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

MEMBERS' HANDBOOK

Update No. 221

(Issued 30 November 2018)

Document Reference and Title	***Instructions***	***Explanations***
VOLUME I		
Contents of Volume I	Discard existing page i and ii & replace with revised page i and ii.	Revised contents pages
PROFESSIONAL ETHICS		
Code of Ethics for Professional Accountants	Insert the revised Code after the extant Code	- Note

Note:

The Institute has revised the *Code of Ethics for Professional Accountants* (the "revised Code") adopting the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the International Ethics Standards Board (the "International Code") in April 2018.

The revised Code issued by the Institute consists of the following Chapters:
- A is based on the International Code
- [B – not used]
- C contains either local application or represents an amplification of provisions in the International Code (i.e. Chapter A of this Code)
- D is a comparison of the revised Code with the International Code
- E applies to specialized areas of practice
- F contains guidelines on anti-money laundering and counter-terrorist financing for professional accountants.

Chapters C, E and F are carried forward from the extant *Code of Ethics for Professional Accountants (Revised February 2018)* and form an integral part of the revised Code.

Chapter A of the revised Code will be effective as of 15 June 2019, subject to the following:

Independence Standards
- Part 4A of Chapter A relating to independence for audit and review engagements will be effective for audits and reviews of financial statements for periods beginning on or after 15 June 2019.
- Part 4B of Chapter A relating to independence for assurance engagements with respect to subject matter covering periods will be effective for periods beginning on or after 15 June 2019; otherwise, it will be effective as of 15 June 2019.

Long Association Provisions (Section 540)

The effective date of Chapter A of the revised Code does not override the effective date of the revised Long Association provisions in Sections 290 and 291 as set out in the January 2017 long association close-off document released by the International Ethics Standards Board for Accountants, which is as follows:

(a) Subject to the transitional provision in (c) below, paragraphs 290.148 to 290.168 are effective for audits of financial statements for periods beginning on or after 15 December 2018. Early adoption is permitted.

(b) For assurance engagements covering periods, paragraphs 291.137 to 291.141 will be effective for periods beginning on or after 15 December 2018; otherwise, they will be effective as of 15 December 2018. Early adoption is permitted.

(c) Paragraph 290.163 shall have effect only for audits of financial statements for periods beginning prior to 15 December 2023. This will facilitate the transition to the required cooling-off period of five consecutive years for engagement partners in those jurisdictions where the legislative body or regulator (or organization authorized or recognized by such legislative body or regulator) has specified a cooling-off period of less than five consecutive years.

The effective dates of Chapter A are the same as that of the International Code. Early adoption is permitted.

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

MEMBERS' HANDBOOK
CONTENTS OF VOLUME I

(Updated to November 2018)

COE
Issued November 2018

Effective on 15 June 2019

Code of Ethics for Professional Accountants

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

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This Code of Ethics for Professional Accountants is based on the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code) of the International Ethics Standards Board for Accountants (IESBA), published by the International Federation of Accountants (IFAC) in April 2018 and is used with permission of IFAC.

CONTENTS

PREFACE

This Preface has been approved by the Council of the Hong Kong Institute of Certified Public Accountants (the “Institute”) for publication.

1. Pursuant to section 18A of the Professional Accountants Ordinance, Council may, in relation to the practice of accountancy, issue or specify any statement of professional ethics required to be observed, maintained or otherwise applied by members of the Institute.

2. Council has mandated the Ethics Committee (EC) to develop the HKICPA Code of Ethics for Professional Accountants (the "Code"). Within this remit, Council permits the EC to work in whatever way it considers most effective and efficient and this may include forming advisory working groups or other forms of specialist advisory groups to give advice in preparing the Code.

3. The Institute, as a member of the International Federation of Accountants (IFAC), is committed to the IFAC’s broad objective of supporting the development of high-quality international standards and enhancing a coordinated worldwide accountancy profession with common standards. The IFAC Board has established the International Ethics Standards Board for Accountants (IESBA) to function as an independent standard-setting body under the auspices of IFAC and subject to the oversight of the Public Interest Oversight Board (PIOB).

4. The IESBA develops and issues, under its own standard setting authority, the International Code of Ethics for Professional Accountants (including International Independence Standards) (the "International Code”). The International Code is for use by professional accountants around the world. The IESBA establishes the International Code for international application following due process. The IFAC establishes separate requirements for its member bodies with respect to the International Code.

5. As an obligation of its membership, the Institute is obliged to support the work of IFAC by (a) informing its members of every pronouncement developed by IESBA, and (b) implementing those pronouncements, when and to the extent possible under local circumstances.

6. The Institute has determined to adopt the International Code as the ethical requirements for its members.

7. Where the Council of the Institute deems it necessary, it has included, and may develop further, additional ethical requirements on matters of relevance not covered by the International Code.

8. This Code issued by the Institute consists of:

   - A is based on the International Code (issued in April 2018)
   - [B – Not used]
   - C contains either local application or represents an amplification of provisions in the International Code (i.e. Chapter A of this Code)
   - D is a comparison of the Code with the International Code
   - E applies to specialized areas of practice
   - F contains guidelines on anti-money laundering and counter-terrorist financing for professional accountants

   Chapter A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework that professional accountants shall apply. It provides examples of safeguards that may be appropriate to address threats to compliance

with the fundamental principles. It also describes situations where safeguards are not available to address the threats, and consequently, the circumstance or relationship creating the threats shall be avoided.

Chapter C sets out additional ethical requirements on specific areas. Chapter E sets out ethical requirements that apply to specialized areas of practice. Chapter F sets out guidelines on anti-money laundering and counter-terrorist financing for professional accountants.

Chapters C, E and F form an integral part of this Code. Members need to be aware of these additional requirements and comply with them. Additional local guidance is also provided, which is either incorporated by way of footnotes, Appendices or references to the relevant sections of the Code. The basic principles, requirements and application material are to be understood and applied in the context of the entire Code.

9. It is not practical to establish ethical requirements that apply to all situations and circumstances members of the Institute may encounter. Members of the Institute should therefore consider the ethical requirements as the basic principles they should follow in performing their work.

10. Council requires members of the Institute to comply with the Code. 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. Disciplinary action may include an order that the name of the member be removed from the Institute's membership register.

11. The Code is likely to be taken into account when the work of members of the Institute is being considered in a court of law or in other contested situations.

A REQUIREMENTS AND APPLICATION MATERIAL FOR PROFESSIONAL ACCOUNTANTS

USER GUIDE

(This Guide is a non-authoritative aid to using the Requirements and Application Material for Professional Accountants.)

Purpose of Chapter A, Requirements and Application Material for Professional Accountants

1. Chapter A of the Code contains the requirements and application material for professional accountants ("Chapter A") which sets out fundamental principles of ethics for professional accountants, reflecting the profession's recognition of its public interest responsibility. These principles establish the standard of behavior expected of a professional accountant. The fundamental principles are: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior.

2. Chapter A provides a conceptual framework that professional accountants are to apply in order to identify, evaluate and address threats to compliance with the fundamental principles. It sets out requirements and application material on various topics to help accountants apply the conceptual framework to those topics.

3. In the case of audits, reviews and other assurance engagements, Chapter A sets out *Independence Standards,* established by the application of the conceptual framework to threats to independence in relation to these engagements.

How Chapter A, Requirements and Application Material, is Structured

4. Chapter A contains the following material:

    - Part 1 – *Complying with the Code, Fundamental Principles and Conceptual Framework*, which includes the fundamental principles and the conceptual framework and is applicable to all professional accountants.

    - Part 2 – *Professional Accountants in Business*, which sets out additional material that applies to professional accountants in business when performing professional activities. Professional accountants in business include professional accountants employed, engaged or contracted in an executive or non-executive capacity in, for example:

        - Commerce, industry or service.
        - The public sector.
        - Education.
        - The not-for-profit sector.
        - Regulatory or professional bodies.

    Part 2 is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm, whether as a contractor, employee or owner.

- Part 3 – *Professional Accountants in Public Practice*, which sets out additional material that applies to professional accountants in public practice when providing professional services.

- *Independence Standards*, which sets out additional material that applies to professional accountants in public practice when providing assurance services, as follows:

    - Part 4A – *Independence for Audit and Review Engagements*, which applies when performing audit or review engagements

    - Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements, which applies when performing assuranc*e engagements that are not audit or review engagements

- *Glossary,* which contains defined terms (together with additional explanations where appropriate) and described terms which have a specific meaning in certain parts of Chapter A and other chapters of the Code. For example, as noted in the Glossary, in Part 4A, the term "audit engagement" applies equally to both audit and review engagements. The Glossary also includes lists of abbreviations that are used in Chapter A, other chapters of the Code and other standards to which the Code refers.

5. Chapter A and other sections of the Code contain sections which address specific topics. Some sections contain subsections dealing with specific aspects of those topics. Each section of Chapter A is structured, where appropriate, as follows:

    - Introduction – sets out the subject matter addressed within the section, and introduces the requirements and application material in the context of the conceptual framework. Introductory material contains information, including an explanation of terms used, which is important to the understanding and application of each Part and its sections.

    - Requirements – establish general and specific obligations with respect to the subject matter addressed.

    - Application material – provides context, explanations, suggestions for actions or matters to consider, illustrations and other guidance to assist in complying with the requirements.

