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Lunch Forum on Adoption of Revised Code of Ethics by SMPs in areas of provision of taxation services, company secretarial services and account preparation services



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**Key revisions to Section 290
(Independence – Audit and Review
Engagements) of the HKICPA Code of
Ethics for Professional Accountants**

Key revisions to Section 290 (Independence – Audit and Review Engagements) of the HKICPA Code of Ethics for Professional Accountants

(A) Public Interest Entities (PIEs)

- The Code introduces a new definition of "Public Interest Entities" (290.25). Listed entity provisions to be applied to all public interest entities

Public interest entities defined as:

- *Listed entities;*
- *Entities defined by regulation or legislation as a public interest entity; and*
- *Entities for which the audit is required by regulation or legislation to be conducted in compliance with the same independence provisions as apply to listed entities*

- Firms are required to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders (290.26). Factors to be considered include:
 - The nature of business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;
 - Size; and
 - Number of employees

(B) Documentation

- The Code introduces additional guidance on what firms are required to document as to their conclusions regarding compliance with independence requirements (290.29)
- Documentation provides evidence of the professional accountant's judgments in forming conclusions regarding compliance with independence requirements. The absence of documentation is not a determinant of whether a firm considered a particular matter nor whether it is independent

- The professional accountant shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions.

Accordingly:

- When safeguards are required to reduce a threat to an acceptable level, the professional accountant shall document the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level; and
- When a threat required significant analysis to determine whether safeguards were necessary and the professional accountant concluded that they were not because the threat was already at an accepted level, the professional accountant shall document the nature of the threat and the rationale for the conclusion

(C) Client Mergers and Acquisitions

- The Code introduces new requirements and application guidance addressing situations where, as a result of a merger or acquisition, an entity becomes a related entity of an audit client (290.33 – 38)

(D) Key Audit Partner

- The Code introduces a new term "Key Audit Partner" to whom, notably in the case of Public Interest Entities, certain requirements will apply. Firms will need to analyze which partner should be regarded as a Key Audit Partner with respect to an individual audit client.

(E) Management Responsibilities

- The Code introduces a new section dealing with "Management Responsibilities". The firm shall not assume a management responsibility for an audit client
- Management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources (290.162)

- To avoid the risk of assuming a management responsibility when providing non-assurance services to an audit client, the firm shall be satisfied that a member of management is responsible for making the significant judgments and decisions that are the proper responsibility of management, evaluating the results of the service and accepting responsibility for the actions to be taken arising from the results of the service
 - This reduces the risk of the firm inadvertently making any significant judgments or decisions on behalf of management
 - The risk is further reduced when the firm gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues (290.166)

- Activities that are routine and administrative, or involve matters that are insignificant, generally are deemed not to be a management responsibility (290.164)
 - For example, executing an insignificant transaction that has been authorized by management or monitoring the dates for filing statutory returns and advising an audit client of those dates is deemed not to be a management responsibility
 - Further, providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility
- The Code contains a description of activities that would, and would not, be generally regarded as a management responsibilities (see 290.162 – 166)

(F) Taxation Services (290.181 – 194)

- The Code contains new provisions relating to threats that are created by certain tax services. The provisions address tax services under four broad headings:
 - Tax return preparation
 - Tax calculations
 - Tax planning and other advisory services
 - Assistance in resolution of tax disputes

Tax Return Preparation (290.183)

- Such services do not generally creates threat to independence if management takes responsibility for the returns, including any significant judgments made:
 - The services are generally based on historical information;
 - Principally involve analysis and presentation of historical information under existing law;
 - Tax return is subject to whatever review or approval process the tax authority deems appropriate.

Tax Calculations (290.184-186)

- *Non-public interest entities (290.184)*
 - Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of preparing accounting entries that will be subsequently audited by the firm creates a self-review threat
 - The significance of the threat will depend on:
 - *Complexity of the relevant tax law and regulation and the degree of judgment necessary in applying them*
 - *Level of tax expertise of the client's personnel*
 - *Materiality of the amounts to the financial statements*

- Safeguards shall be applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:
 - *Using professionals who are not members of the audit team to perform the service;*
 - *If the service is performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the tax calculations; or*
 - *Obtaining advice on the service from an external tax professional*

• *Public interest entities (290.185 – 186)*

- Except in emergency situations, in the case of an audit client that is a public interest entity, a firm **shall not** prepare tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion

Tax Planning and Other Advisory Services (290.187-191)

