

*Ethics Circular 1*

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# Guidance for Small and Medium Practitioners on the Code of Ethics for Professional Accountants

This Ethics Circular does not constitute an ethics standard and is issued with the intent to provide guidance in order to assist small and medium practitioners including sole practitioners, on their adoption of the Code on the provision of non-assurance services and other topical issues to an audit client without modifying the requirements as set out in the Code\*. Professional judgment should be used by practitioners in its application. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this Ethics Circular can be accepted by the Institute.

\* This Ethics Circular has been updated with reference to the Code revised by the Institute in July 2022 to incorporate the new and revised non-assurance services provisions:

- Revised Section 600 and the conforming amendments to Part 4A: effective for audits and reviews of financial statements for periods beginning on or after 15 December 2022.
- The conforming and consequential amendments to Sections 900 and 950 in relation to assurance engagements with respect to underlying subject matters covering periods of time: effective for periods beginning on or after 15 December 2022; otherwise, these amendments will be effective as of 15 December 2022.
- Early adoption is permitted.



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## HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

### ETHICS CIRCULAR 1

(Revised December 2018; October 2022; March 2023)

## APPLICATION OF THE CODE OF ETHICS BY SMALL AND MEDIUM PRACTITIONERS

This revised Ethics Circular 1 was endorsed by the Institute’s Ethics Committee in March 2023 and supersedes the Ethics Circular 1 previously issued in October 2022.

This Ethics Circular does not constitute an ethics standard and is issued with the intent to provide guidance in order to assist small and medium practitioners (“SMPs”) including sole practitioners, on their application of the Institute’s *Code of Ethics for Professional Accountants* (the “Code”) to certain non-assurance services and other topical issues. This Ethics Circular does not override any requirements of the Code. This Ethics Circular is not intended to cover all types of non-assurance services as listed in the Code and does not cover personal financial relationship. Practitioners are to note that there are no exemptions from the requirements of the Code for SMPs. Apparent failures by practitioners of the Institute to comply with the Code may result in disciplinary action.

The Institute will from time to time review the appropriateness of this Ethics Circular and make necessary revisions to the guidance, especially when the Code is being revised.

Professional judgment should be used by practitioners in application of this Ethics Circular. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this Ethics Circular can be accepted by the Institute. Practitioners should read the Code, which can be accessed at the Institute’s Members Handbook.

For the purposes of this Ethics Circular, all the references to the Code cited in this Ethics Circular should refer to Chapter A of the Code, unless otherwise specified.

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## BACKGROUND

1. The Institute's *Code of Ethics for Professional Accountants* (the "Code") has been revised to maintain convergence with the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the International Ethics Standards Board for Accountants ("IESBA") in April 2018. Following the new and revised provisions to the IESBA's Code issued in January 2021, April 2021 and January 2022, the Code has been further updated to incorporate the following provisions in July 2022:

- *Revisions to the Code Addressing the Objectivity of an Engagement Quality Reviewer and Other Appropriate Reviewers;*
- *Revisions to the Non-Assurance Services Provisions of the Code;*
- *Revisions to the Fee-related Provisions of the Code; and*
- *Quality Management-related Conforming Amendments to the Code.*

The above revisions to (a) Part 4A will become effective for audits or reviews of financial statements for periods beginning on or after 15 December 2022; (b) Part 4B will become effective for assurance engagements beginning on or after 15 December 2022; and (c) conforming and consequential amendments to other sections of the Code will become effective as of 15 December 2022.

2. This Ethics Circular was first developed by the Special Task Force on Adoption of Revised Code of Ethics by Small and Medium Practitioners ("SMPs") and endorsed by the Institute's Ethics Committee in May 2015 and was further revised in December 2018, October 2022 and March 2023. This Ethics Circular does not constitute an ethics standard and is issued with the intent to provide guidance in order to assist SMPs including sole practitioners, on their adoption of the Code on the following areas of non-assurance services and other topical issues:

- Identification of public interest entities<sup>1</sup> (Part 1)
- Provision of company secretarial services to audit clients (Part 2)
- Provision of accounting and bookkeeping services to audit clients (Part 3)
- Provision of tax services to audit clients (Part 4)
- Provision of internal audit services to audit clients (Part 5)

Practitioners should read the Code, which is the Institute's authoritative ethics requirements, as contained in the Institute's Members Handbook.

3. Staff of IESBA has prepared:
  - A set of questions and answers to explain key revisions to the non-assurance services provisions of the IESBA Code<sup>2</sup>. It complements the Basis for Conclusions for the final pronouncement and is intended to assist stakeholders to better understand the new requirements and guidance; and

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<sup>1</sup> The IESBA issued a final pronouncement in April 2022 to revise definitions of the listed entity and public interest entity in the IESBA Code which will be converged into the Institute's Code for local adoption in due course. Amendments to the revised provisions may be considered by the Ethics Committee after consultation with local stakeholders. The provisions will become effective for audits of financial statements for periods beginning on or after 15 December 2024.

<sup>2</sup> IESBA Staff Questions and Answers: Revised Non-Assurance Services Provisions of the IESBA Code can be accessed at: [https://www.ifac.org/system/files/publications/files/FINAL-IESBA-Non-Assurance-Services-Staff-Question-and-Answers\\_0.pdf](https://www.ifac.org/system/files/publications/files/FINAL-IESBA-Non-Assurance-Services-Staff-Question-and-Answers_0.pdf)

- A mapping table to assist readers in their review of the revised non-assurance services provisions<sup>3</sup>.
4. It is important for practitioners to identify, evaluate and address threats, which inevitably involves professional judgment. Practitioners are expected to document the relevant facts and circumstances and the threats evaluation and to provide further explanations when required.

## CONSIDERATION FOR PROVIDING NON-ASSURANCE SERVICES

### *The fundamental principles*

5. Paragraph 110.1 A1 states that a professional accountant shall comply with the following fundamental principles:
- Integrity
  - Objectivity
  - Professional competence and due care
  - Confidentiality
  - Professional behavior

Each of these fundamental principles is discussed in more detail in Section 110.

6. The Code requires professional accountants to comply with the fundamental principles of ethics. The Code also requires them to apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles. Applying the conceptual framework requires exercising professional judgment, remaining alert for new information and to changes in facts and circumstances, and using the reasonable and informed third party test. As defined in the Code, the reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.
7. Compliance with the fundamental principles may potentially be threatened by a broad range of facts and circumstances. The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to an audit client and whether the audit client is a public interest entity, to an assurance client that is not an audit client, or to a non-assurance client.

Threats fall into one or more of the following categories:

- Self-interest;
- Self-review;

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<sup>3</sup> IESBA Staff Mapping Table Comparison of Extant and Revised Non-Assurance Services Provisions of the IESBA Code can be accessed at: <https://www.ifac.org/system/files/publications/files/Mapping-Table-Comparison-Extant-Versus-Final-Provisions-Non-Assurance-Services-final.pdf>

- Advocacy;
- Familiarity; and
- Intimidation.

These threats are discussed further in the Code. Paragraph 300.6 A1 contains examples of facts and circumstances that might create such threats for a professional accountant when undertaking a professional service.