How to Use Chapter A, Requirements and Application Material

The Fundamental Principles, Independence and Conceptual Framework

6. Chapter A requires professional accountants to comply with the fundamental principles of ethics. It 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.

7. 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. When threats are not at an acceptable level, the conceptual framework requires the accountant to address those threats. Applying safeguards is one way that

threats might be addressed. Safeguards are actions individually or in combination that the accountant takes that effectively reduce threats to an acceptable level.

8. In addition, it requires professional accountants to be independent when performing audit, review and other assurance engagements. The conceptual framework applies in the same way to identifying, evaluating and addressing threats to independence as to threats to compliance with the fundamental principles.

9. Complying with Chapter A requires knowing, understanding and applying:

- All of the relevant provisions of a particular section in the context of Part 1, together with the additional material set out in Sections 200, 300, 400 and 900 of Chapter A, as applicable.

- All of the relevant provisions of a particular section, for example, applying the provisions that are set out under the subheadings titled “General” and “All Audit Clients” together with additional specific provisions, including those set out under the subheadings titled “Audit Clients that are not Public Interest Entities” or “Audit Clients that are Public Interest Entities.”

- All of the relevant provisions set out in a particular section together with any additional provisions set out in any relevant subsection.

Requirements and Application Material of Chapter A

10. Chapter A is to be read and applied with the objective of complying with the fundamental principles, applying the conceptual framework and, when performing audit, review and other assurance engagements, being independent.

Requirements

11. In Chapter A, requirements are designated with the letter “R” and, in most cases, include the word “shall.” The word “shall” in Chapter A imposes an obligation on a professional accountant or firm to comply with the specific provision in which “shall” has been used.

12. In some situations, Chapter A provides a specific exception to a requirement. In such a situation, the provision is designated with the letter “R” but uses “may” or conditional wording.

13. When the word “may” is used in Chapter A, it denotes permission to take a particular action in certain circumstances, including as an exception to a requirement. It is not used to denote possibility.

14. When the word “might” is used in Chapter A, it denotes the possibility of a matter arising, an event occurring or a course of action being taken. The term does not ascribe any particular level of possibility or likelihood when used in conjunction with a threat, as the evaluation of the level of a threat depends on the facts and circumstances of any particular matter, event or course of action.

Application Material

15. In addition to requirements, Chapter A contains application material that provides context relevant to a proper understanding of Chapter A. In particular, the application material is intended to help a professional accountant to understand how to apply the conceptual framework to a particular set of circumstances and to understand and comply with a specific requirement. While such application material does not of itself impose a requirement, consideration of the material is

necessary to the proper application of Chapter A, including application of the conceptual framework. Application material is designated with the letter “A.”

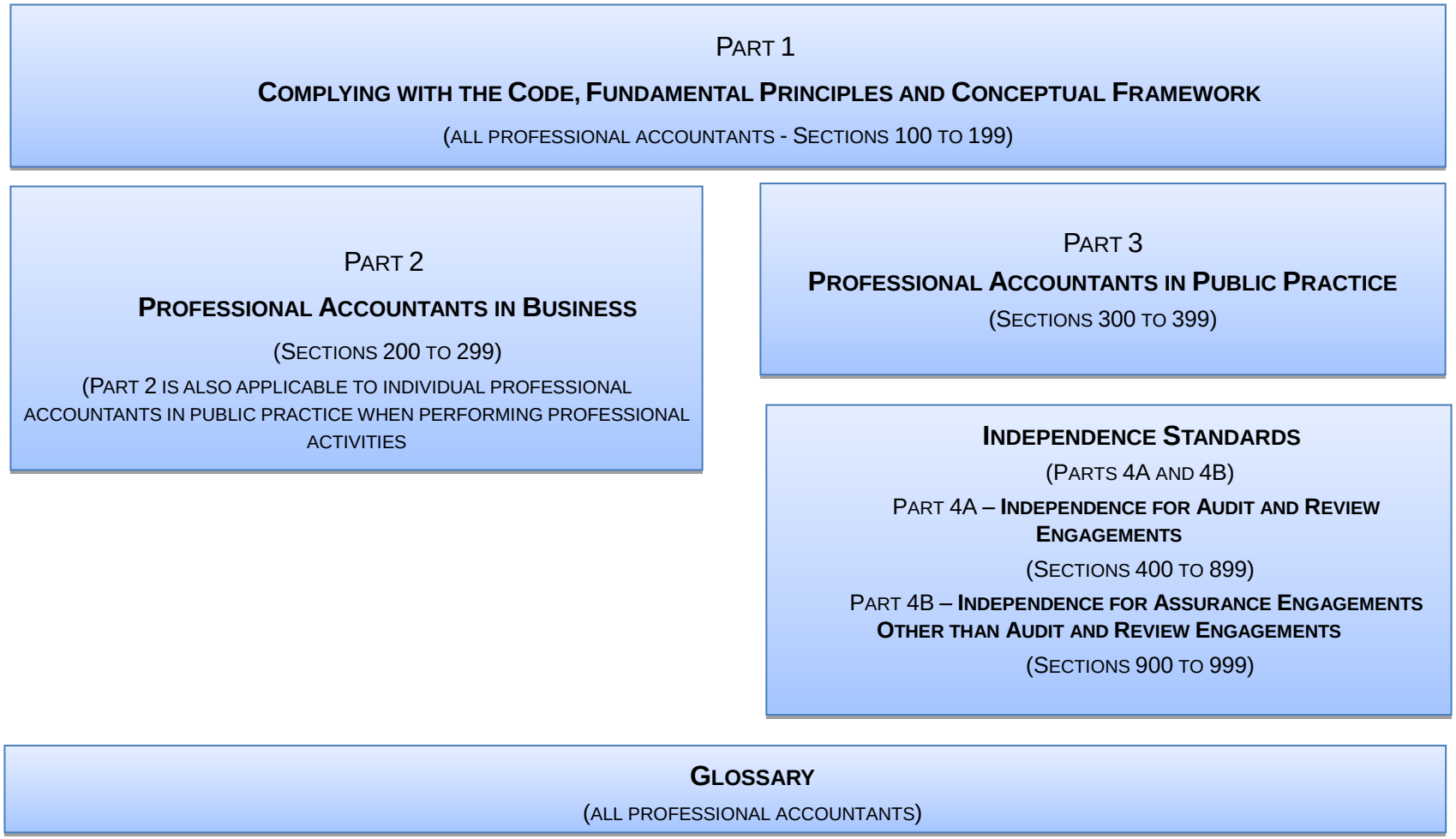
16. Where application material includes lists of examples, these lists are not intended to be exhaustive.

Appendix to Guide to Chapter A, Requirements and Application Material

17. The Appendix to this Guide provides an overview of Chapter A.

Appendix to User Guide to Chapter A

OVERVIEW OF THE REQUIREMENTS AND APPLICATION MATERIAL FOR PROFESSIONAL ACCOUNTANTS



REQUIREMENTS AND APPLICATION MATERIAL FOR PROFESSIONAL ACCOUNTANTS

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PART 1 – COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

PART 1 – COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

SECTION 100

COMPLYING WITH THE CODE

General

100.1 A1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employing organization. Therefore, the Code contains requirements and application material to enable professional accountants to meet their responsibility to act in the public interest.

100.2 A1 The requirements in the Code, designated with the letter "R," impose obligations.

100.2 A2 Application material, designated with the letter "A," provides context, explanations, suggestions for actions or matters to consider, illustrations and other guidance relevant to a proper understanding of the Code. In particular, the application material is intended to help a professional accountant to understand how to apply the conceptual framework to a particular set of circumstances and to understand and comply with a specific requirement. While such application material does not of itself impose a requirement, consideration of the material is necessary to the proper application of the requirements of the Code, including application of the conceptual framework.

R100.3 A professional accountant shall comply with the Code. There might be circumstances where laws or regulations preclude an accountant from complying with certain parts of the Code. In such circumstances, those laws and regulations prevail, and the accountant shall comply with all other parts of the Code.

100.3 A1 The principle of professional behavior requires a professional accountant to comply with relevant laws and regulations. Some jurisdictions might have provisions that differ from or go beyond those set out in the Code. Accountants in those jurisdictions need to be aware of those differences and comply with the more stringent provisions unless prohibited by law or regulation.

100.3 A2 A professional accountant might encounter unusual circumstances in which the accountant believes that the result of applying a specific requirement of the Code would be disproportionate or might not be in the public interest. In those circumstances, the accountant is encouraged to consult with a professional or regulatory body.

Breaches of the Code

R100.4 Paragraphs R400.80 to R400.89 and R900.50 to R900.55 address a breach of *Independence Standards*. A professional accountant who identifies a breach of any other provision of the Code shall evaluate the significance of the breach and its impact on the accountant's ability to comply with the fundamental principles. The accountant shall also:

(a) Take whatever actions might be available, as soon as possible, to address the consequences of the breach satisfactorily; and

(b) Determine whether to report the breach to the relevant parties.

100.4 A1 Relevant parties to whom such a breach might be reported include those who might have been affected by it, a professional or regulatory body or an oversight authority.

SECTION 110

THE FUNDAMENTAL PRINCIPLES

General

110.1 A1 There are five fundamental principles of ethics for professional accountants:

(a) Integrity – to be straightforward and honest in all professional and business relationships.

(b) Objectivity – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.

(c) Professional Competence and Due Care – to:

(i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

(ii) Act diligently and in accordance with applicable technical and professional standards.

