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

DISCIPLINE COMMITTEE

IN THE MATTER OF: Charges against **KERRY WILLIAM BUTLER, CA**, a member of the Institute, under **Rule 206.1** of the Rules of Professional Conduct, as amended.

TO: Mr. Kerry W. Butler, CA
Collins Barrow
Mono Plaza R.R. 4
Orangeville, ON L9W 2Z1

AND TO: The Professional Conduct Committee, ICAO

REASONS
(Decision and Order Made July 11, 2007)

1. This panel of the Discipline Committee of the Institute of Chartered Accountants of Ontario met on July 11, 2007, to hear charges of professional misconduct brought by the Professional Conduct Committee against Kerry William Butler, a member of the Institute.

2. Ms. Alexandra Hersak appeared on behalf of the Professional Conduct Committee and was accompanied by Mr. Robert G. Robertson, CA, the investigator appointed by the Professional Conduct Committee in this matter. Mr. Butler attended and was represented by his counsel, Mr. Chris Hluchan.

3. The decision of the panel was made known at the conclusion of the hearing and the written Decision and Order sent to the parties on July 18, 2007. These reasons, given pursuant to Bylaw 573, contain the charges, the decision, the order, and the panel's reasons for its decision and order.

CHARGES

4. The following charges were laid against Mr. Butler by the Professional Conduct Committee on March 28, 2007:

1. THAT, the said Kerry W. Butler, in or about the period of January 1, 2004 through May 30, 2004, while engaged to review the financial statements of "JMP" as at January 31, 2004, 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 carry out sufficient and appropriate analysis and review to satisfy himself that the financial statements were plausible;

(b) he failed to carry out a review sufficient to establish as plausible the balance sheet item “Deposits and prepaid expenses 278,934”;

(c) he failed to carry out a review sufficient to establish as plausible the balance sheet item “Inventories 315,939”;

(d) he failed to ensure proper financial statement presentation and disclosure; and

(e) he failed to document procedures important to support his review engagement report.

2. THAT, the said Kerry W. Butler, in or about the period of January 1, 2005 through May 30, 2005, while engaged to review the financial statements of “JMP” as at January 31, 2005, 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 carry out sufficient and appropriate analysis and review to satisfy himself that the financial statements were plausible;

(b) he failed to carry out a review sufficient to establish as plausible the balance sheet item “Deposits and prepaid expenses 352,226”;

(c) he failed to carry out a review sufficient to establish as plausible the balance sheet item “Inventories 513,832”;

(d) he failed to ensure proper financial statement presentation and disclosure; and

(e) he failed to document procedures important to support his review engagement report.

PRELIMINARY MATTERS

5. Prior to Mr. Butler entering a plea to the charges, the Professional Conduct Committee withdrew particular (d) of charge No. 1 and particular (d) of charge No. 2.

PLEA

6. Mr. Butler entered a plea of guilty to each of the charges as they remained, and acknowledged that he understood that, on the basis of the plea of guilty and on that basis alone, he could be found guilty of the charges.

EVIDENCE

7. The evidence for the Professional Conduct Committee was entered through the testimony of Mr. Robertson, CA. The Professional Conduct Committee also filed a Document Brief (Exhibit 2), to which Mr. Robertson referred in the course of his evidence. The evidence presented by the Professional Conduct Committee was not contested by Mr. Butler, and is briefly summarized below.

8. Mr. Butler is the senior partner in the Orangeville office of Collins Barrow, a public accounting firm. He was retained by "JMP" to review the financial statements of that company for fiscal 2004 and 2005. Much of the work on the engagement was performed by a technician in his office, but he supervised and reviewed the work, and signed the Review Engagement Report appended to the financial statements for both years.

9. For each fiscal year, Mr. Butler, as required by Collins Barrow policy, included in the working paper file a "Knowledge of Business" form for JMP (Exhibit 2, Tabs B and E). However, the forms were left mostly blank, and the form for 2005 was simply a copy of the form for 2004. Mr. Butler failed to identify any of the financial risks and vulnerabilities of the company and its industry which would have been apparent had the forms been properly completed.