8. Practitioners are reminded that under paragraph R600.8, a determination shall be made as to whether providing a non-assurance service would create a threat to independence before a firm or network firm accepts an engagement to provide such service to an audit client. In evaluating the significance of any threat created by a particular non-assurance service, consideration shall be given to any threat that the audit team has reason to believe is created by providing other related non-assurance services. If a threat is created that cannot be reduced to an acceptable level by the application of safeguards, the non-assurance service shall not be provided. In evaluating the significance of a threat, qualitative as well as quantitative factors shall be taken into account. Paragraph 600.9 A2 and subsections 601 to 610 provide guidance on factors that are relevant in identifying the different threats and evaluating the level of threats that might be created by providing a non-assurance service to an audit client. Acceptable level is defined in the Code as a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the professional accountant complies with the fundamental principles.
9. Notwithstanding the provisions in the Code which allow practitioners to provide certain non-assurance services to audit clients, practitioners may consider requesting approval from those charged with governance on such non-assurance services. This procedure is not explicitly required by the Code or the Hong Kong Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (“HKSQM 1”) and is at the discretion by the practitioners depending on specific entity’s facts and circumstances.
10. Paragraphs 600.10 A1 and 600.10 A2 states that materiality is a factor that is relevant in evaluating threats created by providing a non-assurance service to an audit client. Subsections 601 to 610 refer to materiality in relation to an audit client’s financial statements. The concept of materiality in relation to an audit is addressed in Hong Kong Standard on Auditing (“HKSA”) 320, *Materiality in Planning and Performing an Audit*, and in relation to a review in Hong Kong Standard on Assurance Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*. The determination of materiality involves the exercise of professional judgment and is impacted by both quantitative and qualitative factors. It is also affected by perceptions of the financial information needs of users. Where the Code expressly prohibits the provision of a non-assurance service to an audit client, a firm or a network firm is not permitted to provide that service, regardless of the materiality of the outcome or results of the non-assurance service on the financial statements on which the firm will express an opinion.
11. Under paragraph 600.11 A1, providing advice and recommendations might create a self-review threat. Whether providing advice and recommendations creates a self-review threat involves making the determination set out in paragraph R600.14:
  - The results of the service will form part of or affect the accounting records, the internal controls over financial reporting, or the financial statements on which the firm will express an opinion; and

- In the course of the audit of those financial statements on which the firm will express an opinion, the audit team will evaluate or rely on any judgments made or activities performed by the firm or network firm when providing the service.

Where the audit client is not a public interest entity and a self-review threat is identified, the firm is required to apply the conceptual framework to evaluate and address the threat. Paragraph R600.16 requires a firm or a network firm shall not provide a non-assurance service to an audit client that is a public interest entity if the provision of that service might create a self-review threat in relation to the audit of the financial statements on which the firm will express an opinion.

12. As an exception to R600.16, a firm or a network firm under paragraph R600.17, may provide advice and recommendations to an audit client that is a public interest entity in relation to information or matters arising in the course of an audit, provided that the firm does not assume a management responsibility and applies the conceptual framework to identify, evaluate and address threats, other than self-review threats, to independence that might be created by the provision of that advice.

Examples that are provided under paragraph 600.17 A1 include:

- Advising on accounting and financial reporting standards or policies and financial statement disclosure requirements.
  - Advising on the appropriateness of financial and accounting control and the methods used in determining the stated amounts in the financial statements and related disclosures.
  - Proposing adjusting journal entries arising from audit findings.
  - Discussing findings on internal controls over financial reporting and processes and recommending improvements.
  - Discussing how to resolve account reconciliation problems.
  - Advising on compliance with group accounting policies.
13. Paragraphs R600.21 to R600.23 require a firm to communicate with those charged with governance of a public interest entity before the firm or a network firm provides non-assurance services to entities within the corporate structure of which the public interest entity forms part that might create threats to the firm's independence from the public interest entity. The purpose of the communication is to enable those charged with governance of the public interest entity to have effective oversight of the independence of the firm that audits the financial statements of that public interest entity. Paragraph 600.20 A2 provides examples that the firm might agree with those charged with governance of the public interest entity to facilitate compliance with the requirements.
- Establish the procedure for the provision of information about a proposed non-assurance service which might be on an individual engagement basis, under a general policy, or on any other agreed basis.
  - Identify the entities to which the process would apply, which might include other public interest entities within the corporate structure.
  - Identify any services that can be provided to the entities identified in paragraph R600.21 without specific approval of those charged with governance if they agree as a general policy that these services are not prohibited under this section and would not create threats to the firm's independence or, if any such threats are created, they would be at an acceptable level.

- Establish how those charged with governance of multiple public interest entities within the same corporate structure have determined that authority for approving services is to be allocated.
  - Establish a procedure to be followed where the provision of information necessary for those charged with governance to evaluate whether a proposed service might create a threat to the firm's independence is prohibited or limited by professional standards, laws or regulations, or might result in the disclosure of sensitive or confidential information.
  - Specify how any issues not covered by the process might be resolved.
14. Paragraph 600.21 A1 provides the following examples of information that might be provided to those charged with governance of the public interest entity in relation to a particular non-assurance service:
- The nature and scope of the service to be provided.
  - The basis and amount of the proposed fee.
  - Where the firm has identified any threats to independence that might be created by the provision of the proposed service, the basis for the firm's assessment that the threats are at an acceptable level or, if not, the actions the firm or network firm will take to eliminate or reduce any threats to independence to an acceptable level.
  - Whether the combined effect of providing multiple services creates threats to independence or changes the level of previously identified threats.
15. Based on the above, firms should evaluate the significance of the threats created by the particular non-assurance service in order to evaluate whether safeguards need to be applied or what safeguards are to be applied. The conceptual framework recognizes that the existence of conditions, policies and procedures established by the profession, legislation, regulation, the firm, or the employing organization might impact the identification of threats. Those conditions, policies and procedures might also be a relevant factor in the professional accountant's evaluation of whether a threat is at an acceptable level.
16. Under paragraph R120.10, if the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating them or reducing them to an acceptable level. The accountant shall do so by:
- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
  - (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
  - (c) Declining or ending the specific professional activity.
17. Practitioners are expected to document and to explain the relevant facts and circumstances and the threats evaluation.
18. Practitioner's documentation and explanation must be sufficient to enable a reasonable and informed third party to likely conclude, weighing all the specific facts and circumstances available to the practitioner at that time, that compliance with the fundamental principles is not compromised.



19. Firms are required to design, implement and operate a system of quality management, and establish quality objectives that address the fulfillment of responsibilities as required under HKSQM 1 to maintain independence with reference to the Code.
20. As is the case whenever professional judgment is exercised, practitioners must be prepared to explain the basis for their decision or conclusion and be prepared to defend it against challenges from third parties including regulators.

***Management responsibilities***

21. Paragraph 400.13 A1 states that management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.
22. Paragraph 400.13 A3 explains that determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgment. Examples of activities that would be considered a management responsibility include:
  - Setting policies and strategic direction.
  - Hiring or dismissing employees.
  - Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
  - Authorizing transactions.
  - Controlling or managing bank accounts or investments.
  - Deciding which recommendations of the firm or network firm or other third parties to implement.
  - Reporting to those charged with governance on behalf of management.
  - Taking responsibilities for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
  - Taking responsibility for designing, implementing, monitoring or maintaining internal control.
23. Paragraph R400.13 requires that a firm or a network firm shall not assume a management responsibility for an audit client. Paragraph 400.13 A2 states that self-review, self-interest and familiarity threats are created when a firm or a network firm assumes a management responsibility for an audit client. Assuming a management responsibility might also create an advocacy threat because the firm or network firm becomes too closely aligned with the views and interests of management. Subject to compliance with paragraph R400.14, providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility. The provision of advice and recommendations to an audit client might create a self-review threat and is addressed in Section 600. When a firm or a network firm provides a non-assurance service to an audit client, there is a risk that the firm or network firm will assume a management responsibility unless the firm or network firm is satisfied that the requirements in paragraph R400.14 has been complied with.

24. Paragraph R400.14 further requires that when performing a professional activity for an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the proper responsibility of management. This includes ensuring that the client's management:
- (a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the activities. Such an individual, preferably within senior management, would understand:
    - (i) The objectives, nature and results of the activities; and
    - (ii) The respective client and firm or network firm responsibilities.However, the individual is not required to possess the expertise to perform or re-perform the activities.
  - (b) Provides oversight of the activities and evaluates the adequacy of the results of the activities performed for the client's purpose.
  - (c) Accepts responsibility for the actions, if any, to be taken arising from the results of the activities.
25. Paragraphs 602.2 A1 and 602.3 A1 clarify that administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Providing such services to an audit client does not usually create a threat when such services are clerical in nature and require little or no professional judgement. Examples of administrative services include word processing or document formatting, preparing administrative or statutory forms for client approval, submitting such forms as instructed by the client, monitoring statutory filing dates, and advising an audit client of those dates.