(d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.

(e) Professional Behavior – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

R110.2 A professional accountant shall comply with each of the fundamental principles.

110.2 A1 The fundamental principles of ethics establish the standard of behavior expected of a professional accountant. The conceptual framework establishes the approach which an accountant is required to apply to assist in complying with those fundamental principles. Subsections 111 to 115 set out requirements and application material related to each of the fundamental principles.

110.2 A2 A professional accountant might face a situation in which complying with one fundamental principle conflicts with complying with one or more other fundamental principles. In such a situation, the accountant might consider consulting, on an anonymous basis if necessary, with:

- Others within the firm or employing organization.
- Those charged with governance.
- A professional body.
- A regulatory body.
- Legal counsel.

However, such consultation does not relieve the accountant from the responsibility to exercise professional judgment to resolve the conflict or, if necessary, and unless prohibited by law or regulation, disassociate from the matter creating the conflict.

110.2 A3 The professional accountant is encouraged to document the substance of the issue, the details of any discussions, the decisions made and the rationale for those decisions.

SUBSECTION 111 – INTEGRITY

R111.1 A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.

111.1 A1 Integrity implies fair dealing and truthfulness.

R111.2 A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information provided recklessly; or

(c) Omits or obscures required information where such omission or obscurity would be misleading.

111.2 A1 If a professional accountant provides a modified report in respect of such a report, return, communication or other information, the accountant is not in breach of paragraph R111.2.

R111.3 When a professional accountant becomes aware of having been associated with information described in paragraph R111.2, the accountant shall take steps to be disassociated from that information.

SUBSECTION 112 – OBJECTIVITY

R112.1 A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.

R112.2 A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

SUBSECTION 113 – PROFESSIONAL COMPETENCE AND DUE CARE

R113.1 A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:

(a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

(b) Act diligently and in accordance with applicable technical and professional standards.

113.1 A1 Serving clients and employing organizations with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities.

113.1 A2 Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.

113.1 A3 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

R113.2 In complying with the principle of professional competence and due care, a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision.

R113.3 Where appropriate, a professional accountant shall make clients, the employing organization, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities.

SUBSECTION 114 – CONFIDENTIALITY

R114.1 A professional accountant shall comply with the principle of confidentiality, which requires an accountant to respect the confidentiality of information acquired as a result of professional and business relationships. An accountant shall:

(a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member;

(b) Maintain confidentiality of information within the firm or employing organization;

(c) Maintain confidentiality of information disclosed by a prospective client or employing organization;

(d) Not disclose confidential information acquired as a result of professional and business relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;

(e) Not use confidential information acquired as a result of professional and business relationships for the personal advantage of the accountant or for the advantage of a third party;

(f) Not use or disclose any confidential information, either acquired or received as a result of a professional or business relationship, after that relationship has ended; and

(g) Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

114.1 A1 Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant in the knowledge that the information will not be disclosed to a third party. Nevertheless, the following are circumstances where professional accountants are or might be required to disclose confidential information or when such disclosure might be appropriate:

(a) Disclosure is required by law, for example:

(i) Production of documents or other provision of evidence in the course of legal proceedings; or

(ii) Disclosure to the appropriate public authorities of infringements of the law that come to light;

(b) Disclosure is permitted by law and is authorized by the client or the employing organization; and

(c) There is a professional duty or right to disclose, when not prohibited by law:

(i) To comply with the quality review of a professional body;

(ii) To respond to an inquiry or investigation by a professional or regulatory body;

(iii) To protect the professional interests of a professional accountant in legal proceedings; or

(iv) To comply with technical and professional standards, including ethics requirements.

114.1 A2 In deciding whether to disclose confidential information, factors to consider, depending on the circumstances, include:

- Whether the interests of any parties, including third parties whose interests might be affected, could be harmed if the client or employing organization consents to the disclosure of information by the professional accountant.
- Whether all the relevant information is known and substantiated, to the extent practicable. Factors affecting the decision to disclose include:
  - Unsubstantiated facts.
  - Incomplete information.
  - Unsubstantiated conclusions.
- The proposed type of communication, and to whom it is addressed.
- Whether the parties to whom the communication is addressed are appropriate recipients.

R114.2 A professional accountant shall continue to comply with the principle of confidentiality even after the end of the relationship between the accountant and a client or employing organization. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but shall not use or disclose any confidential information acquired or received as a result of a professional or business relationship.

Additional requirements are set out in Section 400 "Unlawful Acts or Defaults by Clients of Members" and Section 500 "Unlawful Acts or Defaults by or on Behalf of a Member's Employer" under Chapter C of the Code.

SUBSECTION 115 – PROFESSIONAL BEHAVIOR

R115.1 A professional accountant shall comply with the principle of professional behavior, which requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession. A professional accountant shall not knowingly engage in any business, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

115.1 A1 Conduct that might discredit the profession includes conduct that a reasonable and informed third party would be likely to conclude adversely affects the good reputation of the profession.

R115.2 When undertaking marketing or promotional activities, a professional accountant shall not bring the profession into disrepute. A professional accountant shall be honest and truthful and shall not make:

(a) Exaggerated claims for the services offered by, or the qualifications or experience of, the accountant; or

(b) Disparaging references or unsubstantiated comparisons to the work of others.

115.2 A1 If a professional accountant is in doubt about whether a form of advertising or marketing is appropriate, the accountant is encouraged to consult with the relevant professional body.

Additional requirements are set out in Section 800 "Use of Designations and Institute's Logo" and Section 900 "Practice Promotion" under Chapter C of the Code.

SECTION 120

THE CONCEPTUAL FRAMEWORK

Introduction

120.1 The circumstances in which professional accountants operate might create threats to compliance with the fundamental principles. Section 120 sets out requirements and application material, including a conceptual framework, to assist accountants in complying with the fundamental principles and meeting their responsibility to act in the public interest. Such requirements and application material accommodate the wide range of facts and circumstances, including the various professional activities, interests and relationships, that create threats to compliance with the fundamental principles. In addition, they deter accountants from concluding that a situation is permitted solely because that situation is not specifically prohibited by the Code.

120.2 The conceptual framework specifies an approach for a professional accountant to:

(a) Identify threats to compliance with the fundamental principles;

(b) Evaluate the threats identified; and

(c) Address the threats by eliminating or reducing them to an acceptable level.

Requirements and Application Material

General

R120.3 The professional accountant shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles set out in Section 110.

120.3 A1 Additional requirements and application material that are relevant to the application of the conceptual framework are set out in:

(a) Part 2 – *Professional Accountants in Business*;

(b) Part 3 – *Professional Accountants in Public Practice*; and

(c) *Independence Standards*, as follows:

(i) Part 4A – *Independence for Audit and Review Engagements*; and

(ii) Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements*.

R120.4 When dealing with an ethics issue, the professional accountant shall consider the context in which the issue has arisen or might arise. Where an individual who is a professional accountant in public practice is performing professional activities pursuant to the accountant's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with the provisions in Part 2 that apply to these circumstances.

R120.5 When applying the conceptual framework, the professional accountant shall:

(a) Exercise professional judgment;

(b) Remain alert for new information and to changes in facts and circumstances; and

(c) Use the reasonable and informed third party test described in paragraph 120.5 A4.

Exercise of Professional Judgment

120.5 A1 Professional judgment involves the application of relevant training, professional knowledge, skill and experience commensurate with the facts and circumstances, including the nature and scope of the particular professional activities, and the interests and relationships involved. In relation to undertaking professional activities, the exercise of professional judgment is required when the professional accountant applies the conceptual framework in order to make informed decisions about the courses of actions available, and to determine whether such decisions are appropriate in the circumstances.

120.5 A2 An understanding of known facts and circumstances is a prerequisite to the proper application of the conceptual framework. Determining the actions necessary to obtain this understanding and coming to a conclusion about whether the fundamental principles have been complied with also require the exercise of professional judgment.

120.5 A3 In exercising professional judgment to obtain this understanding, the professional accountant might consider, among other matters, whether:

- There is reason to be concerned that potentially relevant information might be missing from the facts and circumstances known to the accountant.
- There is an inconsistency between the known facts and circumstances and the accountant's expectations.
- The accountant's expertise and experience are sufficient to reach a conclusion.
- There is a need to consult with others with relevant expertise or experience.
- The information provides a reasonable basis on which to reach a conclusion.
- The accountant's own preconception or bias might be affecting the accountant's exercise of professional judgment.
- There might be other reasonable conclusions that could be reached from the available information.

Reasonable and Informed Third Party

120.5 A4 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 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.

Identifying Threats

R120.6 The professional accountant shall identify threats to compliance with the fundamental principles.

120.6 A1 An understanding of the facts and circumstances, including any professional activities, interests and relationships that might compromise compliance with the fundamental principles, is a prerequisite to the professional accountant's identification of threats to such compliance. The existence of certain conditions, policies and procedures established by the profession, legislation, regulation, the firm, or the employing organization that can enhance the accountant acting ethically might also help identify threats to compliance with the fundamental principles. Paragraph 120.8 A2 includes general examples of such conditions, policies and procedures which are also factors that are relevant in evaluating the level of threats.

120.6 A2 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. It is not possible to define every situation that creates threats. In addition, the nature of engagements and work assignments might differ and, consequently, different types of threats might be created.

