

Ethics Circular 1

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

This revised Ethics Circular 1 was endorsed by the Institute's Ethics Committee in December 2015 and supersedes the Ethics Circular 1 previously issued in May 2015. 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 proprietors, 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 members 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.



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

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HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

ETHICS CIRCULAR 1

APPLICATION OF REVISED CODE OF ETHICS BY SMALL AND MEDIUM PRACTITIONERS

This revised Ethics Circular 1 was endorsed by the Institute's Ethics Committee in December 2015 and supersedes the Ethics Circular 1 previously issued in May 2015.

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 proprietors, on their adoption of the Institute's Code of Ethics for Professional Accountants (the Code) on certain non-assurance services and other topical issues without modifying the requirements as set out in 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 members of the Institute to comply with the Code are liable to be enquired into by the appropriate committee established under the authority of the Institute, and disciplinary action may result.

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 members 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. Members should read the Code, which can be accessed at the Institute's Members Handbook.

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BACKGROUND

1. The Institute's Code of Ethics for Professional Accountants (the Code) was revised to maintain convergence with the revised Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants in July 2009. The revised Code clarifies ethical requirements for all professional accountants and strengthens the independence requirements that apply to auditors. The Code was issued in June 2010 and has been effective from 1 January 2011.
2. The Institute has set up a Special Task Force on Adoption of Revised Code of Ethics by Small and Medium Practitioners (Task Force), which is the joint effort of the Institute's Small and Medium Practitioners Leadership Panel and Ethics Committee, to look into implementation issues faced by Small and Medium Practitioners (SMPs) and to develop guidance to help SMPs.
3. This Ethics Circular is developed by the Task Force and is endorsed by the Institute's Ethics Committee. 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 proprietors, on their adoption of the Code on the following areas of non-assurance services and other topical issues without modifying the requirements as set out in the Code:
 - identification of public interest entities (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 taxation services to audit clients (Part 4)

Members should read the Code, which is the Institute's authoritative ethics requirements, as contained in the Institute's Members Handbook.
4. It is also important for practitioners to perform "threats and safeguards" evaluation, which inevitably involves professional judgment. Practitioners are expected to document the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation and to provide further explanations when required.

CONSIDERATION FOR PROVIDING NON-ASSURANCE SERVICES

Threats and safeguards

5. Paragraph 100.5 of the Code 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 Sections 110 – 150 of the Code.

6. Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships. 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;
- advocacy;
- familiarity; and
- intimidation.

These threats are discussed further in Part A of the Code. Paragraphs 200.4 – 200.8 of the Code contain examples of circumstances that create such threats for a professional accountant in public practice.

7. Members are reminded that under paragraph 290.156 of the Code a determination shall be made as to whether providing a non-assurance service would create a threat to independence before the 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. Acceptable level is defined in the Code as a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

8. 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 for professional risk management purpose. This procedure is not explicitly required by the Code or the Hong Kong Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services*

Engagements and is at the discretion by the practitioners depending on specific entity's facts and circumstances.

9. 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. It is possible to have circumstances where safeguards are not required given the relevant threats created by the particular non-assurance service are not significant.
10. Practitioners are expected to document and to explain the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation.
11. 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.
12. Firms are required to establish policies and procedures as required under Hong Kong Standard on Quality Control 1 to maintain independence with reference to the Code.
13. As is the case whenever professional judgment is exercised auditors 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

14. Paragraph 290.159 of the Code 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.
15. Paragraph 290.160 of the Code explains that determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of 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 of bank accounts or investments.
 - Deciding which recommendations of the 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 controls.
16. Paragraph 290.161 of the Code states that a firm shall not assume a management responsibility for an audit client. The threats created would be so significant that no safeguards could reduce the threats to an acceptable level. For example, deciding which recommendations of the firm to implement will create self-review and self-interest threats. Further, assuming a management responsibility creates a familiarity threat because the firm becomes too closely aligned with the views and interests of management. Subject to compliance with paragraph 290.162 of the Code, providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility.
17. Paragraph 290.162 of the Code further states that to avoid the risk of assuming a management responsibility when providing non-assurance services to an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the responsibility of management. This includes ensuring that the client's management:
- 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 services. Such an individual, preferably within senior management, would understand the objectives, nature and results of the services and the respective client and firm responsibilities. However, the individual is not required to possess the expertise to perform or re-perform the services;
 - Provides oversight of the services and evaluates the adequacy of the results of the services performed for the client's purpose; and
 - Accepts responsibility for the actions, if any, to be taken arising from the results of the services.
18. Paragraph 290.163 of the Code clarifies that administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services require little to no professional judgement and are clerical in nature. Examples of administrative services include word processing services, 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. Providing such services does not generally create a threat to independence. However, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Networks and network firms