### ***Networks and network firms***

26. A network firm is defined under the Code as a firm or entity that belongs to a network, which is a larger structure:
- That is aimed at co-operation; and
  - That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality management policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.

Under paragraph R400.51, a network firm shall be independent of the audit clients of the other firms within the network as required by Part 4A of the Code. The independence requirements under Part 4A of the Code that apply to a network firm apply to any entity that meets the definition of a network firm. It is not necessary for the entity also to meet the definition of a firm. For example, a consulting practice or professional law practice might be a network firm but not a firm. Paragraphs 400.50 A1 to 400.54 A1 provide further guidance on networks and network firms.

## **PART 1 – IDENTIFICATION OF PUBLIC INTEREST ENTITIES** *(Ref: Common questions 1 – 4 in Appendix)*

27. Public interest entities<sup>1</sup>, for the purpose of auditor independence, is defined in the Code to include:
- (a) A listed entity, or
  - (b) An entity:
    - (i) Defined by regulation or legislation as a public interest entity; or
    - (ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation might be promulgated by any relevant regulator, including an audit regulator.

Other entities might also be considered to be public interest entities, as set out in paragraph 400.8.

28. It is stated in footnote 1a that currently under the legislation of Hong Kong, there is no definition of public interest entity or requirement for the audit of an entity to be conducted with the same independence requirements applicable to the audit of listed entities.
29. Paragraph 400.8 further encourages firms 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. Factors to be considered include:
- The nature of the 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.
  - Number of employees.

Practitioners are therefore encouraged, but not required, to review their own client base and determine whether any clients, other than listed entities, should be treated as public interest entities. If the practitioners choose to do so, this may be performed alongside with the evaluation process of acceptance and continuance of client relationships and specific engagements under HKSQM 1; and the required procedures to understand the entity and related environment under HKSA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*.

30. When practitioners choose to apply paragraph 400.8, it is possible for different practitioners to make different determinations based on different facts and circumstances. When making such professional judgment, it is important for practitioners to document and to be able to explain the thought process that they have gone through and judgments involved in considering whether any of their clients are public interest entities.
31. The Code contains more stringent requirements in respect of audits of public interest entities. Whilst not being required by the Code, practitioners are not restricted from applying, based on their professional judgment, those more stringent requirements to non-public interest entity audit clients.

## **PART 2 – PROVISION OF COMPANY SECRETARIAL SERVICES TO AUDIT CLIENTS (Ref: Common questions 5 – 7 in Appendix)**

### ***For all audit clients, including public interest entities and non-public interest entities***

32. Paragraph R523.3 requires that a partner or employee of the firm or a network firm shall not serve as a director or officer of an audit client of the firm.
33. Paragraph 523.4 A1 explains that the position of Company Secretary has different implications in different jurisdictions. Duties might 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. Usually this position is seen to imply a close association with the entity.
34. Paragraph R523.4 requires that a partner or employee of the firm or a network firm shall not serve as Company Secretary for an audit client of the firm, unless:
- (a) This practice is specifically permitted under local law, professional rules or practice;
  - (b) Management makes all relevant decisions; and
  - (c) The duties and activities performed are limited to those of a routine and administrative nature, such as the preparing minutes and maintaining statutory returns.
35. Furthermore, partners and staff cannot act as officers of an audit client under the requirements of the Companies Ordinance (Cap. 622). No partner or employee of a firm or director or employee of any of its controlled or affiliated companies can be a director of a company which is audited by that firm. Neither can a limited liability company controlled by or affiliated in any way with a firm serve as a director in any way of a company which is audited by the firm. These are set out in Statement 1.303, *General Guidance – Restrictions on Appointments as Secretaries and Directors of Audit Clients*<sup>4</sup>.

## **PART 3 – PROVISION OF ACCOUNTING AND BOOKKEEPING SERVICES TO AUDIT CLIENTS (Ref: Common questions 8 – 10 in Appendix)**

36. Accounting and bookkeeping services comprise a broad range of services including:
- Preparing accounting records or financial statements.
  - Recording transactions.
  - Providing payroll services.
  - Resolving account reconciliation problems.
  - Converting existing financial statements from one financial reporting framework to another.

Subsection 601 contains requirements and application material that are relevant in identifying and evaluating the level of threat created by providing accounting and bookkeeping services.

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<sup>4</sup> Statement 1.303 can be accessed at Volume I of the Institute's Members Handbook at: [http://app1.hkicpa.org.hk/ebook/HKSA\\_Members\\_Handbook\\_Master/volumel/1\\_303.pdf](http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumel/1_303.pdf)

***For all audit clients, including public interest entities and non-public interest entities***

37. Paragraph 601.4 A1 states that providing accounting and bookkeeping services to an audit client creates a self-review threat when there is a risk that the results of the services will affect the accounting records or the financial statements on which the firm will express an opinion.

***For audit clients that are not public interest entities***

38. Paragraph R601.5 requires that a firm or a network firm shall not provide to an audit client that is not a public interest entity accounting and bookkeeping services, including preparing financial statements on which the firm will express an opinion or financial information which forms the basis of such financial statements, unless:
- (a) The services are of a routine or mechanical nature, and
  - (b) The firm addresses any threats that are not at an acceptable level.
39. Paragraph 601.5 A1 states that accounting and bookkeeping services that are routine or mechanical involve information, data or material in relation to which the client has made any judgments or decisions that might be necessary, and require little or no professional judgement. Paragraph 601.5 A2 provides examples of services that might be regarded as routine or mechanical:
- Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.
  - Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.
  - Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.
  - Posting transactions coded by the client to the general ledger.
  - Posting client-approved entries to the trial balance.
  - Preparing financial statements based on information in the client-approved trial balance and preparing related notes based on client-approved records.

The firm or a network firm may provide such services to audit clients that are not public interest entities provided that the firm or network firm complies with the requirements of paragraph R400.14 to ensure that it does not assume a management responsibility in connection with the service and with the requirement in paragraph R601.5(b).

Paragraph 601.5 A3 provides examples of actions that might be safeguards to address a self-review threat created when providing accounting and bookkeeping services of a routine or mechanical nature to an audit client that is not a public interest entity:

- Using professionals who are not audit team members to perform the service.
- Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.

***For audit clients that are public interest entities***

40. The Code recognizes that more stringent requirements are necessary in the event that an audit client is a public interest entity. Under paragraph R601.6, a firm or a network firm shall not provide accounting and bookkeeping services to an audit client that is a public interest entity.
41. As an exception to paragraph R601.6, a firm or a network firm under paragraph R601.7 may prepare statutory financial statements for a related entity of a public interest entity audit client included in subparagraph (c) or (d) of the definition of a related entity as stated in the Glossary of the Code<sup>5</sup> provided that:
- The audit report on the group financial statements of the public interest entity has been issued;
  - The firm or network firm does not assume management responsibility and applies the conceptual framework to identify, evaluate and address threats to independence;
  - The firm or network firm does not prepare the accounting records underlying the statutory financial statements of the related entity and those financial statements are based on client approved information; and
  - The statutory financial statements of the related entity will not form the basis of future group financial statements of that public interest entity.

**PART 4 – PROVISION OF TAX SERVICES TO AUDIT CLIENTS**  
***(Ref: Common questions 11 – 15 in Appendix)***

42. Tax services comprise a broad range of services, including:
- Tax return preparation.
  - Tax calculations for the purpose of preparing accounting entries.
  - Tax advisory services.
  - Tax planning services.
  - Tax services involving valuations.
  - Assistance in the resolution of tax disputes.