120.6 A3 Threats to compliance with the fundamental principles fall into one or more of the following categories:

(a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgment or behavior;

(b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the accountant, or by another individual within the accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity;

(c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organization's position to the point that the accountant's objectivity is compromised;

(d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organization, a professional accountant will be too sympathetic to their interests or too accepting of their work; and

(e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

120.6 A4 A circumstance might create more than one threat, and a threat might affect compliance with more than one fundamental principle.

Evaluating Threats

R120.7 When the professional accountant identifies a threat to compliance with the fundamental principles, the accountant shall evaluate whether such a threat is at an acceptable level.

Acceptable Level

120.7 A1 An acceptable level is a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.

Factors Relevant in Evaluating the Level of Threats

120.8 A1 The consideration of qualitative as well as quantitative factors is relevant in the professional accountant's evaluation of threats, as is the combined effect of multiple threats, if applicable.

120.8 A2 The existence of conditions, policies and procedures described in paragraph 120.6 A1 might also be factors that are relevant in evaluating the level of threats to compliance with fundamental principles. Examples of such conditions, policies and procedures include:

- Corporate governance requirements.
- Educational, training and experience requirements for the profession.
- Effective complaint systems which enable the professional accountant and the general public to draw attention to unethical behavior.
- An explicitly stated duty to report breaches of ethics requirements.
- Professional or regulatory monitoring and disciplinary procedures.

Consideration of New Information or Changes in Facts and Circumstances

R120.9 If the professional accountant becomes aware of new information or changes in facts and circumstances that might impact whether a threat has been eliminated or reduced to an acceptable level, the accountant shall re-evaluate and address that threat accordingly.

120.9 A1 Remaining alert throughout the professional activity assists the professional accountant in determining whether new information has emerged or changes in facts and circumstances have occurred that:

(a) Impact the level of a threat; or

(b) Affect the accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

120.9 A2 If new information results in the identification of a new threat, the professional accountant is required to evaluate and, as appropriate, address this threat. (Ref: Paras. R120.7 and R120.10).

Addressing Threats

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.

Actions to Eliminate Threats

120.10 A1 Depending on the facts and circumstances, a threat might be addressed by eliminating the circumstance creating the threat. However, there are some situations in which threats can only be addressed by declining or ending the specific professional activity. This is because the circumstances that created the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level.

Safeguards

120.10 A2 Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.

Consideration of Significant Judgments Made and Overall Conclusions Reached

R120.11 The professional accountant shall form an overall conclusion about whether the actions that the accountant takes, or intends to take, to address the threats created will eliminate those threats or reduce them to an acceptable level. In forming the overall conclusion, the accountant shall:

(a) Review any significant judgments made or conclusions reached; and

(b) Use the reasonable and informed third party test.

Considerations for Audits, Reviews and Other Assurance Engagements

Independence

120.12 A1 Professional accountants in public practice are required by *Independence Standards* to be independent when performing audits, reviews, or other assurance engagements. Independence is linked to the fundamental principles of objectivity and integrity. It comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an audit or assurance team member's integrity, objectivity or professional skepticism has been compromised.

120.12 A2 *Independence Standards* set out requirements and application material on how to apply the conceptual framework to maintain independence when performing audits, reviews or other assurance engagements. Professional accountants and firms are required to comply with these standards in order to be independent when conducting such engagements. The conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles applies in the same way to compliance with independence requirements. The categories of threats to compliance with the fundamental principles described in paragraph 120.6 A3 are also the categories of threats to compliance with

independence requirements.

Professional Skepticism

120.13 A1 Under auditing, review and other assurance standards, including those issued by the Institute, professional accountants in public practice are required to exercise professional skepticism when planning and performing audits, reviews and other assurance engagements. Professional skepticism and the fundamental principles that are described in Section 110 are inter-related concepts.

120.13 A2 In an audit of financial statements, compliance with the fundamental principles, individually and collectively, supports the exercise of professional skepticism, as shown in the following examples:

- *Integrity* requires the professional accountant to be straightforward and honest. For example, the accountant complies with the principle of integrity by:

  (a) Being straightforward and honest when raising concerns about a position taken by a client; and

  (b) Pursuing inquiries about inconsistent information and seeking further audit evidence to address concerns about statements that might be materially false or misleading in order to make informed decisions about the appropriate course of action in the circumstances.

  In doing so, the accountant demonstrates the critical assessment of audit evidence that contributes to the exercise of professional skepticism.

- *Objectivity* requires the professional accountant not to compromise professional or business judgment because of bias, conflict of interest or the undue influence of others. For example, the accountant complies with the principle of objectivity by:

  (a) Recognizing circumstances or relationships such as familiarity with the client, that might compromise the accountant's professional or business judgment; and

  (b) Considering the impact of such circumstances and relationships on the accountant's judgment when evaluating the sufficiency and appropriateness of audit evidence related to a matter material to the client's financial statements.

  In doing so, the accountant behaves in a manner that contributes to the exercise of professional skepticism.

- *Professional competence and due care* requires the professional accountant to have professional knowledge and skill at the level required to ensure the provision of competent professional service, and to act diligently in accordance with applicable standards, laws and regulations. For example, the accountant complies with the principle of professional competence and due care by:

(a) Applying knowledge that is relevant to a particular client's industry and business activities in order to properly identify risks of material misstatement;

(b) Designing and performing appropriate audit procedures; and

(c) Applying relevant knowledge when critically assessing whether audit evidence is sufficient and appropriate in the circumstances.

In doing so, the accountant behaves in a manner that contributes to the exercise of professional skepticism.

Additional requirements are set out in Section 600 "Ethics in Tax Practice", Section 700 "Corporate Finance Advice" under Chapter C of the Code.

PART 2 – PROFESSIONAL ACCOUNTANTS IN BUSINESS

PART 2 – PROFESSIONAL ACCOUNTANTS IN BUSINESS

SECTION 200

APPLYING THE CONCEPTUAL FRAMEWORK – PROFESSIONAL ACCOUNTANTS IN BUSINESS

Introduction

200.1 This Part of the Code sets out requirements and application material for professional accountants in business when applying the conceptual framework set out in Section 120. It does not describe all of the facts and circumstances, including professional activities, interests and relationships, that could be encountered by professional accountants in business, which create or might create threats to compliance with the fundamental principles. Therefore, the conceptual framework requires professional accountants in business to be alert for such facts and circumstances.

200.2 Investors, creditors, employing organizations and other sectors of the business community, as well as governments and the general public, might rely on the work of professional accountants in business. Professional accountants in business might be solely or jointly responsible for the preparation and reporting of financial and other information, on which both their employing organizations and third parties might rely. They might also be responsible for providing effective financial management and competent advice on a variety of business-related matters.

200.3 A professional accountant in business might be an employee, contractor, partner, director (executive or non-executive), owner-manager, or volunteer of an employing organization. The legal form of the relationship of the accountant with the employing organization has no bearing on the ethical responsibilities placed on the accountant.

200.4 In this Part, the term “professional accountant” refers to:

(a) A professional accountant in business; and

(b) An individual who is a professional accountant in public practice when performing professional activities pursuant to the accountant’s relationship with the accountant’s firm, whether as a contractor, employee or owner. More information on when Part 2 is applicable to professional accountants in public practice is set out in paragraphs R120.4, R300.5 and 300.5 A1.

Requirements and Application Material

General

R200.5 A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

200.5 A1 A professional accountant has a responsibility to further the legitimate objectives of the accountant’s employing organization. The Code does not seek to hinder accountants from fulfilling that responsibility, but addresses circumstances in which compliance with the fundamental principles might be compromised.

200.5 A2 Professional accountants may promote the position of the employing organization when furthering the legitimate goals and objectives of their employing organization, provided that any statements made are neither false nor misleading. Such actions usually would not create an advocacy threat.

200.5 A3 The more senior the position of a professional accountant, the greater will be the ability and opportunity to access information, and to influence policies, decisions made and actions taken by others involved with the employing organization. To the extent that they are able to do so, taking into account their position and seniority in the organization, accountants are expected to encourage and promote an ethics-based culture in the organization. Examples of actions that might be taken include the introduction, implementation and oversight of:

- Ethics education and training programs.
- Ethics and whistle-blowing policies.
- Policies and procedures designed to prevent non-compliance with laws and regulations.

Identifying Threats

200.6 A1 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. The categories of threats are described in paragraph 120.6 A3. The following are examples of facts and circumstances within each of those categories that might create threats for a professional accountant when undertaking a professional activity:

(a) Self-interest Threats

- A professional accountant holding a financial interest in, or receiving a loan or guarantee from, the employing organization.
- A professional accountant participating in incentive compensation arrangements offered by the employing organization.
- A professional accountant having access to corporate assets for personal use.
- A professional accountant being offered a gift or special treatment from a supplier of the employing organization.

(b) Self-review Threats

- A professional accountant determining the appropriate accounting treatment for a business combination after performing the feasibility study supporting the purchase decision.

(c) Advocacy Threats

- A professional accountant having the opportunity to manipulate information in a prospectus in order to obtain favorable financing.

(d) Familiarity Threats

- A professional accountant being responsible for the financial reporting of the employing organization when an immediate or close family member employed by the organization makes decisions that affect the financial reporting of the organization.
- A professional accountant having a long association with individuals influencing business decisions.

(e) Intimidation Threats

- A professional accountant or immediate or close family member facing the threat of dismissal or replacement over a disagreement about:
  - The application of an accounting principle.
  - The way in which financial information is to be reported.
- An individual attempting to influence the decision-making process of the professional accountant, for example with regard to the awarding of contracts or the application of an accounting principle.

