

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO
THE CHARTERED ACCOUNTANTS ACT, 1956

DISCIPLINE COMMITTEE

IN THE MATTER OF: Charges against **DAVID ANTHONY HUGHES, CA**, a member of the Institute, under **Rules 206 and 206.1** of the Rules of Professional Conduct, as amended.

TO: Mr. David A. Hughes, CA
84 - 365 Bennington Gate
WATERLOO, ON N2T 2L1

AND TO: The Professional Conduct Committee, ICAO

REASONS
(Decision and Order Made May 8, 2006)

1. This panel of the Discipline Committee of the Institute of Chartered Accountants of Ontario met on May 8, 2006 to hear charges brought by the Professional Conduct Committee against David Anthony Hughes, a member of the Institute.

2. Ms. Barbara Glendinning appeared on behalf of the Professional Conduct Committee. She was accompanied by Mr. Raymond Harris, FCA, and Ms. Kelly Khalilieh, CA, the investigators appointed by the Professional Conduct Committee. Mr. Hughes was in attendance and was represented by counsel, Mr. Paul Alexander.

3. The decision of the panel was made known to the parties at the conclusion of the hearing on May 8, 2006, and the written Decision and Order sent to them on May 10, 2006. These reasons, given pursuant to Bylaw 574, include the charges, the decision, the order, and the reasons of the panel for its decision and order.

CHARGES

4. The following charges, as amended at the hearing on May 8, 2006, were laid by the Professional Conduct Committee against Mr. Hughes on December 14, 2005:

1. THAT the said David A. Hughes, in or about the period December 31, 2003 through January 17, 2004 while engaged to perform an audit of the financial statements of "S. Ltd." for the year ended December 31, 2003, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206 of the rules of professional conduct (as amended), in that:
 - (a) he failed to make a preliminary decision as to materiality and the components of audit risk at the planning stage or throughout the audit;
 - (b) he failed to ensure disclosure of the accounting policies relating to start-up costs and ISO certification;

- (c) he failed to ensure appropriate disclosure of long-term debt;
 - (d) he failed to ensure disclosure on the cash flow statement of the cash flows relating to interest, or of the separate amounts of cash and cash equivalents;
 - (e) he failed to ensure appropriate disclosure of related party transactions;
 - (f) he failed to ensure disclosure of interest rate risk, credit risk and fair value of financial instruments;
 - (g) he failed to ensure disclosure of the amount and expiry date of unused tax losses, and the amount of deductible temporary differences, for which no future income tax asset has been recognized;
 - (h) he failed to obtain sufficient appropriate audit evidence to enable him to evaluate whether management's estimates of the required amortization provisions were reasonable;
 - (i) he failed to perform analytical procedures on revenue, expenses, gross margin and balance sheet items; and
 - (j) he failed to document items important to support his report, in that his working papers contained no documentation to evidence:
 - (i) the audit strategy used;
 - (ii) the procedures used to audit pre-production costs;
 - (iii) the procedures used to audit inventory;
 - (iv) the procedures used to audit accounts payable;
 - (v) the procedures used to audit revenue/expenses;
 - (vi) the procedures used to confirm sales cut-off;
 - (vii) the alternative procedures used to verify accounts receivable;
 - (viii) the procedures used to satisfy himself as to the adequacy of the allowance for doubtful accounts;
 - (ix) the reasons why he did not seek confirmation from the client's lawyer as to claims or possible claims; and
 - (x) the search for unrecorded liabilities.
2. THAT the said David A. Hughes, in or about the period December 31, 2004 through April 25, 2005 while engaged to perform an audit of the financial statements of "S. Ltd." for the year ended December 31, 2004, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206.1 of the rules of professional conduct, in that:
- (a) he failed to ensure disclosure of the accounting policies relating to start-up costs and ISO certification;
 - (b) he failed to ensure appropriate disclosure of long-term debt;
 - (c) he failed to ensure disclosure of the nature of pledged assets;