19. 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 control policies and procedures, common

business strategy, the use of a common brand-name, or a significant part of professional resources.

Under paragraph 290.13 of the Code, the firm shall be independent of the audit clients of the other firms within the network (unless otherwise stated in the Code) if a firm is deemed to be a network firm. The independence requirements that apply to a network firm apply to any entity, such as a consulting practice or professional law practice, that meets the definition of a network firm. Please refer to paragraphs 290.13-24 of the Code for further guidance on networks and network firms.

PART 1 - IDENTIFICATION OF PUBLIC INTEREST ENTITIES

(Ref: Common questions 1 – 4 in Appendix)

20. Public interest entities, for the purpose of auditor independence, is defined in paragraph 290.25 of the Code to include:
- all listed entities; and
 - any entity (a) defined by regulation or legislation as a public interest entity or (b) 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 may be promulgated by any relevant regulator, including an audit regulator.
21. It is stated in footnote 1b of the Code that currently under the legislation of Hong Kong, there is no definition of public interest entity or requirement for audit of an entity to be conducted with the same independence requirements applicable to the audit of listed entities.
22. Paragraph 290.26 of the Code further encourages the 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; and
 - 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 Hong Kong Standard on Quality Control 1 "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements"; and the required procedures to understand the entity and related environment under Hong Kong Standard on Auditing 315 (Revised) "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".

23. When practitioners choose to apply paragraph 290.26, 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.
24. 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

25. Paragraph 290.144 of the Code states that if a partner or employee of the firm serves as a director or officer of an audit client, the self review and self-interest threats created would be so significant that no safeguards could reduce the threats to an acceptable level. Accordingly, no partner or employee shall serve as director or officer of an audit client.
26. Paragraphs 290.145 and 291.134 of the Code explain that the position of company secretary has different implications in different jurisdictions. Duties may range from administrative duties, such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally, this position is seen to imply a close association with the entity.
27. Paragraph 290.146 of the Code states that if a partner or employee of the firm or a network firm serves as company secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant that no safeguards could reduce the threats to an acceptable level unless the duties and functions undertaken are limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns, and are permitted by law.
28. Paragraphs 290.147 and 291.136 of the Code further clarify that performing routine administrative services to support a company secretarial function or providing advice in relation to company secretarial administration matters does not generally create threats to independence, as long as client management makes all relevant decisions.
29. Furthermore, partners and staff cannot act as officers of an audit client under the requirements of the Companies Ordinance. 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". Statement 1.303 can be accessed at Volume I of the Institute's Members Handbook (http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumel/1_303.pdf).

PART 3 - PROVISION OF ACCOUNTING AND BOOKKEEPING SERVICES TO AUDIT CLIENTS

(Ref: Common questions 8 – 11 in Appendix)

30. Paragraph 290.165 of the Code states that providing an audit client with accounting and bookkeeping services, such as preparing accounting records or financial statements, creates a self-review threat when the firm subsequently audits the financial statements.

For audit clients who are not public interest entities

31. Paragraph 290.168 of the Code states that firms may provide services related to the preparation of accounting records and financial statements to an audit client that is not a public interest entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Services that are routine or mechanical in nature require little to no professional judgement from the professional accountant. Some examples of such services are:

- 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.
- Recording a transaction for which the client has already determined the amount to be recorded, even though the transaction involves a significant degree of subjectivity.
- Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.
- Posting client-approved entries to the trial balance.
- Preparing financial statements based on information in the client-approved trial balance and preparing the related notes based on client-approved records.