Evaluating Threats

200.7 A1 The conditions, policies and procedures described in paragraphs 120.6 A1 and 120.8 A2 might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level.

200.7 A2 The professional accountant's evaluation of the level of a threat is also impacted by the nature and scope of the professional activity.

200.7 A3 The professional accountant's evaluation of the level of a threat might be impacted by the work environment within the employing organization and its operating environment. For example:

- Leadership that stresses the importance of ethical behavior and the expectation that employees will act in an ethical manner.
- Policies and procedures to empower and encourage employees to communicate ethics issues that concern them to senior levels of management without fear of retribution.
- Policies and procedures to implement and monitor the quality of employee performance.
- Systems of corporate oversight or other oversight structures and strong internal controls.
- Recruitment procedures emphasizing the importance of employing high caliber competent personnel.
- Timely communication of policies and procedures, including any changes to them, to all employees, and appropriate training and education on such policies and procedures.
- Ethics and code of conduct policies

200.7 A4 Professional accountants might consider obtaining legal advice where they believe that unethical behavior or actions by others have occurred, or will continue to occur, within the employing organization.

Addressing Threats

200.8 A1 Sections 210 to 270 describe certain threats that might arise during the course of performing professional activities and include examples of actions that might address such threats.

200.8 A2 In extreme situations, if the circumstances that created the threats cannot be eliminated and safeguards are not available or capable of being applied to reduce the threat to an acceptable level, it might be appropriate for a professional accountant to resign from the employing organization.

Communicating with Those Charged with Governance

R200.9 When communicating with those charged with governance in accordance with the Code, a professional accountant shall determine the appropriate individual(s) within the employing organization's governance structure with whom to communicate. If the accountant communicates with a subgroup of those charged with governance, the accountant shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

200.9 A1 In determining with whom to communicate, a professional accountant might consider:

(a) The nature and importance of the circumstances; and

(b) The matter to be communicated.

200.9 A2 Examples of a subgroup of those charged with governance include an audit committee or an individual member of those charged with governance.

R200.10 If a professional accountant communicates with individuals who have management responsibilities as well as governance responsibilities, the accountant shall be satisfied that communication with those individuals adequately informs all of those in a governance role with whom the accountant would otherwise communicate.

200.10 A1 In some circumstances, all of those charged with governance are involved in managing the employing organization, for example, a small business where a single owner manages the organization and no one else has a governance role. In these cases, if matters are communicated with individual(s) with management responsibilities, and those individual(s) also have governance responsibilities, the professional accountant has satisfied the requirement to communicate with those charged with governance.

SECTION 210

CONFLICTS OF INTEREST

Introduction

210.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

210.2 A conflict of interest creates threats to compliance with the principle of objectivity and might create threats to compliance with the other fundamental principles. Such threats might be created when:

(a) A professional accountant undertakes a professional activity related to a particular matter for two or more parties whose interests with respect to that matter are in conflict; or

(b) The interest of a professional accountant with respect to a particular matter and the interests of a party for whom the accountant undertakes a professional activity related to that matter are in conflict.

A party might include an employing organization, a vendor, a customer, a lender, a shareholder, or another party.

210.3 This section sets out specific requirements and application material relevant to applying the conceptual framework to conflicts of interest.

Requirements and Application Material

General

R210.4 A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.

210.4 A1 Examples of circumstances that might create a conflict of interest include:

- Serving in a management or governance position for two employing organizations and acquiring confidential information from one organization that might be used by the professional accountant to the advantage or disadvantage of the other organization.
- Undertaking a professional activity for each of two parties in a partnership, where both parties are employing the accountant to assist them to dissolve their partnership.
- Preparing financial information for certain members of management of the accountant's employing organization who are seeking to undertake a management buy-out.
- Being responsible for selecting a vendor for the employing organization when an immediate family member of the accountant might benefit financially from the transaction.

- Serving in a governance capacity in an employing organization that is approving certain investments for the company where one of those investments will increase the value of the investment portfolio of the accountant or an immediate family member.

Conflict Identification

R210.5 A professional accountant shall take reasonable steps to identify circumstances that might create a conflict of interest, and therefore a threat to compliance with one or more of the fundamental principles. Such steps shall include identifying:

(a) The nature of the relevant interests and relationships between the parties involved; and

(b) The activity and its implication for relevant parties.

R210.6 A professional accountant shall remain alert to changes over time in the nature of the activities, interests and relationships that might create a conflict of interest while performing a professional activity.

Threats Created by Conflicts of Interest

210.7 A1 In general, the more direct the connection between the professional activity and the matter on which the parties' interests conflict, the more likely the level of the threat is not at an acceptable level.

210.7 A2 An example of an action that might eliminate threats created by conflicts of interest is withdrawing from the decision-making process related to the matter giving rise to the conflict of interest.

210.7 A3 Examples of actions that might be safeguards to address threats created by conflicts of interest include:

- Restructuring or segregating certain responsibilities and duties.
- Obtaining appropriate oversight, for example, acting under the supervision of an executive or non-executive director.

Disclosure and Consent

General

210.8 A1 It is generally necessary to:

(a) Disclose the nature of the conflict of interest and how any threats created were addressed to the relevant parties, including to the appropriate levels within the employing organization affected by a conflict; and

(b) Obtain consent from the relevant parties for the professional accountant to undertake the professional activity when safeguards are applied to address the threat.

210.8 A2 Consent might be implied by a party's conduct in circumstances where the professional accountant has sufficient evidence to conclude that the parties know the circumstances at the outset and have accepted the conflict of interest if they do not raise an objection to the existence of the conflict.

210.8 A3 If such disclosure or consent is not in writing, the professional accountant is encouraged to document:

(a) The nature of the circumstances giving rise to the conflict of interest;

(b) The safeguards applied to address the threats when applicable; and

(c) The consent obtained.

Other Considerations

210.9 A1 When addressing a conflict of interest, the professional accountant is encouraged to seek guidance from within the employing organization or from others, such as a professional body, legal counsel or another accountant. When making such disclosures or sharing information within the employing organization and seeking guidance of third parties, the principle of confidentiality applies.

SECTION 220

PREPARATION AND PRESENTATION OF INFORMATION

Introduction

220.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

220.2 Preparing or presenting information might create a self-interest, intimidation or other threats to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

220.3 A1 Professional accountants at all levels in an employing organization are involved in the preparation or presentation of information both within and outside the organization.

220.3 A2 Stakeholders to whom, or for whom, such information is prepared or presented, include:

- Management and those charged with governance.
- Investors and lenders or other creditors.
- Regulatory bodies.

This information might assist stakeholders in understanding and evaluating aspects of the employing organization's state of affairs and in making decisions concerning the organization. Information can include financial and non-financial information that might be made public or used for internal purposes.

Examples include:

- Operating and performance reports.
- Decision support analyses.
- Budgets and forecasts.
- Information provided to the internal and external auditors.
- Risk analyses.
- General and special purpose financial statements.
- Tax returns.
- Reports filed with regulatory bodies for legal and compliance purposes.

220.3 A3 For the purposes of this section, preparing or presenting information includes recording, maintaining and approving information.

R220.4 When preparing or presenting information, a professional accountant shall:

(a) Prepare or present the information in accordance with a relevant reporting framework, where applicable;

(b) Prepare or present the information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately;

(c) Exercise professional judgment to:

(i) Represent the facts accurately and completely in all material respects;

(ii) Describe clearly the true nature of business transactions or activities; and

(iii) Classify and record information in a timely and proper manner; and

(d) Not omit anything with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.

220.4 A1 An example of influencing a contractual or regulatory outcome inappropriately is using an unrealistic estimate with the intention of avoiding violation of a contractual requirement such as a debt covenant or of a regulatory requirement such as a capital requirement for a financial institution.

Use of Discretion in Preparing or Presenting Information

R220.5 Preparing or presenting information might require the exercise of discretion in making professional judgments. The professional accountant shall not exercise such discretion with the intention of misleading others or influencing contractual or regulatory outcomes inappropriately.

220.5 A1 Examples of ways in which discretion might be misused to achieve inappropriate outcomes include:

- Determining estimates, for example, determining fair value estimates in order to misrepresent profit or loss.
- Selecting or changing an accounting policy or method among two or more alternatives permitted under the applicable financial reporting framework, for example, selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss.
- Determining the timing of transactions, for example, timing the sale of an asset near the end of the fiscal year in order to mislead.
- Determining the structuring of transactions, for example, structuring financing transactions in order to misrepresent assets and liabilities or classification of cash flows.
- Selecting disclosures, for example, omitting or obscuring information relating to financial or operating risk in order to mislead.

R220.6 When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the professional accountant shall exercise professional judgment to identify and consider:

(a) The purpose for which the information is to be used;

(b) The context within which it is given; and

(c) The audience to whom it is addressed.

220.6 A1 For example, when preparing or presenting pro forma reports, budgets or forecasts, the inclusion of relevant estimates, approximations and assumptions, where appropriate, would enable those who might rely on such information to form their own judgments.

220.6 A2 The professional accountant might also consider clarifying the intended audience, context and purpose of the information to be presented.

Relying on the Work of Others

R220.7 A professional accountant who intends to rely on the work of others, either internal or external to the employing organization, shall exercise professional judgment to determine what steps to take, if any, in order to fulfill the responsibilities set out in paragraph R220.4.

