



By e-mail < Edcomments@ifac.org >

16 October 2007

Our Ref.: C/EC

Senior Technical Manager,
International Ethics Standards Board for Accountants,
International Federation of Accountants,
545 Fifth Avenue, 14th Floor,
New York,
New York 10017,
USA.

Dear Sir,

[IESBA Exposure Draft of Sections 290 and 291 of the Code of Ethics on Independence – Proposed Additional Requirements in relation to Internal Audit Services, Relative Size of Fees and Contingent Fees](#)

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned IESBA Exposure Draft.

Overall, as stated in our submission letter dated 2 May 2007 on the IESBA December 2006 Exposure Draft on Auditor Independence, we are supportive of the current work of the IESBA which seeks to consider what revisions to auditor independence requirements might be needed given the changing environment in the past few years and that the last substantive revision to the IFAC Code of Ethics for Professional Accountants was made in November 2001.

We recognize the challenge faced by the IESBA in setting requirements that are suitable for application across a range of engagements and by firms ranging from sole practitioners to the larger international accounting firms. Despite this, we endorse the principle of having one globally applicable Code of Ethics for Professional Accountants. However, we are concerned that the proposals in the Exposure Draft are geared more towards providing an optimal solution for the larger firms and engagements. This focus has resulted in proposals that in many cases may result in impractical requirements and/or disadvantageous cost-benefit outcomes for Small and Medium-sized Enterprises (SMEs) in that the cost of the audit is significantly greater than the benefits to the users of the auditor's report.



All companies incorporated in Hong Kong are subject to a statutory audit and there are currently approximately 600,000 such companies with approximately 1000 being listed companies and the rest primarily SMEs. Furthermore, approximately 83% of the accounting firms in Hong Kong are sole practitioners with another 13% having only two partners (this group is hereafter referred to as “sole practitioners and small accounting firms”). It is very common for Hong Kong sole practitioners and small accounting firms to provide both auditing and non-auditing services to the abovementioned SMEs and accordingly, we request the Exposure provides more guidance on safeguards that may be applicable for sole practitioners and the small accounting firms.

In summary, we recommend that the IESBA reconsiders the proposals in the Exposure Draft and provides more guidance on safeguards applicable to sole practitioners and small accounting firms to ensure that the benefits of the changes outweigh the costs to SMEs. Under a principle-based approach, there should be safeguards and practical relief for all practitioners rather than rules-based outright prohibitions. The rewrite of this Independence component of the Code is substantially rules-based rather than principles-based. In this regard, we also encourage the IESBA to prioritize the redrafting of the entire Code using a similar drafting convention to that used by the International Auditing and Assurance Standards Board in its Clarity project.

The attachment contains comments on each of the three areas under consideration – Internal Audit, Relative Size of Fees and Contingent Fees for your consideration.

We trust that our comments are of assistance to you. If you require any clarifications on our comments, please do not hesitate to contact me or Steve Ong, Deputy Director, Standard Setting (ong@hki CPA.org.hk).

Yours faithfully,

A handwritten signature in black ink that reads 'Patricia McBride'. The signature is written in a cursive, flowing style.

Patricia McBride
Executive Director

PM/SO/jc
Encl.



**HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS
ON THE IESBA EXPOSURE DRAFT OF SECTIONS 290 AND 291 OF THE CODE
OF ETHICS ON INDEPENDENCE
- AUDIT AND REVIEW ENGAGEMENTS, AND OTHER ASSURANCE
ENGAGEMENTS**

1. INTERNAL AUDIT SERVICES

We agree that when assisting an audit client in the performance of a significant part of the client's internal audit function, the audit firm should ensure that it does not perform management functions, as no safeguards could reduce the threats to an acceptable level if the firm does perform management functions. In this regard, we note that paragraph 290.190 of the Exposure Draft attempts to set out a list of all the types of management functions that the client should be performing before an audit firm can provide internal audit services. While we are not questioning that the points in (a) to (f) are inappropriate, we would encourage the IESBA to draft the proposed requirements in such a way that they are more "principle based" rather than explicitly stating that a firm should only provide internal audit services to an audit client if all of conditions in (a) to (f) are met.