In all cases, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Arranging for such services to be performed by an individual who is not a member of the audit team; or
 - If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the work performed.
32. It is possible to have circumstances that relevant threat is at an acceptable level and hence employment of safeguards is not required. The practitioners are expected to document and to be able to explain the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation.

For audit clients who are public interest entities

33. The Code recognises that more stringent requirements are necessary in the event that an audit client is a public interest entity. Under paragraph 290.169 of the Code, a firm shall not provide to an audit client that is a public interest entity accounting and bookkeeping services, including payroll services, or prepare financial statements on which the firm will express an opinion or financial information which forms the basis of the financial statements.
34. Despite paragraph 290.169 of the Code, a firm under paragraph 290.170 of the Code may provide accounting and bookkeeping services, including payroll services and the preparation of financial statements or other financial information, of a routine or mechanical nature for divisions or related entities of an audit client that is a public interest entity if the personnel providing the services are not members of the audit team and:
- The divisions or related entities for which the service is provided are collectively immaterial to the financial statements on which the firm will express an opinion; or
 - The services relate to matters that are collectively immaterial to the financial statements of the division or related entity.
35. Additional guidance is provided in the financial reporting and auditing alert issue 14 and 15 which can be accessed at <http://www.hkicpa.org.hk/en/standards-and-regulations/technical-resources/financial-and-auditing-alert/>

PART 4 - PROVISION OF TAXATION SERVICES TO AUDIT CLIENTS
(Ref: Common questions 12 – 16 in Appendix)

36. Taxation services comprise a broad range of services, including:
- tax return preparation;
 - tax calculations for the purpose of preparing the accounting entries;
 - tax planning and other tax advisory services; and
 - assistance in the resolution of tax disputes.

Tax return preparation

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

37. Under paragraph 290.179 of the Code, tax return preparation services involve assisting clients with their tax reporting obligations by drafting and completing information, including the amount of tax due (usually on standardized forms) required to be submitted to the applicable tax authorities. Such services also include 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 (including providing explanations of and technical support for the approach being taken). Tax return preparation services are generally based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. Further, the tax returns are subject to whatever review or approval process the tax authority deems appropriate.
38. Based on the above, providing tax return preparation services does not generally create a threat to independence if management takes responsibility for the returns including any significant judgments made.

Tax calculations for the purpose of preparing the accounting entries

Audit clients that are not public interest entity

39. Under paragraph 290.180 of the Code, preparing calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of preparing accounting entries that will be subsequently audited by the firm creates a self-review threat. The significance of the threat will depend on (a) the complexity of the relevant tax law and regulation and the degree of judgment necessary in applying them, (b) the level of tax expertise of the client's personnel, and (c) the materiality of the amounts to the financial statements.
40. In relation to the complexity of the relevant tax law and regulation and the degree of judgment necessary in applying them, practitioners may consider whether the tax calculations are clearly supported by tax authority or other precedent, by established practice or has a basis in tax law that is likely to prevail.
41. If such services are to be provided to audit clients who are not public interest entities, safeguards shall be applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:
- using professionals who are not members of the audit team to perform the service;
 - if the service is performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the tax calculations; or
 - obtaining advice on the service from an external tax professional.

It is possible to have circumstances that relevant threat is at an acceptable level and hence employment of safeguards is not required. The practitioners are expected to

document and be able to explain the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation.

Audit clients that are public interest entities

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

Tax planning and other tax advisory services

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

43. Tax planning or other tax advisory services comprise a broad range of services, such as advising the client how to structure its affairs in a tax effective manner or advising on the application of a new tax law or regulation. A self-review threat may be created where the advice will affect matters to be reflected in the financial statements. The existence and significance of any threat will depend on factors such as:
- the degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements;
 - the extent to which the outcome of the tax advice will have a material effect on the financial statements;
 - whether the effectiveness of the tax advice depends on the accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the accounting treatment or presentation under the relevant financial reporting framework;
 - the level of tax expertise of the client's employees;
 - the extent to which the advice is supported by tax law or regulation, other precedent or established practice; and
 - whether the tax treatment is supported by a private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.
44. Paragraph 290.183 of the Code states that providing tax planning and other tax advisory services where the advice is clearly supported by tax authority or other precedent, by established practice or has a basis in tax law that is likely to prevail does not generally create a threat to independence.
45. If such services are to be provided to audit client, the significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:
- using professionals who are not members of the audit team to perform the service;
 - having a tax professional, who was not involved in providing the tax service, advise the audit team on the service and review the financial statement treatment;

- obtaining advice on the service from an external tax professional; or
- obtaining pre-clearance or advice from the tax authority.