220.7 A1 Factors to consider in determining whether reliance on others is reasonable include:

- The reputation and expertise of, and resources available to, the other individual or organization.
- Whether the other individual is subject to applicable professional and ethics standards.

Such information might be gained from prior association with, or from consulting others about, the other individual or organization.

Addressing Information that Is or Might be Misleading

R220.8 When the professional accountant knows or has reason to believe that the information with which the accountant is associated is misleading, the accountant shall take appropriate actions to seek to resolve the matter.

220.8 A1 Actions that might be appropriate include:

- Discussing concerns that the information is misleading with the professional accountant's superior and/or the appropriate level(s) of management within the accountant's employing organization or those charged with governance, and requesting such individuals to take appropriate action to resolve the matter. Such action might include:
    - Having the information corrected.
    - If the information has already been disclosed to the intended users, informing them of the correct information.

- Consulting the policies and procedures of the employing organization (for example, an ethics or whistle-blowing policy) regarding how to address such matters internally.

220.8 A2 The professional accountant might determine that the employing organization has not taken appropriate action. If the accountant continues to have reason to believe that the information is misleading, the following further actions might be appropriate provided that the accountant remains alert to the principle of confidentiality:

- Consulting with:
  - A relevant professional body.
  - The internal or external auditor of the employing organization.
  - Legal counsel.
- Determining whether any requirements exist to communicate to:
  - Third parties, including users of the information.
  - Regulatory and oversight authorities.

R220.9 If after exhausting all feasible options, the professional accountant determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the accountant shall refuse to be or to remain associated with the information.

220.9 A1 In such circumstances, it might be appropriate for a professional accountant to resign from the employing organization.

Documentation

220.10 A1 The professional accountant is encouraged to document:

- The facts.
- The accounting principles or other relevant professional standards involved.
- The communications and parties with whom matters were discussed.
- The courses of action considered.
- How the accountant attempted to address the matter(s).

Other Considerations

220.11 A1 Where threats to compliance with the fundamental principles relating to the preparation or presentation of information arise from a financial interest, including compensation and incentives linked to financial reporting and decision making, the requirements and application material set out in Section 240 apply.

220.11 A2 Where the misleading information might involve non-compliance with laws and regulations, the requirements and application material set out in Section 260 apply.

220.11 A3 Where threats to compliance with the fundamental principles relating to the preparation or presentation of information arise from pressure, the requirements and application material set out in Section 270 apply.

SECTION 230

ACTING WITH SUFFICIENT EXPERTISE

Introduction

230.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

230.2 Acting without sufficient expertise creates a self-interest threat to compliance with the principle of professional competence and due care. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R230.3 A professional accountant shall not intentionally mislead an employing organization as to the level of expertise or experience possessed.

230.3 A1 The principle of professional competence and due care requires that a professional accountant only undertake significant tasks for which the accountant has, or can obtain, sufficient training or experience.

230.3 A2 A self-interest threat to compliance with the principle of professional competence and due care might be created if a professional accountant has:

- Insufficient time for performing or completing the relevant duties.
- Incomplete, restricted or otherwise inadequate information for performing the duties.
- Insufficient experience, training and/or education.
- Inadequate resources for the performance of the duties.

230.3 A3 Factors that are relevant in evaluating the level of such a threat include:

- The extent to which the professional accountant is working with others.
- The relative seniority of the accountant in the business.
- The level of supervision and review applied to the work.

230.3 A4 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining assistance or training from someone with the necessary expertise.
- Ensuring that there is adequate time available for performing the relevant duties.

R230.4 If a threat to compliance with the principle of professional competence and due care cannot be addressed, a professional accountant shall determine whether to decline to perform the duties in question. If the accountant determines that declining is appropriate, the accountant shall communicate the reasons.

Other Considerations

230.5 A1 The requirements and application material in Section 270 apply when a professional accountant is pressured to act in a manner that might lead to a breach of the principle of professional competence and due care.

SECTION 240

FINANCIAL INTERESTS, COMPENSATION AND INCENTIVES LINKED TO FINANCIAL REPORTING AND DECISION MAKING

Introduction

240.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

240.2 Having a financial interest, or knowing of a financial interest held by an immediate or close family member might create a self-interest threat to compliance with the principles of objectivity or confidentiality. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R240.3 A professional accountant shall not manipulate information or use confidential information for personal gain or for the financial gain of others.

240.3 A1 Professional accountants might have financial interests or might know of financial interests of immediate or close family members that, in certain circumstances, might create threats to compliance with the fundamental principles. Financial interests include those arising from compensation or incentive arrangements linked to financial reporting and decision making.

240.3 A2 Examples of circumstances that might create a self-interest threat include situations in which the professional accountant or an immediate or close family member:

- Has a motive and opportunity to manipulate price-sensitive information in order to gain financially.
- Holds a direct or indirect financial interest in the employing organization and the value of that financial interest might be directly affected by decisions made by the accountant.
- Is eligible for a profit-related bonus and the value of that bonus might be directly affected by decisions made by the accountant.
- Holds, directly or indirectly, deferred bonus share rights or share options in the employing organization, the value of which might be affected by decisions made by the accountant.
- Participates in compensation arrangements which provide incentives to achieve targets or to support efforts to maximize the value of the employing organization's shares. An example of such an arrangement might be through participation in incentive plans which are linked to certain performance conditions being met.

240.3 A3 Factors that are relevant in evaluating the level of such a threat include:

- The significance of the financial interest. What constitutes a significant financial interest will depend on personal circumstances and the materiality of the financial interest to the individual.
- Policies and procedures for a committee independent of management to determine the level or form of senior management remuneration.
- In accordance with any internal policies, disclosure to those charged with governance of:
  - All relevant interests.
  - Any plans to exercise entitlements or trade in relevant shares.
- Internal and external audit procedures that are specific to address issues that give rise to the financial interest.

240.3 A4 Threats created by compensation or incentive arrangements might be compounded by explicit or implicit pressure from superiors or colleagues. See Section 270, *Pressure to Breach the Fundamental Principles*.

SECTION 250

INDUCEMENTS, INCLUDING GIFTS AND HOSPITALITY

Introduction

250.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

250.2 Offering or accepting inducements might create a self-interest, familiarity or intimidation threat to compliance with the fundamental principles, particularly the principles of integrity, objectivity and professional behavior.

250.3 This section sets out requirements and application material relevant to applying the conceptual framework in relation to the offering and accepting of inducements when undertaking professional activities that does not constitute non-compliance with laws and regulations. This section also requires a professional accountant to comply with relevant laws and regulations when offering or accepting inducements.

Requirements and Application Material

General

250.4 A1 An inducement is an object, situation, or action that is used as a means to influence another individual's behavior, but not necessarily with the intent to improperly influence that individual's behavior. Inducements can range from minor acts of hospitality between business colleagues to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:

- Gifts.
- Hospitality.
- Entertainment.
- Political or charitable donations.
- Appeals to friendship and loyalty.
- Employment or other commercial opportunities.
- Preferential treatment, rights or privileges.

Inducements Prohibited by Laws and Regulations

R250.5 In many jurisdictions, there are laws and regulations, such as those related to bribery and corruption, that prohibit the offering or accepting of inducements in certain circumstances. The professional accountant shall obtain an understanding of relevant laws and regulations and comply with them when the accountant encounters such circumstances.

250.5 A1 Members should note that under the Prevention of Bribery Ordinance (POBO) (Cap.201)[1a], there are provisions governing acceptance of any advantage (e.g. gift, loan, fee, commission, employment, service, favour) by someone who is in an agent-principal relationship with another person. For example, if an agent receives an advantage from another for doing something or showing favour to another in relation to the affairs or business of the agent's principal (who may be the agent's employer or in some other relationships with the agent which involve trust and confidence), the permission of the principal should be obtained first before receiving the advantage in order to avoid the risk of contravening the POBO.

250.5 A2 The same principle applies to someone who is offering an advantage to another person who is in an agent-principal relationship with some other person: before offering an advantage, the payer should ensure that the agent has obtained permission from his principal for receiving the advantage. Whether an agent-principal relationship exists in any given situation depends on the facts of each case. Members should consult their own legal advisors as and when necessary.

250.5 A3 To deter corrupt approaches and set out clear probity standards for all levels of staff, it is advisable for every company to lay down the company's policy and rules governing acceptance and offering of advantage and entertainment in a Code of Conduct which should cover both directors and staff. Members may use the sample code of conduct provided by the ICAC for the private sector at Appendix 1 as a reference[1b].

[1a] Additional guidance on the POBO is available on the ICAC's website: https://www.icac.org.hk/en/law/law/index.html

[1b] Members may contact the Hong Kong Business Ethics Development Centre (www.hkbedc.icac.hk) of the ICAC for enquiry and advice.

Inducements Not Prohibited by Laws and Regulations

250.6 A1 The offering or accepting of inducements that is not prohibited by laws and regulations might still create threats to compliance with the fundamental principles.

Inducements with Intent to Improperly Influence Behavior

R250.7 A professional accountant shall not offer, or encourage others to offer, any inducement that is made, or which the accountant considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behavior of the recipient or of another individual.

R250.8 A professional accountant shall not accept, or encourage others to accept, any inducement that the accountant concludes is made, or considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behavior of the recipient or of another individual.