- (d) he failed to ensure appropriate disclosure on the cash flow statement of: the purchase of capital assets; pre-production costs; and cash paid for interest;
 - (e) he failed to ensure appropriate disclosure of related party transactions;
 - (f) he failed to ensure disclosure of interest rate risk, credit risk and fair value of financial instruments;
 - (g) he failed to ensure appropriate accounting for and disclosure relating to capital leases;
 - (h) he failed to ensure disclosure of the amount of deductible temporary differences, or disclosure of the fact that no future income tax asset has been recognized for the temporary differences, and for the unused tax losses;
 - (i) he failed to document items important to support his report, in that his working papers contained no documentation to evidence:
 - (i) the procedures used to audit work-in-progress and finished goods;
 - (ii) the procedures used to audit capital assets additions;
 - (iii) the procedures used to audit pre-production costs additions;
 - (iv) the procedures used to audit "vacation payable"; and
 - (v) the reasons why he did not seek confirmation from the client's lawyer as to claims or possible claims.
3. THAT the said David A. Hughes, in or about the period December 31, 2003 through January 27, 2004, while engaged to audit the financial statements of "B.N.H. Inc." for the year ended December 31, 2003, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206 of the rules of professional conduct, in that:
- (a) he failed to disclose in his auditor's report that the financial statements were prepared using a basis of accounting other than generally accepted accounting principles, and to qualify his report accordingly;
 - (b) he failed to ensure that for each financial statement item, the statement of financial position presented a total that includes all funds reported;
 - (c) he failed to ensure that a clear and concise description of the entity's status under income tax legislation was included as an integral part of the financial statements;
 - (d) he failed to ensure appropriate disclosure on the cash flow statement of the interest on capital reserve and capital reserve disbursements;
 - (e) he failed to ensure disclosure on the cash flow statement of cash and cash equivalents and the amount of cash paid for interest;
 - (f) he failed to use assertions to form a basis for the assessment of risks of material misstatement and the design and performance of further audit

procedures;

- (g) he failed to perform analytical procedures on revenue, expenses, gross margin and balance sheet items;
 - (h) he failed to ensure that the representations of management set out in the representation letter dated February 1, 2004 included all required disclosures; and
 - (i) he failed to document items important to support his report, in that his working papers contained no documentation to evidence:
 - (i) the audit strategy used;
 - (ii) the procedures used to audit accounts payable;
 - (iii) the procedures used to audit management fees or other revenues/expenses;
 - (iv) the alternative procedures used to verify accounts receivable; and
 - (v) the reasons why he did not seek confirmation from the client's lawyer as to claims or possible claims.
4. THAT the said David A. Hughes, in or about the period December 31, 2004 through January 18, 2005, while engaged to perform a review of the financial statements of "I.T.P.F.T. Inc." for the year ended December 31, 2004, failed to perform his professional services in accordance with generally accepted standards of practice of the profession, including the Recommendations set out in the *CICA Handbook*, contrary to Rule 206.1 of the rules of professional conduct, in that:
- (a) withdrawn;
 - (b) he failed to ensure disclosure of the risks and fair value of financial instruments;
 - (c) he failed to ensure the disclosure on the cash flow statements of the cash paid for interest and income taxes;
 - (d) he failed to ensure disclosure of foreign exchange gains and losses;
 - (e) he failed to ensure appropriate disclosure of goodwill;
 - (f) he failed to ensure appropriate disclosure of related party transactions;
 - (g) he failed to ensure appropriate disclosure of operating leases; and
 - (h) he failed to document items important to support his report, in that his working papers contained no documentation to evidence:
 - (i) his discussions with management concerning certain revenue and expense items;
 - (ii) his discussions with management concerning changes in certain ratios;
 - (iii) his discussions with management concerning the decline in accounts payable balance ; and
 - (iv) his discussions with management concerning the collectability of

accounts receivable.

5. Mr. Hughes entered a plea of guilty to the charges and acknowledged that on the basis of his plea of guilty and on that basis alone he could be found guilty of the charges.

THE CASE FOR THE PROFESSIONAL CONDUCT COMMITTEE

6. Ms. Glendinning gave a brief opening statement and filed an Agreed Statement of Facts signed by herself on behalf of the Professional Conduct Committee and by Mr. Hughes on his own behalf. In addition, she filed a Document Brief which included the relevant documents. The Agreed Statement of Facts was marked as Exhibit 5 and the Document Brief was marked as Exhibit 6.

7. As the Agreed Statement of Facts is 22 pages and the Document Brief is 85 pages, the parties withdrew while the panel reviewed the evidence.

8. The Agreed Statement of Facts states that particular (a) of charge 4 was withdrawn. It was also evident that particular 4(j) should be re-lettered as particular 4(h). When the parties returned to the Council chamber and the hearing resumed, these two changes were made to the charges. As the panel had no other questions for the parties, and the parties had no further submissions to make, they were excused and the panel deliberated.