Subsection 604 contains requirements and application material that are relevant in identifying and evaluating the level of threat created by providing tax services to an audit client.

43. As set out in paragraphs 604.3 A1 and 604.3 A2, providing tax services to an audit client might create self-review threat when there is a risk that the results of the services will affect the accounting records or the financial statements on which the firm will express an opinion. Such services might also create an advocacy threat. Factors that are relevant in identifying self-review or advocacy threats created by providing any tax service to an audit client, and evaluating the level of such threats include:

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<sup>5</sup> According to the Glossary of the Code, subparagraph (c) and (d) of the definition of a related entity are:

(c) An entity over which the client has direct or indirect control;

(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c).

- The particular characteristics of the engagement.
- The level of tax expertise of the client's employees.
- The system by which the tax authorities assess and administer the tax in question and the role of the firm or network firm in that process.
- The complexity of the relevant tax regime and the degree of judgment necessary in applying it.

***For all audit clients, including public interest entities and non-public interest entities***

44. Paragraphs R604.4 and 604.4 A1 state that a firm or a network firm shall not provide a tax service or recommend a transaction to an audit client if the service or transaction relates to marketing, planning, or opining in favor of a tax treatment that was initially recommended, directly or indirectly, by the firm or network firm, and a significant purpose of the tax treatment or transaction is tax avoidance, unless the firm is confident that the proposed treatment has a basis in applicable tax law or regulation that is likely to prevail. Unless the tax treatment has a basis in applicable tax law or regulation that the firm is confident is likely to prevail, providing such non-assurance service creates self-interest, self-review and advocacy threats that cannot be eliminated and safeguards are not capable of being applied to reduce such threats to an acceptable level.

**A. Tax return preparation**

45. Under paragraph 604.5 A1, tax return preparation services include:
- Assisting clients with their tax reporting obligations by drafting and compiling information, including the amount of tax due (usually on standardized forms) required to be submitted to the applicable tax authorities.
  - Advising on the tax return treatment of past transactions.
  - Responding on behalf of the audit client to the tax authorities' requests for additional information and analysis (for example, providing explanations of and technical support for the approach being taken).

***For all audit clients, including public interest entities and non-public interest entities***

46. Under paragraph 604.6 A1, providing tax return preparation services does not usually create a threat because such services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. In addition, tax returns are subject to whatever review or approval process the tax authority considers appropriate.

**B. Tax calculations for the purpose of preparing accounting entries**

47. Under paragraph 604.7 A1, tax calculation services involve the preparation of calculations of current and deferred tax liabilities or assets for the purpose of preparing accounting entries supporting tax assets and liabilities in the financial statements of the audit client.

***For all audit clients, including public interest entities and non-public interest entities***

48. Under paragraph 604.8 A1, preparing tax calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of preparing accounting entries that support such balances creates a self-review threat.

***For audit clients that are not public interest entity***

49. In addition to the factors in paragraph 604.3 A2, paragraph 604.9 A1 also lists out a factor that is relevant in evaluating the level of self-review threat created when preparing such calculations for an audit client is whether the calculation might have a material effect on the financial statements on which the firm will express an opinion.
50. If such services are to be provided to an audit client who is not public interest entity, safeguards shall be applied when necessary to address such a self-review threat. Paragraph 604.9 A2 provides examples of such safeguards include:
- Using professionals who are not audit team members to perform the service;
  - Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.

***For audit clients that are public interest entities***

51. Paragraph R604.10 requires that a firm or a network firm shall not prepare tax calculations of current and deferred tax liabilities (or assets) for an audit client that is a public interest entity.

**C. Tax advisory and tax planning services**

52. Paragraph 604.11 A1 states that tax advisory and tax planning services comprise a broad range of services, such as advising the audit client how to structure its affairs in a tax efficient manner or advising on the application of a tax law or regulation.

***For all audit clients, including public interest entities and non-public interest entities***

53. Under paragraphs 604.12 A1 and 604.12 A2, providing tax advisory and tax planning services to an audit client might create a self-review threat when there is a risk that the results of the services will affect the accounting records or the financial statements on which the firm will express an opinion. Such services might create an advocacy threat. Providing tax advisory and tax planning services will not create a self-review threat if such services:
- (a) Are supported by a tax authority or other precedent;
  - (b) Are based on an established practice (being a practice that has been commonly used and has not been challenged by the relevant tax authority); or
  - (c) Have a basis in tax law that the firm is confident is likely to prevail.
54. In addition to the factors in paragraph 604.3 A2, paragraph 604.12 A3 also lists out factors that are relevant in identifying self-review or advocacy threats created by providing tax advisory and tax planning services to audit clients, and evaluating the level of such threats include:



- The degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements.
- Whether the tax treatment is supported by a ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.
- The extent to which the outcome of the tax advice might have a material effect on the financial statements.

55. Paragraph R604.13 requires that a firm or a network firm shall not provide tax advisory and tax planning services to an audit client when the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements, and the audit team has doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.

***For audit clients that are not public interest entities***

56. If such services are to be provided to an audit client that is not a public interest entity, paragraph 604.14 A1 provides examples of actions that might be safeguards to address self-review or advocacy threats:

- Using professionals who are not audit team members to perform the service might address self-review or advocacy threats.
- Having an appropriate reviewer, who was not involved in providing the service, review the audit work or service performed might address a self-review threat.
- Obtaining pre-clearance from the tax authorities might address self-review or advocacy threats.

***For audit clients that are public interest entities***

57. Paragraph R604.15 requires that a firm or a network firm shall not provide tax advisory and tax planning services to an audit client that is a public interest entity if the provision of such services might create a self-review threat.

58. Paragraph 604.15 A1 provides examples of actions that might be safeguards to address an advocacy threat created by providing tax advisory and tax planning services to an audit client that is a public interest entity:

- Using professionals who are not audit team members to perform the service.
- Obtaining pre-clearance from the tax authorities.

**D. Assistance in the resolution of tax disputes**

59. Paragraph 604.20 A1 states that a non-assurance service to provide assistance to an audit client in the resolution of tax disputes might arise from a tax authority's consideration of tax calculations and treatments. Such a service might include, for example, providing assistance when the tax authorities have notified the client that arguments on a particular issue have been rejected and either the tax authority or the client refers the matter for determination in a formal proceeding before a tribunal or court.

***For all audit clients, including public interest entities and non-public interest entities***

60. Under paragraphs 604.21 A1 and 604.22 A1, providing assistance in the resolution of a tax dispute to an audit client might create a self-review when there is a risk that the results of the service will affect the accounting records or the financial statements on which the firm will express an opinion. Such a service might also create an advocacy threat. In addition to those identified in paragraph 604.3 A2, factors that are relevant in identifying self-review or advocacy threats created by assisting an audit client in the resolution of tax disputes, and evaluating the level of such threats include:
- The role management plays in the resolution of the dispute.
  - The extent to which the outcome of the dispute will have a material effect on the financial statements on which the firm will express an opinion.
  - Whether the firm or network firm provided the advice that is the subject of the tax dispute.
  - The extent to which the matter is supported by tax law or regulation, other precedent, or established practice.
  - Whether the proceedings are conducted in public.

***For audit clients that are not public interest entities***

61. Under paragraph 604.23 A1, examples of actions that might be safeguards to address self-review or advocacy threats created by assisting an audit client that is not a public interest entity in the resolution of tax disputes include:
- Using professionals who are not audit team members to perform the service might address self-review or advocacy threats.
  - Having an appropriate reviewer who was not involved in providing the service review the audit work or the service performed might address a self-review threat.