- Tax planning or other tax advisory services comprise a broad range of services, such as advising the client how to structure its affairs in a tax efficient manner or advising on the application of a new tax law or regulation
- Self-review threat may be created where advice affects matters reflected in the financial statements. Significance depends on:
 - Degree of subjectivity and materiality
 - Whether effectiveness of the advice depends on accounting treatment and there is reasonable doubt as to the appropriateness of the treatment
 - Level of tax expertise of client
 - Extent to which advice is supported by law or regulation or tax rating

- The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:
 - Using professionals who are not members of the audit team to perform the service;
 - Having a tax professional, who was not involved in providing the tax service, advise the audit team on the service and review the financial statement treatment;
 - Obtaining advice on the service from an external tax professional; or
 - Obtaining pre-clearance or advice from the tax authority

- Where the effectiveness of tax advice depends on a particular accounting treatment or presentation in the financial statements and:
 - (a) The audit team has **reasonable doubt as to the appropriateness of the related accounting treatment or presentation** under the relevant financial reporting framework; and
 - (b) The **outcome or consequences of the tax advice will have a material effect** on the financial statements on which the firm will express an opinion

The self-review threat would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm **shall not** provide such tax advice to an audit client

Assistance in the Resolution of Tax Disputes (290.192–194)

- Where the taxation services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts involved are material to the financial statements on which the firm will express an opinion, the advocacy threat created would be so significant that no safeguards could eliminate or reduce the threat to an acceptable level. Therefore, the firm shall not perform this type of service for an audit client. What constitutes a —public tribunal or court || shall be determined according to how tax proceedings are heard in the particular jurisdiction.
- The firm is not, however, precluded from having a continuing advisory role (for example, responding to specific requests for information, providing factual accounts or testimony about the work performed or assisting the client in analyzing the tax issues) for the audit client in relation to the matter that is being heard before a public tribunal or court.

(G) Corporate Finance Services (290.216 – 219)

- Enhanced discussion of nature of corporate finance services, the threats created, factors to consider and potential safeguards
- Introduces a prohibition on a service where the effectiveness of corporate finance advice depends upon a particular accounting treatment or presentation and there is a reasonable doubt thereon, and the effect on the financial statements is material

- Where the effectiveness of corporate finance advice depends on a particular accounting treatment or presentation in the financial statements and:

- (a) the audit team has **reasonable doubt as to the appropriateness of the related accounting treatment or presentation** under the relevant financial reporting framework; and
- (b) the **outcome or consequences of the corporate finance advice will have a material effect** on the financial statements on which the firm will express an opinion

The self-review threat would be **so significant** that no safeguards could reduce the threat to an acceptable level, in which case the corporate finance advice **shall not** be provided (290.218)

- Providing corporate finance services involving promoting, dealing in, or underwriting an audit client's shares would create an advocacy or self-review threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm **shall not** provide such services to an audit client (290.219)

(H) Requirements Relating to Public Interest Entities

Employment – Cooling off

- A cooling off period must be met before a Key Audit Partner or the firm's Managing Partner (or equivalent) joins an audit client that is a **Public Interest Entity** as:
 - A Director or Officer;
 - An employee in a position to exert significant influence over the preparation of the accounting records or the financial statements
- Cooling off period
 - Key Audit Partner: one audit opinion covering a period of not less than 12 months for which the partner was not a member of the audit team
 - Firm's Managing Partner (or equivalent): one year

Audit partner rotation

- Key Audit Partner in respect of a **Public Interest Entity** is required to rotate after seven years (290.151)
 - Shall not be a member of the engagement team or be Key Audit Partner for two years
 - Key Audit Partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, be permitted an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards
 - *For example, a key audit partner may remain on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation as not possible, as might be the case due to serious illness of the intended engagement partner (290.152)*

- In rare circumstances where a firm has only a few people with necessary knowledge and skill to serve as the Key Audit Partner and rotation is therefore not an available safeguard, rotation is not required provided: (290.155)
 - An independent regulator has provided an exemption from partner rotation in such circumstances; and
 - That regulator has provided alternative safeguards, which are applied

Non-assurance services

- **Accounting and bookkeeping services (290.167 – 174)**
 - For **Non-PIE**: Permissible where the services are of a routine or mechanical nature so long as any self-review threat created is reduced to an acceptable level (290.171)
 - For **PIE**: Except in emergency situations (290.174), a firm **shall not** provide accounting and booking services to an audit client that is a public interest entity (290.172)

- **Tax services (290.181 – 194)**

- Explained in previous slides

- **Internal audit services (290.195 – 200)**

- For **Non-PIE**: When a firm accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the external audit, a self-review threat is created

The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level (290.199)

- For **PIE**: A firm shall not provide internal audit service to an audit client that is a public interest entity where the service relate to:
 - *A significant part of the internal controls over financial reporting;*
 - *Financial accounting systems that generate information that is, separately or in the aggregate, significant to the client's accounting records or financial statements on which the firm will express an opinion; or*
 - *Amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion*

- **Valuation services (290.175 – 180)**

- For **Non-PIE**: If the valuation has a material effect on the financial statements on which the firm will express an opinion and the valuation involves a significant degree of subjectivity, no safeguard could reduce the self-review threat to an acceptable level.