DECISION

9. Upon deliberation, after considering the plea, the Agreed Statement of Facts and the documents set out in the Document Brief, the panel concluded that the allegations set out in the charges, as amended, had been proven. The member had acknowledged the allegations to be true, both in his plea and in the signed Agreed Statement of Facts. The documents in the Document Brief disclosed or confirmed the deficiencies and errors alleged. Accordingly, the panel found Mr. Hughes guilty on all four charges and, upon reconvening the hearing, the Chair read the following decision:

THAT, having seen, heard and considered the evidence, including the Agreed Statement of Facts and Document Brief filed, and having heard the plea of guilty to each of the four charges, charge 4 having been amended in that particular (a) was withdrawn and particular 4(j) was re-lettered particular 4(h), the Discipline Committee finds David Anthony Hughes guilty of charges 1, 2, 3 and 4 as amended.

REASONS FOR THE DECISION

10. The nature of the misconduct is set out in the particulars which the panel found to be true. The panel found the financial statements and working papers extracts in the Document Brief showed a pervasive pattern of failure to keep up to date on changes in both accounting and audit standards of practice.

11. Mr. Hughes failed to take advantage of the opportunities afforded by the practice inspection process to recognize those areas in which he had become woefully out of date. He confirmed that he has undergone four practice inspections in a relatively short period of time. Mr. Hughes' practice had been inspected in July 2001 and reinspected in November 2002, November 2003 and November 2004.

12. The departure from the required standard of practice was significant and in the

circumstances required a finding of professional misconduct.

SANCTION

13. The Professional Conduct Committee did not call evidence with respect to sanction. Mr. Hughes did give oral evidence and filed a letter which he wrote to Ms. Rabinovitch, the Associate Director of Standards Enforcement, on February 17, 2005 (Exhibit 7).

14. In his oral evidence, Mr. Hughes provided information to the panel on his professional practice and personal circumstances. He is currently a sole practitioner and is starting to wind down his practice. At the time of the charges, Mr. Hughes' practice consisted primarily of compilation and tax engagements. He provided audit services to four small, non-profit organizations and one manufacturer with sales under four million dollars.

15. He testified he has been a member of the Institute for 38 years (and a member of the ICAEW for 5 years prior to that), and has served on a number of Committees of the Institute. He further testified that he had started looking for successor arrangements and those talks crystallized in August 2003 and that he began space sharing with another member January 1, 2004.

16. He confirmed that he has undergone four practice inspections in the past six years and that, while each inspection revealed deficiencies in his practice, the deficiencies identified were each addressed and corrected.

17. Mr. Hughes also filed an undertaking addressed to the Institute of Chartered Accountants of Ontario and the Professional Conduct Committee which reads:

I David Anthony Hughes, hereby advise that I have not performed any assurance or review services for clients with fiscal years commencing in 2005 and that I hereby undertake not to perform such services in the future.

Dated at Kitchener this 1st day of May 2006

David A. Hughes
DAVID A HUGHES C.A.

SUBMISSIONS OF THE PARTIES

18. The Professional Conduct Committee requested an order which included: a reprimand; a fine in the range of \$5,000-\$7,000; a suspension for three months; three specified professional development courses; a limited reinvestigation to confirm that the member was not accepting assurance engagements; notice in the usual course and costs in the amount of \$13,000.

19. Ms. Glendinning submitted the Professional Conduct Committee would have requested an order for supervised practice had it not been for Mr. Hughes' undertaking not to perform assurance or review services as he winds down his practice. It was expected that the costs of reinvestigation for purposes of confirming that Mr. Hughes was not accepting assurance engagements would be less onerous than costs of a supervised practice.

20. Ms. Glendinning submitted that the order requested was appropriate in that such a sanction would address the three principles of sanction: rehabilitation, general deterrence and specific deterrence. She submitted it was apparent that Mr. Hughes had allowed his standard of practice to

fall significantly below the standard required and the most aggravating factor was that he had allowed this to happen despite a practice inspection and three reinspections. Mr. Hughes was made aware of the problems but he failed to rectify them or begin to address them appropriately in a timely way. As of January, 2005, he had not taken any professional development courses despite the continued findings of deficiencies during practice inspections.