Furthermore, we note that in paragraph 290.191 that follows from the above proposals are suggestions of safeguards which firms should undertake when considering accepting an engagement to provide internal audit services to an audit client. It is not clear whether these safeguards are in addition to the conditions listed in paragraph 290.190. It would appear that if an engagement meets the conditions listed in paragraph 290.190 as drafted, it would not threaten independence. We would recommend that IESBA reconsiders the drafting of these two paragraphs.

In relation to the safeguards mentioned of using professionals who are not members of the audit team to perform the internal audit services and having an additional professional accountant to review the work or otherwise advise as necessary, we are of the view that small firms will be put in a disadvantaged position as compared to the larger accounting firms. Sole practitioners and small accounting firms may not be able to implement the safeguards mentioned in paragraph 290.191 and accordingly, we request IESBA provides more guidance on safeguards that may be applicable for sole practitioners and the small accounting firms e.g. maybe providing some guidance for sole practitioners and the small accounting firms such that they should not rely on the work of internal auditing in performing their audit.

2. RELATIVE SIZE OF FEES

Request for Specific Comments in the Exposure Draft

- (i) **The proposals state that in the case of audit clients that are entities of significant public interest if the total fees from the client exceed a specified percentage of the total fees of the firm one of the two alternative safeguards should be applied to the following year's audit:**
- **After the audit opinion has been issued a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs a review that is equivalent to an engagement quality control review**
 - **Prior to the issuance of the audit opinion a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs an engagement quality control review.**

Is it appropriate to establish such a threshold, and if so is 15% the appropriate threshold?

In principle, we do not support the setting of an absolute threshold. We would prefer that the approach taken by the IESBA considers the distribution of audit fee size rather than setting on one "bright line". For example, the threat posed by a client contributing 15% of audit fees if there is one of 6 similarly sized clients differs from the case where there is one very large client (say 40%) and over 100 small clients.

It is difficult at this stage to comment whether a threshold of 15% is appropriate as we have no data on the distribution of audit fees and are not clear on the application of the concept of "entity of significant public interest".

We would like to take this opportunity to reiterate our views previously given in our submission dated 2 May 2007 to the IESBA on ED of Sections 290 and 291 of the Code of Ethics on Independence – Audit and Review Engagements and Other Assurance Engagements.

Whilst we understand that each jurisdiction will decide on what it considers to be an ESPI, we are of the view that given that the IESBA Code of Ethics is a principle-based standard, we find it difficult and impractical to fully consider the proposals in the Exposure Draft without an agreed definition of what is an ESPI. The HKICPA will need to develop a consultation paper which will take at least twelve months to identify those entities that should be classified as ESPIs in Hong Kong.

(ii) When such a threshold is exceeded, is it appropriate to require disclosure to those charged with governance?

We would not agree with the proposal that when a threshold is exceeded, it is a requirement to make a disclosure to those charged with governance. We would request IESBA to reconsider whether the making a disclosure to those charged with governance would potentially create an intimidation threat.

(iii) Are the alternative mandatory safeguards of a pre-issuance or a post issuance review appropriate and practical?

Generally, we agree that there should be safeguards in respect of fees where the client is of major significance to the auditors revenue stream. However, we feel that it is too premature to comment on whether the suggested safeguards are appropriate and practical when what is an ESPI has yet to be defined.

We are particularly concerned that the ESPI concept risks embracing many smaller not-for-profit entities and burdening them with additional audit costs. In this regard, we would recommend that more guidance be provided to sole practitioners and the smaller accounting firms of appropriate and practical safeguards which may be relevant to them. For sole practitioners and smaller accounting firms, it could be a difficult task of sourcing an engagement quality control reviewer who is not a member of the firm for both a post-issuance review or a review prior to the issuance of the audit opinion.

In this regard, we are concerned that if the final Standard is issued as drafted, it will create difficulties in establishing new audit firms that audit ESPIs. An initial client base of a new audit firm is more likely to include a few large clients than a large number of smaller clients. This would not be in the public interest.

(iv) If not are there any other alternative safeguards that would adequately address the threat to independence?

Please refer to our above comments.

3. CONTINGENT FEES

We support the proposal that a contingent fee charged by a firm in respect of an audit engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by applying any safeguards. Accordingly, we support that a firm should not entered into any such fee arrangements. However we do not consider that this is an independence issue and recommend it to be included in section 240 *Fees and Other Types of Remuneration* rather than in sections 290/291 on independence.

~ END ~