250.9 A1 An inducement is considered as improperly influencing an individual's behavior if it causes the individual to act in an unethical manner. Such improper influence can be directed either towards the recipient or towards another individual who has some relationship with the recipient. The fundamental principles are an appropriate frame of reference for a professional accountant in considering what constitutes unethical behavior on the part of the accountant and, if necessary by analogy, other individuals.

250.9 A2 A breach of the fundamental principle of integrity arises when a professional accountant offers or accepts, or encourages others to offer or accept, an inducement where the intent is to improperly influence the behavior of the recipient or of another individual.

250.9 A3 The determination of whether there is actual or perceived intent to improperly influence behavior requires the exercise of professional judgment. Relevant factors to consider might include:

- The nature, frequency, value and cumulative effect of the inducement.
- Timing of when the inducement is offered relative to any action or decision that it might influence.
- Whether the inducement is a customary or cultural practice in the circumstances, for example, offering a gift on the occasion of a religious holiday or wedding.
- Whether the inducement is an ancillary part of a professional activity, for example, offering or accepting lunch in connection with a business meeting.
- Whether the offer of the inducement is limited to an individual recipient or available to a broader group. The broader group might be internal or external to the employing organization, such as other customers or vendors.
- The roles and positions of the individuals offering or being offered the inducement.
- Whether the professional accountant knows, or has reason to believe, that accepting the inducement would breach the policies and procedures of the counterparty's employing organization.
- The degree of transparency with which the inducement is offered.

- Whether the inducement was required or requested by the recipient.

- The known previous behavior or reputation of the offeror.

Consideration of Further Actions

250.10 A1 If the professional accountant becomes aware of an inducement offered with actual or perceived intent to improperly influence behavior, threats to compliance with the fundamental principles might still be created even if the requirements in paragraphs R250.7 and R250.8 are met.

250.10 A2 Examples of actions that might be safeguards to address such threats include:

- Informing senior management or those charged with governance of the employing organization of the professional accountant or the offeror regarding the offer.

- Amending or terminating the business relationship with the offeror.

Inducements with No Intent to Improperly Influence Behavior

250.11 A1 The requirements and application material set out in the conceptual framework apply when a professional accountant has concluded there is no actual or perceived intent to improperly influence the behavior of the recipient or of another individual.

250.11 A2 If such an inducement is trivial and inconsequential, any threats created will be at an acceptable level.

250.11 A3 Examples of circumstances where offering or accepting such an inducement might create threats even if the professional accountant has concluded there is no actual or perceived intent to improperly influence behavior include:

- Self-interest threats
    - A professional accountant is offered part-time employment by a vendor.
- Familiarity threats
    - A professional accountant regularly takes a customer or supplier to sporting events.
- Intimidation threats
    - A professional accountant accepts hospitality, the nature of which could be perceived to be inappropriate were it to be publicly disclosed.

250.11 A4 Relevant factors in evaluating the level of such threats created by offering or accepting such an inducement include the same factors set out in paragraph 250.9 A3 for determining intent.

250.11 A5 Examples of actions that might eliminate threats created by offering or accepting such an inducement include:

- Declining or not offering the inducement.

- Transferring responsibility for any business-related decision involving the counterparty to another individual who the professional accountant has no

reason to believe would be, or would be perceived to be, improperly influenced in making the decision.

250.11 A6 Examples of actions that might be safeguards to address such threats created by offering or accepting such an inducement include:

- Being transparent with senior management or those charged with governance of the employing organization of the professional accountant or of the counterparty about offering or accepting an inducement.
- Registering the inducement in a log maintained by the employing organization of the accountant or the counterparty.
- Having an appropriate reviewer, who is not otherwise involved in undertaking the professional activity, review any work performed or decisions made by the accountant with respect to the individual or organization from which the accountant accepted the inducement.
- Donating the inducement to charity after receipt and appropriately disclosing the donation, for example, to those charged with governance or the individual who offered the inducement.
- Reimbursing the cost of the inducement, such as hospitality, received.
- As soon as possible, returning the inducement, such as a gift, after it was initially accepted.

Immediate or Close Family Members

R250.12 A professional accountant shall remain alert to potential threats to the accountant's compliance with the fundamental principles created by the offering of an inducement:

(a) By an immediate or close family member of the accountant to a counterparty with whom the accountant has a professional relationship; or

(b) To an immediate or close family member of the accountant by a counterparty with whom the accountant has a professional relationship.

R250.13 Where the professional accountant becomes aware of an inducement being offered to or made by an immediate or close family member and concludes there is intent to improperly influence the behavior of the accountant or of the counterparty, or considers a reasonable and informed third party would be likely to conclude such intent exists, the accountant shall advise the immediate or close family member not to offer or accept the inducement.

250.13 A1 The factors set out in paragraph 250.9 A3 are relevant in determining whether there is actual or perceived intent to improperly influence the behavior of the professional accountant or of the counterparty. Another factor that is relevant is the nature or closeness of the relationship, between:

(a) The accountant and the immediate or close family member;

(b) The immediate or close family member and the counterparty; and

(c) The accountant and the counterparty.

For example, the offer of employment, outside of the normal recruitment process, to the spouse of the accountant by a counterparty with whom the accountant is negotiating a significant contract might indicate such intent.

250.13 A2 The application material in paragraph 250.10 A2 is also relevant in addressing threats that might be created when there is actual or perceived intent to improperly influence the behavior of the professional accountant or of the counterparty even if the immediate or close family member has followed the advice given pursuant to paragraph R250.13.

Application of the Conceptual Framework

250.14 A1 Where the professional accountant becomes aware of an inducement offered in the circumstances addressed in paragraph R250.12, threats to compliance with the fundamental principles might be created where:

(a) The immediate or close family member offers or accepts the inducement contrary to the advice of the accountant pursuant to paragraph R250.13; or

(b) The accountant does not have reason to believe an actual or perceived intent to improperly influence the behavior of the accountant or of the counterparty exists.

250.14 A2 The application material in paragraphs 250.11 A1 to 250.11 A6 is relevant for the purposes of identifying, evaluating and addressing such threats. Factors that are relevant in evaluating the level of threats in these circumstances also include the nature or closeness of the relationships set out in paragraph 250.13 A1.

Other Considerations

250.15 A1 If a professional accountant is offered an inducement by the employing organization relating to financial interests, compensation and incentives linked to performance, the requirements and application material set out in Section 240 apply.

250.15 A2 If a professional accountant encounters or is made aware of inducements that might result in non-compliance or suspected non-compliance with laws and regulations by other individuals working for or under the direction of the employing organization, the requirements and application material set out in Section 260 apply.

250.15 A3 If a professional accountant faces pressure to offer or accept inducements that might create threats to compliance with the fundamental principles, the requirements and application material set out in Section 270 apply.

SECTION 260

RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

Introduction

260.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

260.2 A self-interest or intimidation threat to compliance with the principles of integrity and professional behavior is created when a professional accountant becomes aware of non-compliance or suspected non-compliance with laws and regulations.

260.3 A professional accountant might encounter or be made aware of non-compliance or suspected non-compliance in the course of carrying out professional activities. This section guides the accountant in assessing the implications of the matter and the possible courses of action when responding to non-compliance or suspected non-compliance with:

(a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the employing organization's financial statements; and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organization's financial statements, but compliance with which might be fundamental to the operating aspects of the employing organization's business, to its ability to continue its business, or to avoid material penalties.

Objectives of the Professional Accountant in Relation to Non-compliance with Laws and Regulations

260.4 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, the objectives of the professional accountant are:

(a) To comply with the principles of integrity and professional behavior;

(b) By alerting management or, where appropriate, those charged with governance of the employing organization, to seek to:

(i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or

(ii) Deter the non-compliance where it has not yet occurred; and

(c) To take such further action as appropriate in the public interest.

Requirements and Application Material

General

260.5 A1 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:

(a) The professional accountant's employing organization;

(b) Those charged with governance of the employing organization;

(c) Management of the employing organization; or

(d) Other individuals working for or under the direction of the employing organization.

260.5 A2 Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

260.5 A3 Non-compliance might result in fines, litigation or other consequences for the employing organization, potentially materially affecting its financial statements. Importantly, such non-compliance might have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public. For the purposes of this section, non-compliance that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.

R260.6 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants are required to address non-compliance or suspected non-compliance. These legal or regulatory provisions might differ from or go beyond the provisions in this section. When encountering such non-compliance or suspected non-compliance, the accountant shall obtain an understanding of those legal or regulatory provisions and comply with them, including:

(a) Any requirement to report the matter to an appropriate authority; and

(b) Any prohibition on alerting the relevant party.

260.6 A1 A prohibition on alerting the relevant party might arise, for example, pursuant to anti-money laundering legislation.

260.7 A1 This section applies regardless of the nature of the employing organization, including whether or not it is a public interest entity.

260.7 A2 A professional accountant who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this section. Whether a matter is clearly inconsequential is to be judged with respect to its nature and its impact, financial or otherwise, on the employing organization, its stakeholders and the general public.

260.7 A3 This section does not address:

(a) Personal misconduct unrelated to the business activities of the employing organization; and

(b) Non-compliance by parties other than those specified in paragraph 260.5 A1.

The professional accountant might nevertheless find the guidance in this section helpful in considering how to respond in these situations.