21. She submitted that rehabilitation was important as Mr. Hughes intended to continue to practise and provide non-assurance services to the public as a chartered accountant. Mr. Hughes acknowledged that he was in need of professional development. The courses which were suggested were intended to provide him with current professional knowledge. As well, Mr. Hughes made an arrangement with a firm of chartered accountants in order to provide him with more assistance.

22. The reprimand, fine, suspension and publication of Mr. Hughes' name were intended to be specific deterrence which would make it clear to Mr. Hughes that he was in need of rehabilitation and prompt him to do what is necessary to comply with the requirements of the profession.

23. The notice, reprimand, fine and suspension were also intended to be a general deterrent to other likeminded members in order to make it clear that they should not permit their standard of practice to lapse and let them know there would be serious consequences if they did so.

24. The request for a limited reinspection to ensure that Mr. Hughes was not accepting assurance engagements was intended to specifically deter Mr. Hughes from accepting such engagements and thus provide a measure of protection to the public.

25. With respect to costs, Ms. Glendinning filed an Outline of Costs (Exhibit 10) and submitted that, while the hearing had not been contested on the issue of guilt, the investigation itself had been lengthy and costly. It took significant time to develop the charges and the Agreed Statement of Facts (Exhibit 5). She submitted that costs in the amount of \$13,000, an amount that was approximately half of the actual costs, would be fair given the expected reduction in Mr. Hughes' income as he wound down his practice.

26. Counsel for the member took issue with the quantum of the fine and costs requested; opposed a suspension; proposed that a statutory declaration from the member should satisfy the requirement to establish that he was not accepting assurance engagements; and asked that the wording of the notice be carefully drafted so as not to exaggerate the misconduct of the member.

27. Mr. Alexander submitted that in light of the evidence with respect to Mr. Hughes' financial position that the fine and costs should be substantially reduced. In his submission, as there had been no moral turpitude on Mr. Hughes' part, a suspension was not necessary.

28. On behalf of Mr. Hughes, Mr. Alexander submitted that Mr. Hughes' breaches were errors of omission, and asked the panel to consider his long and unblemished career and the fact that he had voluntarily withdrawn from providing assurance services.

29. Mr. Alexander submitted that the public had not suffered in any way.

30. He submitted that, while Mr. Hughes had not kept up with changes in the standards of practice of the profession, there should be an acknowledgement of how challenging this has become given the number of changes in recent years. He further submitted that Mr. Hughes erred in judgment in not calling out for help sooner.

31. Both counsel, referred to a number of cases including *Crawley, Ursu, Kalba, Parisi, McLeod, Finstein and Brooman*.

32. When counsel had finished their submissions the parties withdrew and the panel commenced its deliberations.

ORDER

33. When the panel had reached its conclusion as to the appropriate sanction, the parties were recalled and the Chair set out on the record a summary of the terms of the order. The order itself, which was included with the decision sent to the parties on May 10, 2006 reads as follows:

IT IS ORDERED in respect of the charges:

1. THAT Mr. Hughes be reprimanded in writing by the chair of the hearing.
2. THAT Mr. Hughes be and he is hereby fined the sum of \$5,000 to be remitted to the Institute within twelve (12) months from the date this Decision and Order becomes final under the bylaws.
3. THAT Mr. Hughes be and he is hereby charged costs fixed at \$10,000 to be remitted to the Institute within twenty-four (24) months from the date this Decision and Order becomes final under the bylaws.
4. THAT Mr. Hughes be suspended from the rights and privileges of membership in the Institute for a period of three (3) months from the date this Decision and Order becomes final under the bylaws.
5. THAT Mr. Hughes be and he is hereby required to pay for and complete, in their entirety, within eighteen (18) months from the date this Decision and Order becomes final, the following professional development courses made available through the Institute, or, in the event a course listed below becomes unavailable, the successor course which takes its place:
 - (a) *Accounting Refresher*;
 - (b) *Financial Statement Presentation & Disclosure*; and
 - (c) *Review & Compilation Engagements*.
6. THAT Mr. Hughes be reinvestigated by the Professional Conduct Committee, or by a person retained by the Professional Conduct Committee, on one occasion to determine that no assurance or review services are being or have been performed by Mr. Hughes, within one (1) year from the date this Decision and Order becomes final under the bylaws, the cost of the reinvestigation, up to \$1,000, to be paid by Mr. Hughes.
7. THAT notice of this Decision and Order, disclosing Mr. Hughes's name, be given after this Decision and Order becomes final under the bylaws, in the form and manner determined by the Discipline Committee:
 - (a) to the Public Accountants Council for the Province of Ontario;
 - (b) to the Canadian Institute of Chartered Accountants; and
 - (c) by publication in *CheckMark*.

