sufficient documentation was maintained to support the conclusions made in the 2010 Audit related to:

- a. The Company Search Reports;
- b. The Site Investigation Reports;
- c. AI interviews conducted and not conducted, for both Purchased Plantations and Log Trading operations;
- d. The payment of income taxes on Sino-Forest's behalf by AI customers;
- e. The adequacy of Sino-Forest's forestry management system;
- f. The authenticity of the Forestry Confirmations; and
- g. The appropriateness of Sino-Forest's accounting policies related to the description and presentation of cash flows and its use of offsetting transactions.

Acknowledgement

198. Pursuant to CAS 220, Mr. Clifford, as Engagement Partner, was responsible for the conduct of the 2010 Audit.

199. In particular:

- a. CAS 220.15 (a) and (b) state that the engagement partner shall be responsible for the direction, supervision, and performance of the audit engagement and compliance with professional standards (including those on audit documentation – CAS 220.24, CAS 230.8, and CAS 230.A8), and the appropriateness of the auditor's report in the circumstances;

- b. CAS 220.17 states that the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached; and
 - c. CAS 220.18 (a) states that the engagement partner is responsible for the engagement team undertaking consultations.
200. Mr. Clifford admits that, as Engagement Partner for the 2010 Audit, and having attached to Sino-Forest's 2010 financial statements an unqualified audit opinion, he failed to perform his professional services in accordance with generally accepted standards of practice of the profession, as described in this Settlement Agreement, contrary to Rule 206.1 of the Rules of Professional Conduct.

Mitigating Factors

201. Mr. Clifford has been cooperative throughout the CPA Ontario investigation and with respect to the investigations by the Independent Committee of Sino-Forest's Board of Directors and the OSC. It is not alleged in this proceeding that Mr. Clifford acted dishonestly in the 2010 Audit.
202. Mr. Clifford led the audit team as Engagement Partner in 2010.
203. He drew upon, and was supported by, multiple audit and tax partners and staff within the firm.
204. Mr. Clifford states that he understands with the benefit of his experience, and hindsight, that professional standards were not adhered to as admitted in this Settlement Agreement and regrets these lapses. Mr. Clifford represents that he has learned from the experience of the Sino-Forest audits.

Terms of Settlement

205. The PCC and Mr. Clifford agree on the following Terms of Settlement:
206. A payment by way of fine in the amount of C\$400,000;
207. A payment of costs in the amount of C\$1,000,000;
208. Notice of the Terms of this Settlement Agreement is to be published in the manner set out in CPA Ontario Regulation 6-2, ss. 45 and 48, including notice to be given to all members of CPA Ontario, the Public Accountants' Council, all provincial CPA bodies, and in the Globe and Mail and National Post newspapers. All costs associated with the newspaper publication shall be borne by Mr. Clifford and shall be paid in addition to any other monetary amounts agreed to herein; and
209. Mr. Clifford will be allowed 12 months from the time the Discipline Committee approves this Settlement Agreement to pay the fine and costs referred to herein.

210. Mr. Clifford has advised EY and the PCC that he will retire from EY effective June 30, 2020 and will irrevocably surrender his public accounting licence effective on the date of approval of this Settlement Agreement by the Discipline Committee (both together, "Retirement"). The Retirement is a Term of Settlement.
211. A failure by Mr. Clifford to comply with any of the Terms of Settlement will result in the revocation of his membership in CPA Ontario with full publicity in accordance with the manner set out in Regulation 6-2, s. 48.
212. As set out above, Mr. Clifford has not been involved in public accounting activity since he ceased conducting audits in 2017. His retirement is approximately three years prior to the applicable mandatory retirement date at EY. He has surrendered his public accounting licence as a Term of this Settlement Agreement. Absent these facts, and the combined penalty terms agreed to (as set out above), the PCC would have sought a period of suspension from membership of not less than 12 months as a term of sanction.
213. The PCC and Mr. Clifford expressly consent and authorize the Registrar to take any actions associated with revocation of Mr. Clifford's membership in CPA Ontario as prescribed and agreed to herein.
214. Should the Discipline Committee approve this Settlement Agreement, Mr. Clifford agrees to waive his right to a full hearing, judicial review, or appeal of the matter subject to the Settlement Agreement. Upon the member fulfilling the requirements of this Settlement Agreement, the draft allegations attached as Schedule "A", approved by the PCC and dated September 2019, shall be forever stayed.
215. If for any reason this Settlement Agreement is not approved by the Discipline Committee, then:
 - a. This Settlement Agreement and its terms, including all Settlement Negotiations between the PCC and Mr. Clifford leading up to its presentation to the Discipline Committee, shall be without prejudice to the PCC and Mr. Clifford; and
 - b. The PCC and Mr. Clifford shall be entitled to all available proceedings, remedies, and challenges, including proceeding to a hearing on the merits of the allegations, or negotiating a new Settlement Agreement, unaffected by this Settlement Agreement or the Settlement Negotiations.