It is possible to have circumstances that relevant threat is at an acceptable level and hence employment of safeguards is not required. The practitioners are expected to document and be able to explain the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation.

46. Where the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements and:

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

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

Assistance in the resolution of tax disputes

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

47. Paragraph 290.187 of the Code states that an advocacy or self-review threat may be created when the firm represents an audit client in the resolution of a tax dispute once the tax authorities have notified the 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. The existence and significance of any threat will depend on factors such as:

- whether the firm has provided the advice which is the subject of the tax 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;
- 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; and
- the role management plays in the resolution of the dispute.

The significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- using professionals who are not members of the audit team to perform the service;

- having a tax professional, who was not involved in providing the tax service, advise the audit team on the services and review the financial statement treatment; or
- obtaining advice on the service from an external tax professional.

It is possible to have circumstances that relevant threat is at an acceptable level and hence employment of safeguards is not required. The practitioners are expected to document and be able to explain the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation.

48. Paragraph 290.188 of the Code explains that where the taxation services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts involved are material to the financial statements on which the firm will express an opinion, the advocacy threat created would be so significant that no safeguards could eliminate or reduce the threat to an acceptable level. Therefore, the firm shall not perform this type of service for an audit client.
49. Paragraph 290.189 of the Code further clarifies that the firm is not, however, precluded from having a continuing advisory role (for example, responding to specific requests for information, providing factual accounts or testimony about the work performed or assisting the client in analyzing the tax issues) for the audit client in relation to the matter that is being heard before a public tribunal or court.

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 taxation 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 reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

It is possible to have circumstances that relevant threat is at an acceptable level and hence employment of safeguard is not required. It is also possible for different practitioners to make different determinations based on different facts and circumstances. The practitioners are expected to document and be able to explain the relevant facts and circumstances and the determination on the "threats and safeguards" evaluation.

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 – PIE determination on 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 290.26 of the Code.

Question 2 – In-house criteria for PIE determination

Is it a must for practice units to establish their in-house criteria to determine public interest entities under paragraph 290.26 of the Code?

Paragraph 290.26 of the Code encourages the firms to determine whether to treat additional entities, or categories of entities, as public interest entities on the basis that 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 290.26 of the Code.

Question 3 – PIE determination on 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 290.26 of the Code.

Question 4 – PIE determination on 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. 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.

Paragraph 290.25(b) of 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 290.26 of the Code.

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 paragraphs 290.149-153) 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 its client. The client expects a partner or an employee of the firm or a network firm to serve as the client's company secretary.

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 in the abovementioned situation?

Response

As guided by paragraph 290.146 of the Code, a partner or an employee of the firm or a network firm is only permissible to serve as company secretary of the audit client only when:

- fulfilling the relevant legal requirement (i.e. the Hong Kong Companies Ordinance disallows an individual to concurrently hold the posts of auditor and secretary to a company);
- the duties and functions undertaken are limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns; and
- management of client makes all relevant decisions and the practitioners do not assume any management responsibilities or make any management decisions.

Question 6 – Provision of routine administrative services to support the company secretary

The firm audits the financial statements of its client. No partner or employee of the firm or a network firm serves as the company secretary of that audit client.

Issue

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

Response

Under paragraph 290.147 of the Code, performing routine administrative services to support a company secretarial function or providing advice in relation to company secretarial administration matters does not generally create threats to independence as long as client management makes all relevant decisions.

Question 7 - Formation of a separate company secretarial company by a sole proprietor practicing member

A sole proprietor practicing member 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 proprietor practicing member be appointed as the auditor of the concerned entity in the abovementioned situation?