***For audit clients that are public interest entities***

62. Paragraph R604.24 requires that a firm or a network firm shall not provide assistance in the resolution of tax disputes to an audit client that is a public interest entity if the provision of that assistance might create a self-review threat.
63. Paragraph 604.24 A1 provides an example of an action that might be a safeguard to address an advocacy threat for an audit client that is a public interest entity is using professionals who are not audit team members to perform the service.

***Resolution of tax matters including acting as an advocate before a tribunal or court***

***For audit clients that are not public interest entities***

64. Paragraph R604.25 requires a firm or a network firm shall not provide tax services that involve assisting in the resolution of tax disputes to an audit client that is not a public interest entity if the services involve acting as an advocate for the audit client before a 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.

***For audit clients that are public interest entities***

65. Paragraph R604.26 requires that a firm or a network firm shall not provide tax services that involve assisting in the resolution of tax disputes to an audit client that is a public interest entity if the services involve acting as an advocate for the audit client before a tribunal or court. Paragraph 604.27 A1 further clarifies that a firm or a network firm is not, however, precluded from having a continuing advisory role in relation to the matter that is being heard before a tribunal or court, 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 related to the matter.

**PART 5 – PROVISION OF INTERNAL AUDIT SERVICES TO AUDIT CLIENTS**  
***(Ref: Common question 16 in Appendix)***

66. Internal audit services comprise a broad range of activities and might involve assisting the audit client in the performance of one or more aspects of its internal audit activities, including:
- Monitoring of internal control – reviewing controls, monitoring their operation and recommending improvements to them.
  - Examining financial and operating information by:
    - Reviewing the means used to identify, measure, classify and report financial and operating information.
    - Inquiring specifically into individual items including detailed testing of transactions, balances and procedures.
  - Reviewing the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity.
  - Reviewing compliance with:
    - Laws, regulations and other external requirements.
    - Management policies, directives and other internal requirements.

Subsection 605 contains requirements and application material that are relevant in identifying and evaluating the level of threat created by providing internal audit services.

***For all audit clients, including public interest entities and non-public interest entities***

67. Paragraph 605.4 A1 states that providing internal audit services to an audit client might create a self-review threat when there is a risk that the results of the services impact the audit of the financial statements on which the firm will express an opinion.
68. Under paragraph 605.4 A2, when a firm uses the work of an internal audit function in an audit engagement, HKSA's require the performance of procedures to evaluate the adequacy of that work. Similarly, when a firm or a network firm accepts an engagement to provide internal audit services to an audit client, the results of those services might be used in conducting the external audit. This might create a self-review threat because it is possible that the audit team will use the results of the internal audit service for purposes of the audit engagement without:
- (a) Appropriately evaluating those results; or

(b) Exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm.

69. Paragraph 605.4 A3 lists out factors that are relevant in identifying a self-review threat created by providing internal audit services to an audit client, and evaluating the level of such a threat:

- The materiality of the related financial statement amounts.
- The risk of misstatement of the assertions related to those financial statement amounts.
- The degree of reliance that the audit team will place on the work of the internal audit service.

When a self-review threat for an audit client that is a public interest entity has been identified, paragraph R605.6 applies.

***For audit clients that are not public interest entities***

70. Paragraph 605.5 A1 gives an example of an action that might be a safeguard to address a self-review threat created by the provision of an internal audit service to an audit client that is not a public interest entity is using professionals who are not audit team members to perform the service.

***For audit clients that are public interest entities***

71. Paragraphs R605.6 and 605.6 A1 require that a firm or a network firm shall not provide internal audit services to an audit client that is a public interest entity if the provision of such services might create a self-review threat. Examples of that services include:

- The internal controls over financial reporting.
- Financial accounting systems that generate information for the client's accounting records or financial statements on which the firm will express an opinion.
- Amounts or disclosures that relate to the financial statements on which the firm will express an opinion.

## **APPENDIX – COMMON QUESTIONS**

Set out below are the common questions on identification of public interest entities, provision of company secretarial services, accounting and bookkeeping services and tax services to audit clients. Professional judgment should be used by practitioners when considering the responses to the common questions.

Certain responses to the common questions contain example safeguards for practitioners' consideration in eliminating or reducing the threat to an acceptable level. Acceptable level is defined in the Code as a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the professional accountant complies with the fundamental principles. Reasonable and informed third party test is described in paragraph 120.5 A6.

Paragraph R120.10 requires that if the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the professional accountant shall address the threats by eliminating them or reducing them to an acceptable level. The professional accountant shall do so by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

The example safeguards in the responses are non-exhaustive where practitioners can tailor their own safeguards, which are not included in the Code so as to best suit their purpose and circumstances.

### ***Common Questions on Part 1 – Identification of public interest entities***

#### **Question 1: Determination of public interest entities – non-listed companies**

**Does the Code require any non-listed companies to be public interest entities?**

For the purpose of the Code, a non-listed company is not a public interest entity unless the firm considers it to be a public interest entity based on professional judgment in accordance with paragraph 400.8.

#### **Question 2: In-house criteria for determination of public interest entities**

**Is it a must for practice units to establish their in-house criteria to determine public interest entities under paragraph 400.8?**

Paragraph 400.8 encourages firms 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.

Whilst each case should be considered based on its own merits, practice units may consider establishing appropriate in-house criteria in order to ensure consistency in the determination of public interest entities under paragraph 400.8.

### **Question 3: Determination of public interest entities – securities firms**

#### **Are securities firms considered as public interest entities?**

Both the Code and the legislation of Hong Kong do not contain requirement to include securities firms to be public interest entities. A securities firm is not a public interest entity unless the firm considers it to be a public interest entity based on professional judgment in accordance with paragraph 400.8.

### **Question 4: Determination of public interest entities – subsidiaries of listed entities**

#### **Is a subsidiary of a listed entity considered to be a public interest entity?**

This is a practical issue for many SMPs as there are many private company subsidiaries of listed companies in Hong Kong that engage SMPs as their auditors but the listed companies do not engage the SMPs as their group auditors<sup>6</sup>. The concern is whether auditors of subsidiaries of listed companies, who are not the group auditors, are required to comply with the more stringent requirements of the Code that apply to public interest entities.

The Code does not contain an explicit requirement for a subsidiary of a listed entity to itself be regarded as a public interest entity. Auditors should therefore exercise their professional judgment in considering whether to treat subsidiaries of listed companies as public interest entities as they would do with any of their clients under paragraph 400.8.

If a subsidiary of a listed entity is not a public interest entity, the requirements in the Code relating to public interest entities (including the mandatory key audit partner rotation requirement under Section 540) are not applicable to the auditor in relation to the audit of that subsidiary, subject to any specific requirements imposed by the group or group auditor. The group auditor would of course need to observe the requirements specific to public interest entities for the purpose of auditing the group's consolidated financial statements and may impose specific requirements on the auditors of individual subsidiaries for the purposes of compliance with the Code.

### ***Common Questions on Part 2 – Provision of company secretarial services to audit clients***

#### **Question 5: Partner or employee acting as the company secretary of an audit client**

The firm audits the financial statements of a client.

#### ***Issue***

Is it permissible for a partner or an employee of the firm or a network firm to serve as the audit client's company secretary?

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<sup>6</sup> The IESBA released an exposure draft [Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits](#) in February 2022. The proposed revisions relate to the revised definition of engagement team and other proposed new terms for purposes of specifying independence provisions for group audits. The Institute has submitted its [comment letter](#) on this exposure draft.

### **Response**

As required by paragraph R523.4, a partner or an employee of the firm or a network firm shall not serve as company secretary for an audit client of the firm, unless:

- This practice is specifically permitted under local law, professional rules or practice (i.e. the Companies Ordinance (Cap. 622)<sup>7</sup> disallows an individual to concurrently hold the posts of auditor and secretary to a company);
- Management makes all relevant decisions; and
- The duties and activities performed are limited to those of a routine and administrative nature, such as preparing minutes and maintaining statutory returns.

