



23 March 2005

To: Members of the Hong Kong Institute of CPAs
All other interested parties

Exposure Draft of Proposed Professional Ethics Statement 1.207A – Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong

Comments to be received by 22 April 2005

*Issued by the Council,
Hong Kong Institute of Certified Public Accountants*

The Hong Kong Institute of Certified Public Accountants' Council (Council) has issued for consultation an Exposure Draft of proposed Professional Ethics Statement 1.207A – *Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong*.

Council invites comments on the Exposure Draft from any interested party and would like to hear from both those who do agree and those who do not agree with the proposals contained in the Exposure Draft. Comments should be supported by specific reasoning and should preferably be submitted in written form.

The Exposure Draft is available at:

<http://www.hkicpa.org.hk/professionaltechnical/ethics/exposuredraft/1.207A.pdf>.

Comments are requested to be received by **22 April 2005** and may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

23 March 2005
Exposure Draft

Response Due Date
22 April 2005

Draft Professional Ethics Statement 1.207A

Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

CHANGE OF AUDITORS OF A LISTED ISSUER OF THE STOCK EXCHANGE OF HONG KONG

(Response Due Date 22 April 2005)

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This Exposure Draft may be filed in the “Exposure Drafts, Invitations to Comment” section of Volume I of the Institute’s Members’ Handbook.

A copy of the Exposure Draft can also be found on the Institute’s website at:
<http://www.hkicpa.org.hk/professionaltechnical/ethics/exposedraft/1.207A.pdf>.

Introduction and purpose

1. The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) have raised concerns with the Hong Kong Institute of Certified Public Accountants concerning announcements made by listed issuers of the SEHK of the reasons for changes in auditors. In many cases, fee disputes are stated to be the reason for the change. Concern has been expressed that certain auditors have been relying on purported fee disputes to disguise the real reasons for the change. As a result, potentially significant and fundamental matters about the listed issuer may not be disclosed to investors and creditors and the market is not therefore being kept fully informed. It is important that the situation concerning the change of auditors should be disclosed in full to avoid the possibility of the market being misled.
2. The purpose of this Statement, which has been prepared in consultation with the SEHK and the SFC, is to establish a framework to enhance communication by auditors with a listed issuer where there is a change of auditors. The framework requires the outgoing auditors to prepare a letter to the audit committee and the board of directors setting out the circumstances leading to their resignation or termination.
3. This Statement deals with changes of auditors of a listed issuer including auditors who resign before the expiration of their term of office, decide not to seek re-election at the Annual General Meeting, are notified by the directors that they will not be nominated for re-appointment, or are removed during their term of office.
4. This Statement should be read in conjunction with Professional Ethics Statement 1.207 "Professional Ethics – Changes in a professional appointment".
5. Auditors of Hong Kong incorporated listed issuers are reminded that section 140A(2) of the Companies Ordinance requires an auditor who resigns from office before the expiry of its term must, if the resignation is to be effective, include in his resignation a statement of any circumstances connected with his resignation which he considers ought to be brought to the notice of members or creditors of the company, or a statement that there are no such circumstances. However, auditors are to note that this Statement is not intended to provide guidance regarding the requirements of section 140A(2) of the Companies Ordinance.
6. The terms "listed issuer", "incoming auditors" and "outgoing auditors" are used throughout this Statement and are defined as follows:
 - (a) "Listed issuer" means a company listed on the Main Board or Growth Enterprise Market (GEM) of the SEHK.
 - (b) "Incoming auditors" means the auditors or the auditors to be nominated for the current period who did not audit the preceding period's financial statements.
 - (c) "Outgoing auditors" means the auditors who were previously the auditors and have been or are to be replaced by any incoming auditors.

Duty to the shareholders to report on the financial statements

7. Auditors are reminded that once they are appointed, they have a duty to the shareholders to report to them on the financial statements, and should make every reasonable effort to discharge this duty. Auditors should not attempt to avoid the responsibility of reporting on the financial statements by resigning.
8. The auditors' proper course of action, once appointed, is to report on the financial statements. If they are considering resigning during their term of office they should discuss the contentious issues which may lead to their resignation with the audit committee and seek the audit committee's assistance to resolve the issues with management and to complete the audit.

Having completed the audit, if they do not wish to be re-appointed, they should decline to stand for re-appointment when their term of office expires.