10. There was no written plan for the review engagement for either year. The working papers contained no consideration of the inter-relationship of various items, and very little analysis. Nor was there any explanation of items where there was a wide variance from the year before, or those that appeared implausible.

11. JMP represented to Mr. Butler, for both 2004 and 2005, that it was paying by installments the purchase price of a punch and press brake, and that that equipment was not delivered to the company until the latter part of fiscal 2005 and, further, that, even at that time the final sales terms had not been agreed upon and that no paperwork had yet been received. Mr. Butler accepted these representations and decided to disclose the asset and payments as prepaid expenses, in the financial statements. (Exhibit 2, Tab G).

12. The payments made by JMP for the punch and press brake in fiscal 2004 totalled $188,680.99 (of the total prepaid expenses listed of $278,933.74) (Exhibit 2, Tab C). For the same period, the debt/equity ratio for the company was approximately 6:1. The payments made in 2005 were $301,064.26 (of a total prepaid expense of $352,225.53) (Exhibit 2, Tab F), and the debt ratio had worsened to 6.5:1.

13. In fact, JMP had taken delivery of the punch and press brake prior to fiscal 2004, and was in breach of the sales terms for that equipment. Further, the documentation for that sale was in the possession of JMP. The management representations made by JMP were incorrect. Mr. Butler took no steps to verify whether the equipment was on the shop floor, and to obtain information from the vendors. Proper disclosure of the acquisition of the equipment, related debt and amortization of the equipment would have resulted in a severe breach of the company's financial covenants which also would have required disclosure in the financial statements.

14. JMP was a "just in time" manufacturing operation, and its inventory therefore consisted of raw materials and a small amount of finished goods. Inventory on the 2003 financial statements was shown as $214,120. In 2004, it was $315,939, and in 2005, $513,832. JMP did not do a physical year-end inventory count, but did periodically count certain segments and adjusted the inventory accordingly. The Collins Barrow "Review Guideline – Inventory" (Exhibit 2, Tab C) requires the accountant to "obtain the inventory listing, agree total to the general ledger control account". This was not done.

15. When the successor accountant required a physical inventory count in for fiscal 2006, it was determined that the raw materials inventory had been over-stated by $90,000 and the finished goods under-stated by $70,000. In 2004, materiality had been set at $27,000 and in 2005 at $42,000. The inventory was also pledged as security, which was not reflected in either the working papers or the financial statements for 2004 or 2005. The successor accountant reflected, for the

company's fiscal year ended January 31, 2006, an adjustment for correction of prior period errors totaling $315,025 of which $184,260 related to 2005 and the balance to previous years.

16. Mr. Hluchan, on behalf of Mr. Butler, called no evidence.

DECISION

17. The evidence is clear, cogent, compelling, and uncontradicted, and establishes the misconduct as set out in the charges. After deliberating, the panel made the following decision:

> THAT, having seen, heard and considered the evidence, and charge Nos. 1(d) and 2(d) having been withdrawn at the hearing, and having heard the plea of guilty to charge Nos. 1 and 2, as amended, the Discipline Committee finds Mr. Kerry William Butler guilty of charge Nos. 1 and 2, as amended.

SANCTION

18. Mr. Butler testified on the issue of sanction, and stated that, at the time, he believed his work met the standards of the profession. He now realizes it did not. He also relied heavily on management representations and now knows he should have been more wary. The discipline charges have led him to reflect not only on the circumstances of this matter, but on his practice and his position as a public accountant. He wishes to continue in the profession, and is motivated to be educated and improve continuously.

Submissions

19. On behalf of the Professional Conduct Committee, Ms. Hersak submitted that public protection can be achieved through the principles of specific deterrence and rehabilitation, and that the appropriate sanction would include: a written reprimand; a fine in the range of $5,000 - $7,500; three courses of professional development; a re-investigation within twelve months, with the cost, up to $2,000, to be borne by the member; and full publicity. She also sought 50% of the costs of the investigation and hearing, and filed an Outline of Costs indicating that the costs totaled $29,548.13. She clarified that she was seeking, on a partial indemnity basis, $14,000 in costs.