### **Question 6: Provision of administrative services**

The firm audits the financial statements of a client.

### **Issue**

Is it permissible for a partner or employee of the firm or a network firm to perform administrative services to support the company secretary function of the client?

### **Response**

Under paragraphs 602.2 A1 to 602.3 A1, administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Providing administrative services to an audit client does not usually create a threat when such services are clerical in nature and require little or no professional judgment.

Examples of administrative services include:

- Word processing or document formatting.
- Preparing administrative or statutory forms for client approval.
- Submitting such forms as instructed by the client.
- Monitoring statutory filing dates and advising an audit client of those dates.

Practitioners are reminded that under the Companies Ordinance (Cap. 622)<sup>7</sup>, partners and staff cannot act as officers of an audit client. No partner or employee of a firm or director or employee of any of its controlled or affiliated companies can be a director of a company which is audited by that firm. Neither can a limited liability company controlled by or affiliated in any way with a firm serve as a director in any way of a company which is audited by the firm. These are set out in Statement 1.303, *General Guidance – Restrictions on Appointments as Secretaries and Directors of Audit Clients*<sup>8</sup>.

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<sup>7</sup> Companies Ordinance, section 393 which can be accessed at:  
[https://www.elegislation.gov.hk/hk/cap622?xpid=ID\\_1438403544752\\_001](https://www.elegislation.gov.hk/hk/cap622?xpid=ID_1438403544752_001)

<sup>8</sup> Statement 1.303 can be accessed at Volume I of the Institute's Members Handbook at:  
[http://app1.hkicpa.org.hk/ebook/HKSA\\_Members\\_Handbook\\_Master/volumel/1\\_303.pdf](http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumel/1_303.pdf)

**Question 7: Formation of a separate company secretarial company by a sole practitioner**

A sole practitioner owns a separate company secretarial company and that company secretarial company is appointed as the company secretary of an entity.

***Issue***

Is it permissible for that sole practitioner be appointed as the auditor of the concerned entity in the abovementioned situation?

***Response***

Such a structure is not disallowed under the Companies Ordinance (Cap. 622), which only disallows an individual to concurrently hold the posts of auditor and secretary to a company. However, practitioners should still follow the other criteria as highlighted in response to Question 5, including:

- This practice is specifically permitted under local law, professional rules or practice (i.e. the Companies Ordinance (Cap. 622) disallows an individual to concurrently hold the posts of auditor and secretary to a company);
- Management makes all relevant decisions; and
- The duties and activities performed are limited to those of a routine and administrative nature, such as the preparing minutes and maintaining statutory returns.

Practitioners would also need to be mindful that the separate company secretarial company may qualify to be a network firm of the sole practitioner due to the common ownership arrangement and therefore the independence requirements under the Code applies to the sole practitioner also applies to the company secretarial company.

***Common Questions on Part 3 – Provision of accounting and bookkeeping services to audit clients***

**Question 8: Provision of accounting and bookkeeping services to audit clients**

The firm audits the financial statements of a client.

***Issue***

Is it permissible for the firm to provide services related to the preparation of accounting records and financial statements to that audit client in the abovementioned situation?

***Analysis***

Identified threat	Self-review threat
Threat evaluation	<p>The client must take the responsibility for accounting records preparation. The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> <li>• Whether the client is a public interest entity;</li> <li>• Whether the services are routine or mechanical that involve information, data or material in relation to which the client (that is not a public interest entity) has made any judgments or decisions that might be necessary and</li> </ul>



	<p>require little or no professional judgment. Some examples of such services are:</p> <ul style="list-style-type: none"> <li>○ Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.</li> <li>○ Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.</li> <li>○ Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.</li> <li>○ Posting transactions coded by the client to the general ledger.</li> <li>○ Posting client-approved entries to the trial balance.</li> <li>○ Preparing financial statements based on information in the client-approved trial balance and preparing related notes based on client-approved records.</li> </ul> <p>The firm or a network firm may provide such services to audit clients that are not public interest entities provided that the firm or network firm complies with the requirements of paragraph R400.14 to ensure that it does not assume a management responsibility in connection with the service and with the requirement in paragraph R601.5 (b).</p> <p>(Paragraph R601.5 A2)</p>
<p>Safeguard application for an audit client that is a public interest entity</p>	<p>The firm or network firm shall not provide accounting and bookkeeping services. (Paragraph R601.6)</p> <p>However, the firm or network firm may prepare statutory financial statements for a related entity of a public interest entity audit client included in subparagraph (c) or (d) of the definition of a related entity as stated in the Glossary of the Code<sup>9</sup> provided that:</p> <ul style="list-style-type: none"> <li>● The audit report on the group financial statements of the public interest entity has been issued;</li> <li>● The firm or network firm does not assume management responsibility and applies the conceptual framework to identify, evaluate and address threats to independence;</li> <li>● The firm or network firm does not prepare the accounting records underlying the statutory financial statements of the related entity and those financial statements are based on client approved information; and</li> <li>● The statutory financial statements of the related entity will not form the basis of future group financial statements of that public interest entity.</li> </ul> <p>(Paragraph R601.7)</p>

<sup>9</sup> According to the Glossary of the Code, subparagraph (c) and (d) of the definition of a related entity are:  
(c) An entity over which the client has direct or indirect control;  
(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c).

<p>Safeguard application for an audit client that is not a public interest entity</p>	<p>The firm or network firm shall not provide accounting and bookkeeping services including preparing financial statements on which the firm will express an opinion or financial information which forms the basis of such financial statements, unless:</p> <ul style="list-style-type: none"><li>• The services are of a routine or mechanical nature; and</li><li>• The firm addresses any threats that are not at an acceptable level.</li></ul> <p>(Paragraph R601.5)</p> <p>Examples of actions that might be safeguards to address a self-review threat created when providing accounting and bookkeeping services of a routine or mechanical nature to an audit client include:</p> <ul style="list-style-type: none"><li>• Using professionals who are not audit team members to perform the service.</li><li>• Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.</li></ul> <p>(Paragraph 601.5 A3)</p> <p>If the threat cannot be reduced to an acceptable level by the application of safeguards, such non-assurance service shall not be provided.</p>
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**Question 9: Preparation of financial statements from client-prepared trial balance**

The firm audits the financial statements of a client where that client prepares the accounting records and the trial balance and accepts responsibility for preparing such information. The client's management is familiar with the adjusting journal entries and takes the responsibility for the final financial statements.

***Issue***

Is it permissible for a firm to prepare their audit client's financial statements from the trial balance and propose adjusting journal entries in the abovementioned situation?

***Analysis***

The auditor may undergo a similar analysis as highlighted in response to Question 8 for the abovementioned situation.

A firm or a network firm shall not provide to an audit client that is not a public interest entity accounting and bookkeeping services, including preparing financial statements on which the firm will express an opinion or financial information which forms the basis of such financial statements, unless:

- (a) The services are of a routine or mechanical nature; and
- (b) The firm addresses any threats that are not at an acceptable level.

(Paragraph R601.5)

The firm or a network firm may provide such services to audit clients that are not public interest entities provided that the firm or network firm complies with the requirements of paragraph R400.14 to ensure that it does not assume a management responsibility in connection with the service and with the requirement in paragraph R601.5 (b). (Paragraph 601.5 A2)

**Question 10: Dialogue between the firm and audit client management, and technical assistance by the firms to audit clients**

The audit process necessitates dialogue between the firm and audit client management, which may involve:

- The application of accounting standards or policies and financial statement disclosure requirements.
- The appropriateness of financial and accounting control and the methods used in determining the stated amounts of assets and liabilities.
- Proposing adjusting journal entries.

Occasionally the audit client may request technical assistance from the firm on matters such as:

- Resolving account reconciliation problems or analyzing and accumulating information for regulatory reporting;
- Providing technical advice on accounting issues such as the conversion of existing financial statements from one financial reporting framework to another (for example, to comply with group accounting policies or to transition to a different financial reporting framework).