Communication with the audit committee and the board of directors

9. This Statement requires the outgoing auditors to prepare a letter to the audit committee and the board of directors of the listed issuer, whenever:
 - (a) the outgoing auditors resign or decline to stand for re-appointment (Resignation); or
 - (b) the listed issuer decides to propose to its shareholders that the outgoing auditors be removed from office during the auditors' term of office, or there is a proposal or intention not to re-appoint them on the expiry of their term of office (Termination).
10. The outgoing auditors' letter to the audit committee and the board of directors should set out the circumstances leading to their Resignation or Termination, hereafter referred to as "Letter of Resignation or Termination". The circumstances to be disclosed in the Letter of Resignation or Termination are all occurrences that, in the opinion of the outgoing auditors, affect the relationship between the listed issuer and the outgoing auditors.
11. Occurrences that affect the relationship between the listed issuer and the outgoing auditors include, but are not limited to, "disagreements" and/or "unresolved issues", as discussed below. The disagreements and unresolved issues to be disclosed will generally be those that occurred in connection with:
 - (a) the audit of the listed issuer's most recently completed financial year;
 - (b) any period subsequent to the most recently completed financial period for which an audit report has been issued up to the date of the Resignation or Termination.
12. Disagreements refer to any matter of audit scope, accounting principles or policies or financial statement disclosure that, if not resolved to the satisfaction of the outgoing auditors, would have resulted in a qualification in the audit report.
13. Disagreements include both those resolved to the outgoing auditors' satisfaction which affect the relationship between the listed issuer and the outgoing auditors, and those not resolved to the outgoing auditors' satisfaction. Disagreements should have occurred at the decision making level, i.e., between personnel of the listed issuer responsible for the finalization of its financial statements and personnel of the auditors responsible for authorizing the issuance of audit reports with respect to the listed issuer.
14. The term disagreement is to be interpreted broadly. It is not necessary for there to have been an argument for there to have been a disagreement, merely a difference of opinion. The term disagreement does not include initial differences of opinion, based on incomplete facts or preliminary information, that were later resolved to the outgoing auditors' satisfaction, provided that the listed issuer and the outgoing auditors do not continue to have a difference of opinion upon obtaining additional facts or information.
15. Unresolved issues refer to matters which come to the outgoing auditors' attention and which, in the outgoing auditors' opinion, materially impact on the financial statements or audit reports (or which could have a material impact on them), where the outgoing auditors have advised the listed issuer about the matter and:
 - (a) the outgoing auditors have been unable to fully explore the matter and reach a conclusion as to its implications prior to a Resignation or Termination;
 - (b) the matter was not resolved to the outgoing auditors' satisfaction prior to a Resignation or Termination; or

- (c) the outgoing auditors are no longer willing to be associated with the financial statements prepared by management of the listed issuer in relation to circumstances described in SAS 150 “Subsequent events” or HKSA 560 “Subsequent Events” when it becomes effective on “Facts discovered after the financial statements are laid before the shareholders or equivalent” resulting in the withdrawal of an audit report.
16. The outgoing auditors should note that disclosing the circumstances leading to their Resignation or Termination in the Letter of Resignation or Termination is the appropriate method of discharging their responsibilities during a change in a professional appointment without having to be concerned with the professional duty of confidentiality owed to the listed issuer. In the event that the incoming auditors approach the outgoing auditors for professional clearance and ask whether the outgoing auditors are aware of any unusual circumstances surrounding the proposed change of auditors which may be relevant in determining their acceptance of nomination, as required by Professional Ethics Statement 1.207 “Changes in a professional appointment”, the outgoing auditors can refer the incoming auditors to their Letter of Resignation or Termination.

The incoming auditors

17. Since the outgoing auditors are required to disclose the circumstances leading to their Resignation or Termination in the Letter of Resignation or Termination, the incoming auditors should request a copy of the Letter of Resignation or Termination and any correspondence referred to in the letter directly from the listed issuer for consideration in addition to requesting professional clearance from the outgoing auditors before accepting the appointment.
18. If the listed issuer refuses to provide the incoming auditors with a copy of the Letter of Resignation or Termination and any correspondence referred to in the Letter of Resignation or Termination, the incoming auditors should decline to accept nomination.

Announcement made by the listed issuer on the change of auditors

19. Auditors of a listed issuer should be cognizant of the provisions of the Main Board and GEM Listing Rules (Listing Rules) regarding changes in audit appointments.
20. The outgoing auditors should note that the listed issuer is required to make an announcement pursuant to the Listing Rules setting out the reason(s) for the change of auditors and any other matters that need to be brought to the attention of holders of securities of the issuer (including, but not limited to, circumstances set out in the outgoing auditors’ Letter of Resignation or Termination in relation to the change of auditors). In the Letter of Resignation or Termination, the outgoing auditors should remind the listed issuer of this obligation and should give their express consent to the letter being supplied to the SEHK.
21. The outgoing auditors should read and assess whether the circumstances as reported in their Letter of Resignation or Termination, which, in their opinion, need to be brought to the attention of the shareholders, are reflected in the announcement made by the listed issuer. In the event that the outgoing auditors notice that the circumstances leading to their Resignation or Termination as announced by the listed issuer are materially different from the circumstances as reported by them in their Letter of Resignation or Termination in respect of matters that need to be brought to the attention of the shareholders, they should write to the audit committee and board of directors of the listed issuer regarding those matters.
22. In practice, it is recommended that the listed issuer should agree with the outgoing auditors the details relating to the circumstances in the announcement before its issuance. This is to help avoid the situation described in paragraph 21 above. However, it should be noted that such an approach should not unduly delay the listed issuer’s announcement of the change of auditors.
23. If the outgoing auditors write in accordance with paragraph 21 above and the listed issuer takes no adequate action in response, they should consider whether the market has been adequately

informed as to the circumstances leading to their Resignation or Termination. If not, the outgoing auditors should consider whether these should be brought to the attention of the relevant regulatory authority.

24. The outgoing auditors should note that if they were to report those matters to the SEHK, there might be a breach of confidentiality.
25. Should the outgoing auditors decide it necessary to report those matters to the SFC, they will be subject to the protection of sections 380 and 381 of the Securities and Futures Ordinance. Sections 380 and 381 of the Securities and Futures Ordinance provide immunity to a person who is or was an auditor of a company which is listed, or any associated company of the company, who reports to the SFC matters which come to his attention that suggest that at any time since the formation of the listed company, its shareholders have not been given all the information with respect to its affairs that they might reasonably expect. The outgoing auditors are advised to consult their lawyers before communicating.