



By email ([Edcomments@ifac.org](mailto:Edcomments@ifac.org)) and by post

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Technical Manager  
Professional Accountants in Business Committee  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017  
United States

Dear Sir,

**IFAC Exposure Draft (ED) *Proposed Good Practice Guidance:  
Defining and Developing an Effective Code of Conduct***

The Hong Kong Institute of Certified Public Accountants (“the Institute”) welcomes the opportunity to comment on the revised exposure draft (“ED”), “*Defining and Developing an Effective Code of Conduct*”. As the Institute indicated at the time of commenting on the previous ED, this is a highly worthwhile project, particularly in view of the lack of authoritative guidance in this area for the accountancy profession, as the Explanatory Memorandum notes.

We note that extensive changes have been made in the current document in the light of comments made on the earlier ED. As a result, the structure of the ED, based around key principles underpinning good practice in the field has been significantly improved, making the document more readily accessible and usable.

**A) General comments**

The title of the document, “*Defining and Developing an Effective Code of Conduct*”, may not be sufficiently specific to reflect the objective and content. We note that the title has been revised from the previous ED, which referred to the development of a “code of corporate conduct”. Given that the guidance will be issued by IFAC, i.e. an accountancy body, the assumption may be made that it is a code of conduct purely for accountants. We appreciate that the guidance will be relevant not only to corporations and, therefore, one possible alternative title would be, “*Defining and Developing an Effective Code of Conduct for Organisations*”.

The principal target audience of the guidance needs to be clearly established. We believe the guidance to be particularly relevant to the board of directors and senior management of an organisation, and to professional accountants in business (“PAIBs”) who are holding such positions and/or taking up roles in

governance and ethics. Although the section entitled, “*The Role of the Professional Accountant in Business*” seeks to explain the connection between the guidance and the professional and ethical responsibilities of PAIBs in their different roles, it does not seem to be entirely clear. Paragraph 1.14, in particular, which deals with the interaction between codes of organisational conduct, the IFAC Code of Ethics and codes of conduct issued by professional accountancy bodies, is quite confusing.

It is noted from the Explanatory Memorandum, under the sub-heading “Introduction to the PAIB Committee Approach to Good Practice Guidance”, that a preface document and explanatory memorandum will be exposed in early 2007 for public comment. The preface will signal IFAC’s aims and objectives in delivering a program based on developing principles-based pronouncements, and provide detail on scope, authority and due process. We expect that the preface will be important in clarifying the scope, authority and standing of the IFAC good practice guidance. It may also have a direct bearing on the drafting of the guidance. It would be helpful, therefore, if the preface were to be exposed at the same time as the current draft guidance.

The extent, if at all, to which PAIBs in senior positions within a company have any specific professional or ethical responsibility to take steps to influence their company’s ethical culture should be clarified. PAIBs can act only where they have the opportunity and are in a position to drive and support the development of a code of conduct within their organisations, by for example taking a leadership role and championing the project. While senior PAIBs should be encouraged to do this, they should not be penalised or called to account where they are not able to do so. The responsibility for ensuring that an organisation adopts good practice should primarily be that of the board and the senior management as a whole and PAIBs should not be given the additional responsibility of being the “conscience” of an organisation.

In view of the above, while providing effective guidance on good practice, the wording of the guidance should avoid being too prescriptive or definitive. We understand that this is a delicate balance. For example, the statement, in paragraph 1.10, that “[a]lthough all have to uphold the high ethical standards in IFAC’s Code of Ethics, the more senior the position an individual holds, the greater the ability and opportunity to influence events, practices and attitudes” is a generalisation that could be misconstrued. While it may be true from a relative standpoint, even those in senior positions may be working under severe constraints due to, e.g. the demands of major shareholders or, in the public sector, governments and other significant stakeholders.

The ED seems to target all companies, without specific guidance dealing with the differences involved in developing a code for start-ups, growth or mature organisations, private versus state-owned enterprises, etc. Smaller organisations may need help with implementation. While it may be appropriate for initial guidance to be fairly generic in nature, we would suggest that later on this project be supplemented with more tools to, e.g.:

- provide case studies on how a code of conduct could be implemented from a variety of cultural settings;
- examples of compliance / monitoring programs.

As regards the specific questions raised in section headed “*Guide for commentators*” in the Explanatory Memorandum, the Institute’s view is as follows:

1. The principles: Broadly speaking, these seem appropriate, subject to our comments below.
2. Application guidance: Please see our detailed comments below.
3. Appendices: We would suggest combining C and E. They cover much the same material and the basis for the split is unclear. Appendix D could be deleted - the text acknowledges that the diagram is incomplete in terms of cross-relationships between different stakeholders. It would be more useful to place the content in the main body of the text as a table showing types of stakeholder, how they relate to the organisation and what they are looking for from the organisation.