20. Ms. Hersak noted that the Professional Conduct Committee was concerned with Mr. Butler's ready and unquestioning reliance on management representations, and with the maintenance of the public trust in the value attached to the signing of a financial statement by a chartered accountant. She drew the panel's attention to a number of precedents (Exhibit 3) in support of both the type of sanction and the quantum.

21. On behalf of Mr. Butler, Mr. Hluchan submitted that there was no gross breach of standards or inexcusable conduct. Rather, Mr. Butler made a mistake in that he relied on management representations and failed to document his thought processes. Mr. Hluchan pointed out that Mr. Butler did question the prepaid expenses and was misled by the company, although he acknowledged that Mr. Butler could have inquired further and reviewed source documentation to confirm these representations by management. He further submitted that Mr. Butler is truly remorseful and that the discipline process itself has been both deterrent and rehabilitation.

22. Mr. Hluchan took issue with two specific aspects of the sanction submitted by the Professional Conduct Committee. He submitted that the fine sought was excessive, and urged the panel to consider a quantum of $1,500 to $2,500, and he distinguished the cases provided as

precedents from the present matter, pointing out that any fine will serve the purpose of a deterrent.

23. Mr. Hluchan also submitted that the Discipline Committee lacked the jurisdiction to order costs, and filed extracts of the *Statutory Powers Procedure Act* (Exhibit 6) in support of that submission. In particular, he drew the panel's attention to section 17.1(2) which he said limited the panel's discretion to order costs to those cases where the conduct of the party "has been unreasonable, frivolous or vexatious or a party has acted in bad faith".

24. In the alternative, Mr. Hluchan argued that the costs sought by the Professional Conduct Committee were excessive, taking into account that totality of the sanction, the nature of the offence, and the conduct and circumstances of Mr. Butler.

25. In reply, Ms. Hersak submitted that the Discipline Committee did have the authority to impose an order for costs, and argued that this process falls outside the ambit of the provisions of s. 17.1 of the *Statutory Powers Procedure Act*, as the committee has not enacted any rules of procedure. Therefore, she submitted, the authority to order costs flows from the provisions of the enabling legislation, the *Chartered Accountants Act, 1956.*

ORDER

26. After deliberating, the panel made the following order:

IT IS ORDERED in respect of the charges:

1. THAT Mr. Butler be reprimanded in writing by the chair of the hearing.

2. THAT Mr. Butler 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. Butler be and he is hereby charged costs fixed at $10,000 to be remitted to the Institute within twelve (12) months from the date this Decision and Order becomes final under the bylaws.

4. THAT Mr. Butler be and he is hereby required to complete, by paying for and attending in their entirety, within twelve (12) months from the date this Decision and Order becomes final under the bylaws, the following professional development courses made available through the Institute:

   (a) *Financial Statement Presentation & Disclosure – A Practitioner's Workshop;*
   (b) *Review Engagements;* and
   (c) *Accounting Refresher.*

   or, in the event a course listed above becomes unavailable, the successor course which takes its place.

5. THAT notice of this Decision and Order, disclosing Mr. Butler'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 all members of the Institute;
   (b) to the Public Accountants Council for the Province of Ontario; and
   (c) to all provincial institutes/Ordre,

   and shall be made available to the public.

6. THAT in the event Mr. Butler fails to comply with any of the requirements of this Order, he shall thereupon be suspended from the rights and privileges of membership in the Institute until such time as he does comply, provided that he complies within three (3) months from the date of his suspension, and in the event he does not comply within the three month period, 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. Butler's practice, employment and/or residence. All costs associated with the publication shall be borne by Mr. Butler and shall be in addition to any other costs ordered by the committee.