Response

Such a structure is not disallowed under the Hong Kong Companies Ordinance, 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:

- fulfilling the relevant legal requirement (i.e. the Hong Kong Companies Ordinance disallows an individual to concurrently hold the posts of auditor and secretary to a company);
- the duties and functions undertaken are limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns; and
- management of client makes all relevant decisions and the practitioners do not assume any management responsibilities or make any management decisions.

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

Common Questions on Part 3 – Provision of accounting services to audit clients who are not public interest entities

Question 8 – Provision of accounting services to audit clients

The firm audits the financial statements of a client who is not a public interest entity.

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"> • Whether the client is a public interest entity; • Whether the services are of a routine or mechanical in nature. Some example of such services are: <ul style="list-style-type: none"> ○ 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; ○ Recording a transaction for which the client has already determined the amount to be recorded, even though the transaction involves a significant degree of subjectivity; ○ Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values; ○ Posting client-approved entries to the trial balance; and ○ Preparing financial statements based on information in the client-approved trial balance and preparing the related notes based on client-approved records; • Whether the management is familiar with accounting practices and/or principles. <p>In determining whether the services are of a routine or mechanical in nature, practitioners may consider the following non-exhaustive factors as part of its determination process:</p> <ul style="list-style-type: none"> ○ the complexity of financial reporting requirements;

	<ul style="list-style-type: none"> ○ the level of judgment and/or subjectivity involved in the recognition, classification and measurement of the accounting transactions; ○ The total number of client's transactions and whether or not the transactions and/or balances are supported by third party documents, where the auditor are not required to re-compute figures or make any judgment on recognition, classification and measurement of each transaction.
Safeguard application	<p>If the audit client is a public interest entity, the auditor must decline or terminate the financial statements preparation service. (Paragraph 290.169)</p> <p>If the audit client is not a public interest entity and the threat is considered to be at an acceptable level based on evaluation, then no safeguard is need to be employed. Otherwise and if the audit client is not a public interest entity, the firm is to apply safeguards to eliminate the threat or reduce it to an acceptable level. Example of such safeguards include:</p> <ul style="list-style-type: none"> • Arranging for such services to be performed by an individual who is not a member of the audit team; • If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the work performed; • If the client has a limited number of transactions, ensure each transaction and balance of the client are supported by third party documents where the auditor does not re-compute figures or make any judgment on recognition, classification and measurement of each transaction. <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>

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.

Common question on Part 3 – Provision of accounting services to audit clients (including public interest entities and non-public interest entities)

Question 10 – Dialogue between the firm and audit client management

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

- The application of accounting standards, policies and financial statement disclosure requirements;
- The appropriateness of internal controls including financial and accounting controls and the methods used in determining the stated amounts of assets and liabilities; or
- Proposing adjusting journal entries

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 part of the audit process and do not, generally, create threats to independence so long as audit client takes responsibility.

Question 11 – Technical assistance by the firms to audit clients

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 the abovementioned activities create threats to independence and hence the firm is prohibited from performing the abovementioned activities?

Response

The abovementioned activities do not generally create threats to independence provided the firm does not assume a management responsibility for the client.

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

**Tax return preparation service to audit clients
(for both public interest entities and non-public interest entities)**

Question 12 – Preparation of financial 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 financial 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 financial information for that audit client in the abovementioned situation?

Analysis

Identified threat	Not applicable
Threat evaluation	<p>Compilation of such financial information is within the scope of tax return preparation services under paragraph 290.179 of the Code.</p> <p>Tax return preparation services are generally based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. The tax return information are subject to the review or approval process the tax authority deems appropriate.</p>
Safeguard application	Such service does not generally create a threat to independence if management takes responsibility for the returns including any significant judgments made.

Question 13 – 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	Not applicable
Threat evaluation	<p>Advising on tax return treatment of past transactions and responding on behalf of the audit client to the tax authorities' requests for additional information and analysis (including providing explanations of, and technical support, for the approach being taken) is within the scope of tax return preparation services under paragraph 290.179 of the Code.</p> <p>Such services are generally based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice.</p>
Safeguard application	Such service does not generally create a threat to independence if management takes responsibility for the returns including any significant judgments made.

