

Code of Ethics Exposure Draft released for consultation

An Exposure Draft (ED) of the proposed HKSA Code of Ethics (Hong Kong Code) has been released for consultation until 15 December 2002. The ED is available at the HKSA website at: <www.hksa.org.hk/professionaltechnical/ethics/exposedraft/code_of_ethics.pdf>.

The proposed Hong Kong Code is closely modelled on the Code of Ethics for Professional Accountants (International Code) issued by the International Federation of Accountants (IFAC). The adoption of the International Code is a key step by the HKSA to achieving convergence of local standards with international standards.

The ED represents the result of the HKSA Ethics Committee's hard work over the past seven months under the chairmanship of Mr Mark Fong. It is also worth mentioning that the Ethics Committee has taken an active part in the review of the revised s 8 of the International Code on auditors' independence throughout its consultation process which spanned over two years. The composition of the Ethics Committee was expanded during the year with the appointments of four lay members drawn from a wide section of the community. The new lay Committee members are Rita Liaw, executive director of Ethics Development Centre nominated by the ICAC; Chua Guan-Hock, a barrister nominated by Hong Kong Bar

Association; Denis Brock, a solicitor nominated by the Law Society of Hong Kong; and Herbert Hui, a listed company director nominated by The Hong Kong Institute of Directors.

The proposed Hong Kong Code adopts a principles-based (conceptual framework) approach to auditors' independence such that auditors are required to exercise professional judgment, rather than following certain prescriptive rules, to identify threats to independence, to evaluate the significance of those threats, and, if the threats are other than clearly insignificant, to apply safeguards to eliminate or reduce the threats to an acceptable level such that independence of mind and independence in appearance are not compromised.

The ED identifies five categories of threats to auditors' independence and three categories of safeguards that auditors should put in place to mitigate threats in order to preserve their independence (see table). It gives many examples describing specific circumstances and relationships that may create threats to auditors' independence and how they can be dealt with. One of the examples quoted is familiarity threat that may arise when the same lead engagement partner is on an audit of a listed company for a prolonged period since he may have become too familiar with the affairs of the client and, as a result, may have lessened his professional skepticism. Possible safeguards to reduce this threat to an acceptable level are for the lead engagement partner to rotate off the engagement after a pre-defined period, normally no more than seven years, and for him not to resume the lead engagement partner role until a further period of time, normally two years, has elapsed.

In situations where no safeguards are available to reduce the threat to an acceptable level, such as performing valuation of matters material to the financial statements of an audit client where the valuation involves a significant degree of subjectivity (self-review threat), or promoting, dealing in, or underwriting of an audit client's shares (advocacy threat), the engagement to provide these non-audit services should be declined by auditors.

The ED includes a proposed Statement of Policy of the HKSA Council which sets out the authority of the proposed Hong Kong Code and the disciplinary provisions in the Professional Accountants Ordinance for failure to comply with the ethical requirements. The Hong Kong Code will be applicable to both members and registered students of the HKSA.

On finalising the proposed Hong Kong Code, most of the existing Professional Ethics Statements (PES) will be withdrawn, and the remaining PES, being additional local guidance on the application of the Hong Kong Code, will be updated to become Additional Guidance.

In issuing the ED for consultation, the HKSA is aware that IFAC has a plan to restate the International Code on a principles-basis in its entirety in line with that adopted for the section on auditors' independence and to expand the section on the ethical requirements for employed professional accountants. The HKSA will review and issue further consultation on any proposed changes that may be made to the International Code in due course with the aim of attaining convergence of our standards with current international standards at all times.

Comments on all aspects of the ED are welcome. Specific comments are requested on the appropriateness of:

- a move to a conceptual framework approach to auditors' independence (s 8),
- the inclusion of examples of specific circumstances and relationships that may create threats to auditors' independence (Appendix to s 8), and
- further liberalisation of the existing practice promotion rules (s 14).

Comments on the ED are invited to be sent by post, fax or e-mail to:

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Measures to mitigate threats to auditors' independence

Threats to auditors' independence

- ✓ self-interest threat
- ✓ self-review threat
- ✓ advocacy threat
- ✓ familiarity threat
- ✓ intimidation threat

Safeguards to mitigate threats

- ✓ created by the profession, legislation or regulation
- ✓ within the client
- ✓ within the audit firm's own systems and procedures