***Issue***

Would these activities create threats to independence and hence the auditor is prohibited from performing the abovementioned activities?

***Response***

The abovementioned activities are considered to be a normal part of the audit process and do not usually create threats as long as the client is responsible for making decisions in the preparation of accounting records and financial statements, as well as neither the firm nor the network firm assumes a management responsibility for the client.

Providing advice and recommendations might create a self-review threat. Whether providing advice and recommendations creates a self-review threat involves making the determination set out in paragraph R600.14. Where the audit client is not a public interest entity and a self-review threat is identified, the firm is required to apply the conceptual framework to evaluate and address the threat. If the audit client is a public interest entity, paragraphs R600.16 and R600.17 apply. (Paragraph 600.11 A1)

A firm or a network firm shall not provide a non-assurance service to an audit client that is a public interest entity if the provision of that service might create a self-review threat in relation to the audit of the financial statements on which the firm will express an opinion. (Paragraph R600.16)

Unless, such service is in relation to information or matters arising in the course of an audit, provided that the firm does not assume a management responsibility and applies the conceptual framework to identify, evaluate and address threats, other than self-review threats, to independence that might be created by the provision of that advice. (Paragraph R600.17)

**Common Questions on Part 4 – Provision of tax services to audit clients**

**Tax return preparation service to audit clients**

**Question 11: Compilation of additional information required to be submitted to the tax authorities as part of the client’s tax reporting obligation**

The firm audits the financial statements of a client where that client is requesting the firm to compile information, including the amount of income tax due, required to be submitted to the tax authorities as part of the client’s tax reporting obligation.

**Issue**

Can a firm compile such information for that audit client in the abovementioned situation?

**Analysis**

Identified threat	<p>Paragraph 604.5 A1 states that tax return preparation services include assisting clients with their tax reporting obligations by drafting and compiling information, including the amount of tax due (usually on standardized forms) required to be submitted to the applicable tax authorities.</p> <p>Paragraph 604.6 A1 further explains that providing tax return preparation services does not usually create a threat because:</p> <ul style="list-style-type: none"> <li>(a) Tax return preparation services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice; and</li> <li>(b) Tax returns are subject to whatever review or approval process the tax authority considers appropriate.</li> </ul>
Threat evaluation	<p>Compilation of such information is within the scope of tax return preparation services. (Paragraph 604.5 A1)</p> <p>Tax return preparation services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. Further, tax returns are subject to whatever review or approval process the tax authority considers appropriate. (Paragraph 604.6 A1)</p>
Safeguard application for all audit clients	<p>None as providing tax return preparation service does not usually create a threat. (Paragraph 604.6 A1)</p>

**Question 12: Respond on behalf of the audit client to the tax authority’s requests for additional information and analyses**

The firm audits the financial statements of a client where the tax authorities request for additional information and analyses from that client.

**Issue**

Can a firm advise an audit client on the tax return treatment of past transactions and respond on behalf of the client to the tax authority’s requests for additional information and analyses (including providing explanations of, and technical support, for the approach being taken)?

**Analysis**

Identified threat	<p>Paragraph 604.5 A1 states that tax return preparation services also include:</p> <ul style="list-style-type: none"> <li>• Advising on the tax return treatment of past transactions.</li> <li>• Responding on behalf of the audit client to the tax authorities' requests for additional information and analysis (for example, providing explanations of and technical support for the approach being taken).</li> </ul> <p>Paragraph 604.6 A1 further explains that providing tax return preparation services does not usually create a threat because:</p> <p>(a) Tax return preparation services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice; and</p> <p>(b) Tax returns are subject to whatever review or approval process the tax authority considers appropriate.</p>
Threat evaluation	<p>Advising on the tax return treatment of past transactions and responding on behalf of the audit client to the tax authorities' requests for additional information and analysis (for example, providing explanations of and technical support for the approach being taken) is within the scope of tax return preparation services. (Paragraph 604.5 A1)</p> <p>Such services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. (Paragraph 604.6 A1)</p>
Safeguard application for all audit clients	<p>None as providing tax return preparation service does not usually create a threat. (Paragraph 604.6 A1)</p>

***Tax calculations for the purpose of preparing accounting entries to audit clients***

**Question 13: Calculation of current and deferred taxation for accounting entries**

The firm audits the financial statements of a client where that client is requesting the firm to calculate its current and deferred tax liabilities (or assets) for the preparation of accounting entries that will be subsequently audited by the firm.

**Issue**

Can the firm provide services on calculating current and deferred tax liabilities (or assets) to an audit client in the abovementioned situation?

**Analysis**

Identified threat	Self-review threat
Threat evaluation	<p>The client must take the responsibility for the preparation of accounting entries. The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> <li>• Whether the audit client is a public interest entity;</li> <li>• The particular characteristics of the engagement;</li> </ul>

	<ul style="list-style-type: none"> <li>• The level of tax expertise of the client’s employees;</li> <li>• The system by which the tax authorities assess and administer the tax in question and the role of the firm or network firm in that process;</li> <li>• The complexity of the relevant tax regime and degree of judgment necessary in applying it;</li> <li>• Whether the calculation might have a material effect on the financial statements on which the firm will express an opinion.</li> </ul> <p>(Paragraphs 604.3 A2 and 604.9 A1)</p>
Safeguard application for an audit client that is a public interest entity	No safeguard can reduce the self-review threat to an acceptable level. Accordingly, a firm or a network firm shall not prepare tax calculations of current and deferred tax liabilities (or assets). (Paragraph R604.10)
Safeguard application for an audit client that is not a public interest entity	<p>Examples of actions that might be safeguards to address such a self-review threat include:</p> <ul style="list-style-type: none"> <li>• Using professionals who are not audit team members to perform the service.</li> <li>• Having an appropriate reviewer who was not involved in providing the service review the audit work or service performed.</li> </ul> <p>(Paragraph 604.9 A2)</p> <p>If the threat cannot be reduced to an acceptable level by the application of safeguards, such non-assurance service shall not be provided.</p>

***Tax planning and other tax advisory services to audit clients***

**Question 14: Provision of tax planning and other advisory services to audit clients**

The firm serves as the financial statements auditor of a client and the client is requesting the firm to provide tax planning and other tax advisory services which comprise a broad range of services such as advising the client on how to structure its affairs in a tax efficient manner or advising on the application of a new law tax or regulation.

***Issue***

Can a firm provide tax planning and other tax advisory services to an audit client in the abovementioned situation?

***Analysis***

Identified threat	Self-review or advocacy threat may be created where the advice will affect matters to be reflected in the financial statements. (Paragraph 604.12 A1)
Threat evaluation	<p>The client must take the responsibility for consideration and implementation of the tax advice, and ultimately its tax treatment and reporting.</p> <p>Factors that are relevant in identifying and evaluating the level of self-review or advocacy threats created by providing tax planning and other tax advisory services to audit clients include:</p>