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

Question 14 - 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.</p> <p>The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> • Whether the audit client is a public interest entity; • Complexity of the relevant tax law and degree of judgment necessary in applying that; • The level of tax expertise of the client's personnel; • The materiality of the amounts involved to the financial statements.
Safeguard application	<p>If the audit client is a public interest entity, a firm shall not prepare tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion. (Paragraph 290.181)</p> <p>If the audit client is not a public interest entity and the threat is considered to be at an acceptable level based on evaluation, then no safeguard is need to be employed. Otherwise and if the audit client is not a public interest entity, the firm is to apply safeguards to eliminate the threat or reduce it to an acceptable level. Example of such safeguards include:</p> <ul style="list-style-type: none"> • Using professionals who are not members of the audit team to perform the service; • If the service is performed by a member of the audit team, using a partner or senior staff member with appropriate

	<p>expertise who is not a member of the audit team to review the tax calculations;</p> <ul style="list-style-type: none"> • Obtaining advice on the service from an external tax professional. <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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***Tax planning and other tax advisory services to audit clients
(for both public interest entities and non-public interest entities)***

Question 15 – Provision of tax planning and other advisory services to audit clients

The firm serves as the financial statements auditor of a client where 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 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 threat may be created where the advice will affect matters to be reflected in the financial statements (Paragraph 290.183).
Threat evaluation	<p>The client must take the responsibility on consideration and implementation of the tax advice, and ultimately its tax treatment and reporting.</p> <p>The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> • The degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements; • The extent to which the outcome of the tax advice will have a material effect on the financial statements; • Whether the effectiveness of the tax advice depends on the accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the accounting treatment or presentation under the relevant financial reporting framework; • The level of tax expertise of the client's employees;

	<ul style="list-style-type: none"> • The extent to which the advice is supported by tax law or regulation, other precedent or established practice; and • Whether the tax treatment is supported by a private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.
Safeguard application	<p>If the advice is clearly supported by tax authority or other precedent, by established practice or has a basis in tax law that is likely to prevail, providing such tax planning and other tax advisory services does not generally create a threat to independence. No safeguard is therefore needed in such circumstance.</p> <p>A firm shall not provide tax advice to an audit client if the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements and:</p> <ul style="list-style-type: none"> • The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and • The outcome or consequence of the tax advice will have a material effect on the financial statements on which the firm will express an opinion. <p>If the threat is considered to be at an acceptable level based on evaluation, then no safeguard is need to be employed. Otherwise, the firm is to apply necessary safeguard to eliminate the threat or reduce it to an acceptable level. Non-exhaustive examples of such safeguards include:</p> <ul style="list-style-type: none"> • Using professionals who are not members of the audit team to perform the service; • Having a tax professional, who was not involved in providing the tax service, advise the audit team on the service and review the financial statement treatment; • Obtaining advice on the service from an external tax professional; • Obtaining pre-clearance or advice from the tax authority. <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
(including public interest entities and non-public interest entities)***

Question 16 – 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.

Question

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 the tax dispute.</p> <p>The existence and significance of the threat depends on factors such as:</p> <ul style="list-style-type: none"> • Whether the firm has provided the advice which is the subject of the tax 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; • The extent to which the matter is supported by tax law, other precedent, or established practice; • Whether the proceedings are conducted in public; • The role management plays in the resolution of the dispute.

<p>Safeguard application</p>	<p>The firm shall not act as advocate for an audit client before a public tribunal or court in the resolution of a tax matter and when the amounts involved are material to the financial statements on which the firm will express an opinion. (Paragraph 290.188)</p> <p>If the threat is considered to be at an acceptable level based on evaluation, then no safeguard is need to be employed. Otherwise, the firm is to apply necessary safeguard to eliminate the threat or reduce it to an acceptable level. Non-exhaustive examples of such safeguards include:</p> <ul style="list-style-type: none">• Using professionals who are not members of the audit team to perform the service;• Having a tax professional, who was not involved in providing the tax service, advise the audit team on the services and review the financial statement treatment;• Obtaining advice on the service from an external tax professional. <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>Without representing an audit client in the resolution of a tax dispute, the 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 analysing the tax issues) for the audit client in relation to the matter that is being heard before a public tribunal or court (Paragraph 290.189). In such circumstance, the client must take the responsibility for the information being provided to the authority.</p>
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