7. THAT in the event Mr. Butler fails to comply with any of the requirements of this Order, his public accounting licence shall thereupon be suspended until such time as he does comply, provided that he complies within three (3) months from the date of his suspension, and in the event he does not comply within the three month period, his licence shall thereupon be revoked. Notice of his licence suspension and revocation, disclosing his name, shall be given in the manner specified above, and in a newspaper distributed in the geographic area of Mr. Butler's practice, employment and/or residence. All costs associated with the publication shall be borne by Mr. Butler and shall be in addition to any other costs ordered by the committee.

REASONS

27. Unlike many of the precedents provided to us, Mr. Butler did not sign the financial statements knowing the information contained in them was misleading or false. Nor did he perform the engagement without taking any steps to verify the line items. He did, however, rely on management representations and failed to apply critical thought to those processes, even when the representations, on their face, appeared implausible.

28. JMP was a company clearly highly leveraged and under-capitalized. It was cash-strapped, and yet appeared to have tied up an inordinate amount of its scarce resources in an asset (prepaid expenses) that was not generating any revenue. That such a business decision is illogical does not make it impossible. It does, however, make it implausible, and requires closer scrutiny by the accountant.

29. Likewise, JMP's rapidly increasing inventory should have led to more comprehensive questioning as the company was a "just in time" manufacturing operation. Further, given the company was heavily financed, a more comprehensive review of the inventory should have been conducted. While the accountant is not required to perform a physical inventory count, or to be assured the count is accurate, the accountant must determine that the inventory reported is

plausible. There is nothing in the working papers to indicate that such a determination was made, or on what grounds.

30. Mr. Butler failed to identify the risks associated with the company or with its industry, despite having a firm template to follow to do so. He also failed to complete the form properly and to update the form from one year to the next. Had he done so, the company's precarious and worsening financial situation should have led to heightened scrutiny.

31. A large year-over-year increase in the prepaid expense account should have been investigated by Mr. Butler. Had he done so, a review of the Trumpf documentation would have resulted in the proper disclosure of the equipment and its relating debt.

Reprimand

32. A written reprimand is necessary to indicate to Mr. Butler the serious nature of his misconduct. His failure to maintain the standards of the profession reflects not only on him, but on every member of that profession. He has damaged the credibility of every chartered accountant.

Fine

33. A fine is required to act as a specific and general deterrence, to indicate to Mr. Butler the unacceptable nature of his conduct, and to warn all members of the profession. Mr. Butler did not deliberately assist in concealing the true state of JMP's financial affairs, but he did not turn his mind to the relevant issues. It also takes into account the nature of the offence and Mr. Butler's circumstances.

Professional Development

34. Mr. Butler has the ability and the desire to be a competent and contributing member of the profession. He is an excellent candidate for rehabilitation, and the professional development courses ordered will assist with that goal.

Notice

35. Chartered accountancy is a self-governed profession. The privilege of self-government is granted based on the public trust that the profession will be governed in the public interest. The public has a right to know that their trust is well-founded, and so, disciplinary matters are made public in all but the most rare and unusual of circumstances. No such circumstances have been urged on the panel in this matter.

Failure to Comply

36. Although we have no reason to doubt Mr. Butler will comply with this order, it is important that the order provide sanctions for any failure to abide by its terms, both with respect to Mr. Butler's membership and his licence to practise public accounting.

Costs

37. Mr. Hluchan raised the argument that the Discipline Committee lacks the jurisdiction to order costs in these circumstances. However, the Discipline Committee has a clear power granted by the *Chartered Accountants Act, 1956*, to impose costs. Taking into account Mr. Butler's conduct, both that which brought him before the disciplinary process, and that since, and his circumstances, including the totality of the sanction, the quantum ordered is appropriate.

DATED AT TORONTO THIS 23rd DAY OF AUGUST, 2007
BY ORDER OF THE DISCIPLINE COMMITTEE

M.B. MARTENFELD, FCA – DEPUTY CHAIR
DISCIPLINE COMMITTEE

<u>MEMBERS OF THE PANEL:</u>

A. HANSON, CA
J.B. BARRACLOUGH, FCA
S.B. WALKER (Public Representative)