Disclosure of Settlement Agreement

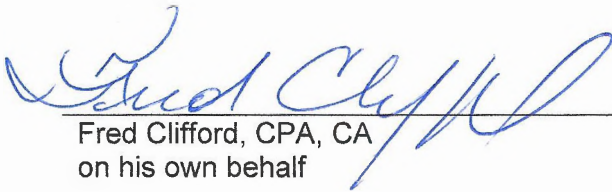
216. This Settlement Agreement and its terms will be treated as confidential by the PCC and Mr. Clifford, until approved by the Discipline Committee, and forever if for any reason whatsoever this Settlement Agreement is not approved by the Discipline Committee, except with the written consent of the PCC and Mr. Clifford, or, as may be required by law.

217. Any obligations of confidentiality shall terminate upon approval of the Settlement Agreement by the Discipline Committee.

All of which is agreed to for the purpose of this proceeding alone this 4th day of June, 2020.



Alexandra E. Hersak, LL.B
Vice President, Investigations & Prosecutions
on behalf of
The Professional Conduct Committee



Fred Clifford, CPA, CA
on his own behalf



SCHEDULE "A"

CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO

THE CHARTERED PROFESSIONAL ACCOUNTANTS OF ONTARIO ACT, 2017

TO: FRED CLIFFORD, CPA, CA

AND TO: The Discipline Committee of CPA Ontario

The Professional Conduct Committee of CPA Ontario hereby makes the following Allegation of professional misconduct against Fred Clifford, CPA, CA, a member of CPA Ontario:

1. THAT the said Fred Clifford, in or about the period January 1, 2010 through March 31, 2011, while acting as the engagement partner with Ernst & Young LLP in an engagement to audit the consolidated financial statements of Sino-Forest Corporation for the year ended December 31, 2010, and having attached to the consolidated financial statements an unqualified audit opinion, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, contrary to Rule 206.1 of the Rules of Professional Conduct, in that:
 - a. he failed to properly plan the audit;
 - b. he failed to exercise sufficient appropriate professional skepticism;
 - c. he failed to obtain sufficient appropriate audit evidence to support the Consolidated Statements of Income & Retained Earnings item "Revenue \$1,923,526,000";
 - d. he failed to obtain sufficient appropriate audit evidence to support the Consolidated Statements of Income & Retained Earnings item "Cost of sales \$1,252,023,000";
 - e. he failed to obtain sufficient appropriate audit evidence to support the Consolidated Balance Sheets item "Timber holdings \$3,122,517,000";
 - f. he failed to obtain sufficient appropriate audit evidence to support the Consolidated Balance Sheets item "Accounts Receivable (note 4) \$636,626,000";
 - g. he failed to obtain sufficient appropriate audit evidence to support the Consolidated Balance Sheets item "Accounts payable and accrued liabilities (note 18) \$499,854,000";



- h. he failed to identify and assess the risk of material misstatement due to fraud or error despite the presence of numerous fraud risk factors;
- i. he failed to maintain control over external bank confirmation requests;
- j. he failed to ensure correct presentation and disclosure of the Consolidated Statements of Cash Flows items "Cash flows from operating activities of continuing operations \$840,085,000," "Cash flows used in investing activities \$(1,403,067,000)," and "Cash flows from financing activities \$680,743,000"; and
- k. he failed to maintain sufficient documentation to support the conclusions reached in the audit.

Dated at Toronto, Ontario, this ____ day of September, 2019

E.D.M. HUFTON, CPA, CA, CHAIR
PROFESSIONAL CONDUCT COMMITTEE