Accordingly, a firm **shall not** provide such a valuation service to an audit client. (290.179)

- For **PIE**: A firm **shall not** provide valuation services to an audit client that is a public interest entity if the valuation would have a material effect, separately or in the aggregate, on the financial statements on which the firm will express an opinion

- **IT services (290.201 – 206)**

- For **Non-PIE**: Depending on the degree of reliance that will be placed on the particular IT systems as part of the audit, a determination shall be made as to whether to provide such non-assurance services only with personnel who are not members of the audit team and who have different reporting lines within the firm

The significance of any remaining threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level (290.205)

- For **PIE**: A firm **shall not** provide services involving the design or implementation of IT systems that (a) form a significant part of the internal control over financial reporting or (b) generate information that is significant to the client's accounting records or financial statements on which the firm will express an opinion (290.206)

- **Recruiting services (290.214 – 215)**

- For **PIE**: A firm shall not provide service to a PIE audit client with respect to a director or officer of the entity or senior management in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion:
 - *Searching for or seeking out candidates for such positions; and*
 - *Undertaking reference checks of prospective candidates for such positions*

- (I) Contingent Fees (290.224 – 227)**

- The Code introduces a new prohibition on contingent fees for a non-audit assurance services to an audit client if:
 - The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm
 - The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or
 - The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements (290.226)

(J) Evaluation and Compensation (290.228 – 229)

- The Code introduces a requirement that a Key Audit Partner shall not be evaluated on or compensated based on that partner's success in selling non-assurance services to the partner's audit client
- This is not intended to prohibit normal profit-sharing arrangements between partners of a firm

(K) Fees – Relative Size (290.220 – 222)

- For **PIE**
 - Where an audit client is a PIE and, for two consecutive years, the total fees from the client and its related entities (subject to the consideration in Para.290.27) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client

- The firm shall disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm, and discuss which of the safeguards below it will apply to reduce the threat to an acceptable level, and apply the selected safeguard:
 - **Pre-issuance review** performed by a professional accountant who is not a member of the firm prior to the issuance of the audit opinion on the second year's financial statements;
 - **Post-issuance review** performed by professional accountant who is not a member of the firm before the issuance of the audit opinion on the third year's financial statements

- Where the total fees significantly exceed 15%, the firm shall determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required.

In such circumstances a pre-issuance review shall be performed

**(L) Restricted Use and Distribution Reports (290.500 – 514;
291.21 – 27)**

- The Code contains new modified independence requirements relating to certain audit and review reports that include a restriction on use and distribution (290.500 – 514)
- Similar provisions are included in 291.21 - 27

**SERVING AS A DIRECTOR OR OFFICER
(INCLUDING COMPANY SECRETARY) OF
AN AUDIT CLIENT**

**[no change from previous 2006
requirement]**

(M) Serving as a Director or Officer (including company secretary) of an audit client (290.146 – 149)

- If a partner or employee of the firm serves as a director or officer of an audit client, the self-review and self-interest threats created would be so significant that no safeguards could reduce the threats to an acceptable level
 - Accordingly, no partner or employee shall serve as a director or officer of an audit client
- The position of company secretary has different implications in different jurisdictions. Duties may range from administrative duties, such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters
 - Generally this position is seen to imply a close association with the entity

- If a partner or employee of the firm or a network firm serves as Company Secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant that no safeguards could reduce the threat to an acceptable level unless the duties and functions undertaken are limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns, and are permitted by law
- Performing routine administrative services to support a company secretarial function or providing advice in relation to company secretarial administration matters does not generally create threats to independence, so long as client management makes all relevant decisions

- The Companies Ordinance provides, at section 140(2) that:
"None of the following persons shall be qualified for appointment as auditor of a company –
 - (a) an officer or servant of the company
 - (b) a person who is a partner of or in the employment of an officer or servant of the company
 - (c) (Repealed 94 of 1995 s.3)
 - (d) a person who is, by virtue of paragraph (a) or (b), disqualified for appointment as auditor of any other body corporate which is the company's subsidiary or holding company or a subsidiary of the company's holding company, or would be so disqualified if the body corporate were a companyand references in this subsection to an officer or servant shall be construed as not including references to an auditor."

- Section 2 of the Companies Ordinance defines "officer" as including a director, manager or secretary (HKICPA Statement 1.303)

Thank You