In relation to Appendix A, it might be useful to include some real examples of good practice extracted from existing codes of conduct (without names).

An appendix containing common or suggested lists of contents for codes of conduct for different types of organisations (e.g. large private sector, small and medium-sized enterprises and large and small public sector bodies) would be helpful. We note that there was a section in the main body of the previous ED listing the content of a typical code of conduct. This has now been dropped altogether. We believe that the basic concept is sound, although the approach may need to be revised as just suggested.

## **B) Detailed comments**

### ***Why the Topic is Important***

Paragraphs 1.3, 1.7 and 1.8: Suggestions that good conduct and integrity are linked to success in the marketplace and that “good conduct is good business” (paragraph 1.3); that consumers tend to prefer to buy from organisations with a strong record of adhering to standards of conduct and behaving in a socially sensitive way (paragraph 1.7); that an organisation’s failure to establish and implement a code of conduct and to embed its organisational values will ultimately increase the cost of its capital (paragraph 1.8), etc. are potentially contentious statements that need to be supported by hard evidence. Without such evidence, it may be less contentious to quote the converse of these statements. For example, there is evidence from actual cases (e.g., the major corporate failures in the US) that, all other things being equal, poor conduct and a lack of integrity may lead to business failure; consumers may be deterred from

buying from organisations with a poor track record of adhering to standards and behaving in a socially responsible way; and good corporate governance and transparency may be a factor in helping to reduce the cost of capital (because, e.g. they can benefit organisations seeking a credit rating, help to reduce the risk premium for providers of capital and to increase the possible options for raising capital).

The inference in paragraph 1.6 that enterprises in developing countries will be creating a code for the first time, while those in established economies will already have a code, may be incorrect, particularly in relation to the latter point.

### ***Definitions and Key Principles***

Paragraph 2.2 states that the list of contents set out in that paragraph would usually be found in codes of organisations with a “*relatively mature approach to managing ethics and values*”. It is not clear whether this is then intended as “best practice” for all organisations or whether it would depend on the stage of development of a particular organisation.

The definition of “code of conduct” in paragraph 2.4 includes “respects the rights of all constituents affected by its operations”. The definition seems to make a value judgement that all organisations should aspire to be this altruistic in their outlook, which is debatable. In addition, “constituents” is not a term commonly used in this context and, if this arm of the definition is retained, we would suggest replacing it with a more general term.

### ***Principle A***

The switch in approach of the draft guidance from being rules based to values based is also supported. The values and beliefs of an organisation should serve as the foundation for values-based codes. Our further comments are set out below.

There appears to be some conflict between paragraph 3.2 and the remainder of this section. Paragraph 3.2 states: “Managing for compliance is a valid approach to developing a code”. However, the remainder of the section emphasises the advantages of a values-based code and implies that a purely compliance-based approach is not generally sufficient. The previous ED referred to three approaches to developing a code, namely (i) managing for compliance, (ii) managing stakeholder relations and (iii) creating a values-based organisation, as three progressive stages. Given that the ED is advising on good practice, it might be better to make it clear that managing for compliance should be no more than an initial stepping stone to achieving a values-based approach for organisations that may not be ready to move straight to a values-based approach (e.g. because they are still developing the necessary systems and internal controls).

The term “managing for compliance” may need to be elaborated for the benefit of those new to this subject.

It is suggested that the draft should also emphasise the point that good values-based codes make concrete connections between values, standards and the behaviour of employees.

In the first part of paragraph 3.7, “the board of directors” or “those charged with governance” should be added to the list of those who may shape organisational values.

Consideration should also be given to adding the following additional activities into the bullet points in paragraph 3.7:

- creating more collaborative ways of working; and
- reducing bureaucracy and command and control patterns that obstruct change.

The reference in paragraph 3.9 to Appendix B should clarify that these are important values-based principles applicable to individuals, e.g. board or governing body members, in public sector organisations (rather than organisational values as such).

### ***Principle B***

Principle B reads more as commentary than as guidance. As a principle, it seems rather too generic to lend itself to implementation in any specific way and this seems to be borne out by the very general nature of the application guidance. There is a risk that the reader will come to the conclusion that codes of conduct are relative and dependent on the context and that there are no absolute standards. In our view, this would not be the right message to be sending.

Under the circumstances, we would suggest highlighting key areas of commonality, e.g. matters that should be addressed in any code of conduct, which may be high-level matters, before discussing the differences and how these may be reflected in different codes.

A clearer indication of how relevant factors, such as those listed in paragraph 3.10, impact upon codes of conduct would be helpful. Other relevant factors might be:

- strategy
- organisational structure

Paragraph 3.12: The sentiments expressed in the second subparagraph are applicable beyond state-owned and not-for-profit enterprises. We would suggest moving it to the end of the section, as a new paragraph 3.15.