	<ul style="list-style-type: none"> <li>• Whether the tax advisory and tax planning services:             <ul style="list-style-type: none"> <li>○ Are supported by a tax authority or other precedent;</li> <li>○ Are based on an established practice (being a practice that has been commonly used and has not been challenged by the relevant tax authority); or</li> <li>○ Have a basis in tax law that the firm is confident is likely to prevail.</li> </ul> </li> <li>• The degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements.</li> <li>• Whether the tax treatment is supported by a ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.</li> <li>• The extent to which the outcome of the tax advice might have a material effect on the financial statements.</li> </ul> <p>If the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements and the audit team has doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework, a firm or a network firm shall not provide tax advisory and tax planning services to an audit client.</p> <p>(Paragraphs 604.12 A2, 604.12 A3 and R604.13)</p>
<p>Safeguard application for an audit client that is a public interest entity</p>	<p>No safeguard can reduce the self-review threat to an acceptable level. Accordingly, a firm or a network firm shall not provide tax advisory and tax planning services if the provision of such services might create a self-review threat. (Paragraph 604.15)</p> <p>Examples of actions that might be safeguards to advocacy threat created by providing such services include:</p> <ul style="list-style-type: none"> <li>• Using professionals who are not audit team members to perform the service.</li> <li>• Obtaining pre-clearance from the tax authorities.</li> </ul> <p>(Paragraph 604.15 A1)</p>
<p>Safeguard application for an audit client that is not a public interest entity</p>	<p>Examples of actions that might be safeguards to address self-review or advocacy threats created by providing tax advisory and tax planning services include:</p> <ul style="list-style-type: none"> <li>• Using professionals who are not audit team members to perform the service might address self-review or advocacy threats.</li> <li>• Having an appropriate reviewer, who was not involved in providing the service, review the audit work or service performed might address a self-review threat.</li> <li>• Obtaining pre-clearance from the tax authorities might address self-review or advocacy threats.</li> </ul> <p>(Paragraph 604.14 A1)</p> <p>If the threat cannot be reduced to an acceptable level by the application of safeguards, such non-assurance service shall not be provided.</p>

***Provision of assistance in the resolution of tax disputes to audit clients***

**Question 15: Representing an audit client in a formal proceeding on a tax dispute**

The tax authorities have notified an audit client that they have rejected the client’s arguments on a particular issue and either the tax authority or the client is referring the matter for determination in a formal proceeding, for example before a tribunal or court.

***Issue***

Can a firm represent an audit client in the formal proceedings on a tax dispute in the abovementioned situation?

***Analysis***

Identified threat	Advocacy or self-review threat
Threat evaluation	<p>The client must take the responsibility for its formal proceedings on the tax dispute. The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> <li>• The role management plays in the resolution of the dispute.</li> <li>• The extent to which the outcome of the dispute will have a material effect on the financial statements on which the firm will express an opinion.</li> <li>• Whether the firm or network firm provided the advice that is the subject of the tax dispute.</li> <li>• The extent to which the matter is supported by tax law or regulation, other precedent, or established practice.</li> <li>• Whether the proceedings are conducted in public.</li> </ul> <p>(Paragraphs 604.21 A1 and 604.22 A1)</p>
Safeguard application for an audit client that is a public interest entity	<p>No safeguard can reduce the self-review threat to an acceptable level. Accordingly, a firm or a network firm shall not provide assistance in the resolution of tax disputes if the provision of that assistance might create a self-review threat. (Paragraph R604.24)</p> <p>An example of an action that might be a safeguard to address an advocacy threat created by providing such assistance is using professionals who are not audit team members to perform the service. (Paragraph 604.24 A1)</p> <p>In addition, a firm or a network firm shall not provide tax services that involve assisting in the resolution of tax disputes if the services involve acting as an advocate for the audit client before a tribunal or court. (Paragraph R604.26)</p> <p>Without representing an audit client in the resolution of a tax dispute, a firm or network firm is not 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 related to the matter) for the audit client in relation to the matter that is being heard before a tribunal or court. (Paragraph 604.27 A1) In such circumstance, the client must take the responsibility for the information being provided to the authority.</p>



<p>Safeguard application for an audit client that is not a public interest entity</p>	<p>Examples of actions that might be safeguards to address self-review or advocacy threats created by assisting in the resolution of tax disputes include:</p> <ul style="list-style-type: none"> <li>• Using professionals who are not audit team members to perform the service might address self-review or advocacy threats;</li> <li>• Having an appropriate reviewer who was not involved in providing the service review the audit work or the service performed might address a self-review threat.</li> </ul> <p>(Paragraph 604.23 A1)</p> <p>If the threat cannot be reduced to an acceptable level by the application of safeguards, such non-assurance service shall not be provided.</p> <p>In addition, a firm or a network firm shall not provide tax services that involve assisting in the resolution of tax disputes if the services involve acting as an advocate for the audit client before a 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. (Paragraph R604.25)</p> <p>Without representing an audit client in the resolution of a tax dispute, a firm or network firm is not 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 related to the matter) for the audit client in relation to the matter that is being heard before a tribunal or court. (Paragraph 604.27 A1). In such circumstance, the client must take the responsibility for the information being provided to the authority.</p>
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**Common Question on Part 5 – Provision of internal audit services to audit clients**

**Question 16: Provision of internal audit services to audit clients**

The firm is engaged to review its audit client’s internal controls and recommend improvement areas to enhance operating effectiveness.

**Issue**

Is it allowable for the firm to provide services related to the review of internal controls and operating activities in order to provide improvement recommendation to its audit client?

**Analysis**

<p>Identified threat</p>	<p>Self-review threat</p>
<p>Threat evaluation</p>	<p>The client must take the responsibility for designing, implementation and monitoring of internal controls of its operations. The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> <li>• Whether the client is a public interest entity;</li> <li>• The scope and objectives of internal audit services, the size and structure of the client, the requirements of those charged with governance, and the needs and expectations of management which might involve matters that are operational in nature and do not necessarily relate to matters that will</li> </ul>

	<p>be subject to consideration in relation to the audit of the financial statements.</p> <p>(Paragraph 605.2 A2)</p> <p>Providing internal audit services to audit clients might create self-review threat when there is a risk that the results of the services impact the audit of the financial statements on which the firm will express an opinion. When a firm uses the work of an internal audit function in an audit engagement, HKSA's require the performance of procedures to evaluate the adequacy of that work. Similarly, when a firm or a network firm accepts an engagement to provide internal audit services to an audit client, the results of those services might be used in conducting the external audit. It is possible that the audit team will use the results of the internal audit service for purposes of the audit engagement without appropriately evaluating those results or exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm (Paragraphs 605.4 A1 and 605.4 A2).</p> <p>Factors that are relevant in identifying a self-review threat created by providing internal audit services to an audit client, and evaluating the level of such a threat include:</p> <ul style="list-style-type: none"><li>• The materiality of the related financial statement amounts.</li><li>• The risk of misstatement of the assertions related to those financial statement amounts.</li><li>• The degree of reliance that the audit team will place on the work of the internal audit service.</li></ul> <p>(Paragraph 605.4 A3)</p> <p><u>For audit client that is a public interest entity</u></p> <p>When a self-review threat for an audit client that is a public interest entity has been identified, a firm or a network firm shall not provide internal audit services to that client. Examples of the services that are prohibited include internal audit services that relate to:</p> <ul style="list-style-type: none"><li>• The internal controls over financial reporting.</li><li>• Financial accounting systems that generate information for the client's accounting records or financial statements on which the firm will express an opinion.</li><li>• Amounts or disclosures that relate to the financial statements on which the firm will express an opinion.</li></ul> <p>(Paragraphs R605.6 and 605.6 A1)</p> <p><u>For audit client that is not a public interest entity</u></p> <p>Factors in paragraph 605.4 A3 shall be applied to assess whether self-review threats might be created if services in paragraph 605.6 A1 are provided to an audit client that is not a public interest entity. Paragraph 605.6A1 provides some examples of internal audit services that will be subject to consideration in relation to the audit of financial statements.</p>
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<p>Safeguard application for an audit client that is a public interest entity</p>	<p>No safeguard can reduce the self-review threat to an acceptable level. Accordingly, a firm or a network firm shall not provide internal audit services to an audit client that is a public interest entity if the provision of such services might create a self-review threat. (Paragraph R605.6)</p>
<p>Safeguard application for an audit client that is not a public interest entity</p>	<p>An example of an action that might be a safeguard to address a self-review threat created by the provision of an internal audit service to an audit client that is not a public interest entity is using professionals who are not audit team members to perform the service. (Paragraph 605.5 A1)</p>