8. THAT Mr. Hughes surrender his certificate of membership in the Institute to the Discipline Committee secretary within ten (10) days from the date this Decision and Order becomes final under the bylaws.
9. THAT in the event Mr. Hughes fails to comply with any of the requirements of this Order within twenty-four (24) months, he shall thereupon be expelled from membership in the Institute, and notice of his expulsion, disclosing his name, shall be given in the manner specified above, and in a newspaper distributed in the geographic area of Mr. Hughes's practice or employment.

REASONS FOR THE ORDER

Reprimand

34. The panel orders that Mr. Hughes be reprimanded in writing by the Chair of the panel to make clear to him that his conduct in permitting his standards of practice to fall below those expected of a member of profession will not be tolerated by that profession.

Fine

35. The panel concluded that a fine was necessary to act as a specific deterrence for Mr. Hughes and as a general deterrence to other members. While there was a pervasive pattern of failure to keep up to date, the panel heard no submissions and saw no evidence that this failure resulted in harm to any client or the public. The panel considered this mitigating factor, together with the winding down of Mr. Hughes' practice and his undertaking to give up assurance work, when ordering a fine of \$5,000, an amount at the lower end of the range of fines in the precedent cases cited. The panel concluded that twelve months time in which to pay the fine was reasonable given the panel heard no submissions that Mr. Hughes would have difficulty paying the fine or costs.

Costs

36. It is appropriate that the member charged, as opposed to the membership as a whole, bear part of the cost of the investigation and hearing necessitated by his conduct. The panel found the investigation and hearing costs incurred to be reasonable. The panel agreed with the reply submission of the Professional Conduct Committee that the quantum of the costs ordered is fact specific and considered the fact that Mr. Hughes' practice was being wound down, a distinguishing feature of this matter. The panel decided ordering costs of \$10,000, with twenty-four months to pay, was appropriate given Mr. Hughes' changing financial circumstances.

Suspension

37. The panel concluded without hesitancy that something beyond a member's undertaking is needed to protect the public when a member becomes woefully out of date. A period of suspension or a period of supervised practice is necessary to protect the public during the period of re-education and to serve as a general deterrence. Given Mr. Hughes' thirty-eight years of practice experience, the nature of Mr. Hughes' practice and his undertaking not to accept assurance engagements, the panel concluded that a three month suspension was sufficient.

Professional Development

38. A high level of competency is required of members performing compilation engagements, the engagements which Mr. Hughes will now be accepting since he has undertaken not to perform assurance or review engagements. Accordingly, the panel concluded that ordering courses was necessary to rehabilitate Mr. Hughes and protect the public interest. The panel agreed with the Professional Conduct Committee that the three courses ordered would be the most beneficial for bringing Mr. Hughes' knowledge up to date, to best serve clients in the future.

Reinvestigation

39. To protect the public, the panel concluded that a reinvestigation was necessary to ensure that Mr. Hughes was abiding by his undertaking that no assurance or review services were being performed.

Notice

40. The publication of the member's name is often the single greatest general deterrent factor for other members of the profession. By educating those members and informing the public, the Institute fulfills its mandate to protect the public and preserve the standards of the profession. Publication of the proceeding in *CheckMark* is therefore ordered, along with notice to the Public Accountants Council for the Province of Ontario and to the Canadian Institute of Chartered Accountants.

Certificate of Membership

41. The certificate of membership belongs to the Institute issuing it. It is appropriate that the member not possess the certificate for the period of time that he is not a member in good standing and the panel thus orders its surrender for that period of time.

Failure to Comply

42. To encourage compliance with discipline orders in cases in which the member is not expelled outright, orders of a panel generally specify expulsion with newspaper notification to the public as an ultimate consequence for non-compliance. The panel so orders in this hearing.

DATED AT TORONTO THIS 7TH DAY OF MARCH 2007
BY ORDER OF THE DISCIPLINE COMMITTEE

B.L. HAYES, CA – DEPUTY CHAIR
DISCIPLINE COMMITTEE

MEMBERS OF THE PANEL:

J.B. BARRACLOUGH, FCA
L.G. BOURGON, CA
A.D. NICHOLS, FCA
H.G. TARADAY, CA
P. MCBURNEY (PUBLIC REPRESENTATIVE)