### ***Principle C***

The principle requires not only that the board specifically oversee the development of a code, but also that a senior manager be formally appointed to supervise development of a code. The latter requirement may be overly prescriptive in terms of the process.

The application guidance focuses too much on describing the general ethical responsibilities of boards and senior management rather than highlighting their role vis-a-vis code development. The emphasis of this section needs to be shifted more towards the latter.

### ***Principle D***

Principle D advises that “a multi-disciplinary and cross-functional group should lead code development”. Although we note that there is a reference in the principle to the involvement of international personnel, it may be worthwhile to emphasise that, where applicable, “a multi-disciplinary, cross-functional, and cross-country group” should lead code development.

### ***Principle E***

This is a key part of the ED and we would suggest that it be dealt with earlier in the document. We would suggest exchanging the order of Principles B and E, so that the sequence (using the existing lettering) is A, E, C, D, B, F and G.

The activity of understanding the organisation and where it is going should be the first step in paragraph 3.26. Some of the material in the existing paragraph 3.58 could be moved into this paragraph, as not all of the issues raised in paragraph 3.58 are limited to international enterprises.

### ***Principle F***

We would suggest that the principle would be clearer if “in which an organisation operates” were added at the end.

The message is unclear. The principle itself and the opening sentence of paragraph 3.53 are quite prescriptive. However, subsequently a number of questions are posed, particularly in paragraph 3.58, without answers being suggested or an indication being given as to how the answers might impact on the principle. The final bullet in paragraph 3.54 even seems to call into question the basic principle.

At present, the implication is that certain standards are flexible. If this is the committee's view, then more guidance needs to be provided in distinguishing between optional standards (i.e. those can be customised) and mandatory standards; it needs to be explained why something that is important enough to be put in a code of conduct need not be followed throughout the organisation.



Some specific examples of how and what particular standards might be “localised” could help to illustrate the point the ED is seeking to make here.

The second paragraph in 3.55 should be part of the business case contained in paragraphs 1.7-1.8.

In the second and third bullet points of paragraph 3.58, the references to “local” and “locally” may confuse. If the question is viewed from the perspective of the organisation’s home base, then it may be better to say “at home and abroad”.

The final bullet point in paragraph 3.58 states: “The organisation should focus primarily on its own culture rather than the local national culture.” We note a comment made by the ICAEW on the first version of the exposure draft, in a letter of 10 April 2006, that the above statement amounted to an absolute assertion and was debatable. It was suggested that this type of issue should be a consideration for the organisation concerned and not one for prescription by a guidance note. This point does not seem to have been addressed in the latest exposure draft.

### ***Principle G***

As a matter of drafting, we would suggest that the phrase “And punishment should be proportional to the seriousness of the confirmed breach” should form part of the previous sentence.

### ***Appendix A***

The comments on Appendix A of the previous ED, contained in our response of 28 April 2006, still apply as the illustrative code has not been revised. It is quite prescriptive and contains a number of prohibitions and examples of negative wording. Generally, it does not seem to accord well with the description of a values-based code contained in paragraph 3.1.

For the sake of consistency, the heading should refer to a “values-based”, rather than “value-based”, code of conduct.

### ***Appendices C and E***

As indicated in point (3) under “*General Comments*” above, we believe that these two appendices should be combined.

### ***Other Appendices***

Please see the Institute’s suggestions in point (3) under “*General Comments*” above.



### **C) Other comments**

There could be more coverage of the question of fraud and dishonesty (e.g. how to deal with it, to investigate it fairly and with due process, etc.). This would increase the relevance of the guidance as a document to be adopted globally.

For consistency in the terminology used throughout the draft document, it is suggested that the term “professional accountants” / “accountants” be changed to “professional accountants in business”, where appropriate.

On a more general note, the sections on "*Implementing the Principles*" mix the principles with action steps. For some organisations, this section may seem in places too prescriptive and contain assumptions that are not readily applicable to all organisations. While we would not propose further major changes to the overall approach at this stage, in the context of any future revisions after the guidance has been issued, an alternative that the committee might wish to consider would be to discuss each principle, expand each with explanations; then follow this with a separate section on implementation suggestions, with caveats for different types of firms.

To ensure that this guidance can effectively add to, and distinguish itself from, the existing materials on codes of conduct, it may be worthwhile to undertake a brief review of the currently-available literature on this subject.

I hope you find our comments to be helpful and constructive. Please feel free to contact the Institute if you have any questions on this submission.

Yours faithfully,

A handwritten signature in black ink that reads 'Peter Tisman'. The signature is written in a cursive, slightly slanted style.

Peter Tisman  
Director, Specialist Practices

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