Responsibilities of the Employing Organization's Management and Those Charged with Governance

260.8 A1 The employing organization's management, with the oversight of those charged with governance, is responsible for ensuring that the employing organization's business activities are conducted in accordance with laws and regulations. Management and those charged with governance are also responsible for identifying and addressing any non-compliance by:

(a) The employing organization;

(b) An individual charged with governance of the employing organization;

(c) A member of management; or

(d) Other individuals working for or under the direction of the employing organization.

Responsibilities of All Professional Accountants

R260.9 If protocols and procedures exist within the professional accountant's employing organization to address non-compliance or suspected non-compliance, the accountant shall consider them in determining how to respond to such non-compliance.

260.9 A1 Many employing organizations have established protocols and procedures regarding how to raise non-compliance or suspected non-compliance internally. These protocols and procedures include, for example, an ethics policy or internal whistle-blowing mechanism. Such protocols and procedures might allow matters to be reported anonymously through designated channels.

R260.10 Where a professional accountant becomes aware of a matter to which this section applies, the steps that the accountant takes to comply with this section shall be taken on a timely basis. For the purpose of taking timely steps, the accountant shall have regard to the nature of the matter and the potential harm to the interests of the employing organization, investors, creditors, employees or the general public.

Responsibilities of Senior Professional Accountants in Business

260.11 A1 Senior professional accountants in business ("senior professional accountants") are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources. There is a greater expectation for such individuals to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance than other professional accountants within the employing organization. This is because of senior professional accountants' roles, positions and spheres of influence within the employing organization.

Obtaining an Understanding of the Matter

R260.12 If, in the course of carrying out professional activities, a senior professional accountant becomes aware of information concerning non-compliance or suspected non-compliance, the accountant shall obtain an understanding of the matter. This understanding shall include:

(a) The nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur;

(b) The application of the relevant laws and regulations to the circumstances; and

(c) An assessment of the potential consequences to the employing organization, investors, creditors, employees or the wider public.

260.12 A1 A senior professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, the accountant is not expected to have a level of understanding of laws and regulations greater than that which is required for the accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

260.12 A2 Depending on the nature and significance of the matter, the senior professional accountant might cause, or take appropriate steps to cause, the matter to be investigated internally. The accountant might also consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

Addressing the Matter

R260.13 If the senior professional accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall, subject to paragraph R260.9, discuss the matter with the accountant's immediate superior, if any. If the accountant's immediate superior appears to be involved in the matter, the accountant shall discuss the matter with the next higher level of authority within the employing organization.

260.13 A1 The purpose of the discussion is to enable a determination to be made as to how to address the matter.

R260.14 The senior professional accountant shall also take appropriate steps to:

(a) Have the matter communicated to those charged with governance;

(b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority;

(c) Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated;

(d) Reduce the risk of re-occurrence; and

(e) Seek to deter the commission of the non-compliance if it has not yet occurred.

260.14 A1 The purpose of communicating the matter to those charged with governance is to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities.

260.14 A2 Some laws and regulations might stipulate a period within which reports of non-compliance or suspected non-compliance are to be made to an appropriate authority.

R260.15 In addition to responding to the matter in accordance with the provisions of this section, the senior professional accountant shall determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed.

260.15 A1 Such disclosure would be pursuant to the senior professional accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

Determining Whether Further Action Is Needed

R260.16 The senior professional accountant shall assess the appropriateness of the response of the accountant's superiors, if any, and those charged with governance.

260.16 A1 Relevant factors to consider in assessing the appropriateness of the response of the senior professional accountant's superiors, if any, and those charged with governance include whether:

- The response is timely.
- They have taken or authorized appropriate action to seek to rectify, remediate or mitigate the consequences of the non-compliance, or to avert the non-compliance if it has not yet occurred.
- The matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

R260.17 In light of the response of the senior professional accountant's superiors, if any, and those charged with governance, the accountant shall determine if further action is needed in the public interest.

260.17 A1 The determination of whether further action is needed, and the nature and extent of it, will depend on various factors, including:

- The legal and regulatory framework.
- The urgency of the situation.
- The pervasiveness of the matter throughout the employing organization.
- Whether the senior professional accountant continues to have confidence in the integrity of the accountant's superiors and those charged with governance.
- Whether the non-compliance or suspected non-compliance is likely to recur.
- Whether there is credible evidence of actual or potential substantial harm to the interests of the employing organization, investors, creditors, employees or the general public.

260.17 A2 Examples of circumstances that might cause the senior professional accountant no longer to have confidence in the integrity of the accountant's superiors and those charged with governance include situations where:

- The accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
- Contrary to legal or regulatory requirements, they have not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

R260.18 The senior professional accountant shall exercise professional judgment in determining the need for, and nature and extent of, further action. In making this determination, the accountant shall take into account whether a reasonable and informed third party would be likely to conclude that the accountant has acted appropriately in the public interest.

260.18 A1 Further action that the senior professional accountant might take includes:

- Informing the management of the parent entity of the matter if the employing organization is a member of a group.
- Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.
- Resigning from the employing organization.

260.18 A2 Resigning from the employing organization is not a substitute for taking other actions that might be needed to achieve the senior professional accountant's objectives under this section. In some jurisdictions, however, there might be limitations as to the further actions available to the accountant. In such circumstances, resignation might be the only available course of action.

Seeking Advice

260.19 A1 As assessment of the matter might involve complex analysis and judgments, the senior professional accountant might consider:

- Consulting internally.
- Obtaining legal advice to understand the accountant's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with a regulatory or professional body.

Determining Whether to Disclose the Matter to an Appropriate Authority

260.20 A1 Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

260.20 A2 The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm that is or might be caused by the matter to investors, creditors, employees or the general public. For example, the senior professional accountant might determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The employing organization is engaged in bribery (for example, of local or foreign government officials for purposes of securing large contracts).
- The employing organization is regulated and the matter is of such significance as to threaten its license to operate.
- The employing organization is listed on a securities exchange and the matter might result in adverse consequences to the fair and orderly market in the employing organization's securities or pose a systemic risk to the financial markets.
- It is likely that the employing organization would sell products that are harmful to public health or safety.
- The employing organization is promoting a scheme to its clients to assist them in evading taxes.

260.20 A3 The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken. The appropriate authority will depend upon the nature of the matter. For example, the appropriate authority would be a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the senior professional accountant or other individuals.

R260.21 If the senior professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions.

Imminent Breach

R260.22 In exceptional circumstances, the senior professional accountant might become aware of actual or intended conduct that the accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the employing organization, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted pursuant to paragraph R114.1 (d) of the Code.

Documentation

260.23 A1 In relation to non-compliance or suspected non-compliance that falls within the scope of this section, the senior professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the accountant's superiors, if any, and those charged with governance and other parties.
- How the accountant's superiors, if any, and those charged with governance have responded to the matter.
- The courses of action the accountant considered, the judgments made and the decisions that were taken.
- How the accountant is satisfied that the accountant has fulfilled the responsibility set out in paragraph R260.17.

Responsibilities of Professional Accountants Other than Senior Professional Accountants

R260.24 If, in the course of carrying out professional activities, a professional accountant becomes aware of information concerning non-compliance or suspected non-compliance, the accountant shall seek to obtain an understanding of the matter. This understanding shall include the nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur.

260.24 A1 The professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, the accountant is not expected to have a level of understanding of laws and regulations greater than that which is required for the accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

260.24 A2 Depending on the nature and significance of the matter, the professional accountant might consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

R260.25 If the professional accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall, subject to paragraph R260.9, inform an immediate superior to enable the superior to take appropriate action. If the accountant's immediate superior appears to be involved in the matter, the accountant shall inform the next higher level of authority within the employing organization.

R260.26 In exceptional circumstances, the professional accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action. If the accountant does so pursuant to paragraphs 260.20 A2 and A3, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions.

Documentation

260.27 A1 In relation to non-compliance or suspected non-compliance that falls within the scope of this section, the professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the accountant's superior, management and, where applicable, those charged with governance and other parties.
- How the accountant's superior has responded to the matter.
- The courses of action the accountant considered, the judgments made and the decisions that were taken.

Additional requirements are set out in Section 500 "Unlawful Acts or Defaults by or on behalf of a Member's Employer" under Chapter C of the Code and "Guidelines on Anti-Money Laundering and Counter-Terrorist Financing for Professional Accountants" under Chapter F of the Code.

SECTION 270

PRESSURE TO BREACH THE FUNDAMENTAL PRINCIPLES

Introduction

270.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

270.2 Pressure exerted on, or by, a professional accountant might create an intimidation or other threat to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R270.3 A professional accountant shall not:

(a) Allow pressure from others to result in a breach of compliance with the fundamental principles; or

(b) Place pressure on others that the accountant knows, or has reason to believe, would result in the other individuals breaching the fundamental principles.

270.3 A1 A professional accountant might face pressure that creates threats to compliance with the fundamental principles, for example an intimidation threat, when undertaking a professional activity. Pressure might be explicit or implicit and might come from:

- Within the employing organization, for example, from a colleague or superior.
- An external individual or organization such as a vendor, customer or lender.
- Internal or external targets and expectations.

270.3 A2 Examples of pressure that might result in threats to compliance with the fundamental principles include:

- Pressure related to conflicts of interest:
    - Pressure from a family member bidding to act as a vendor to the professional accountant's employing organization to select the family member over another prospective vendor.

    See also Section 210, *Conflicts of Interest*.

- Pressure to influence preparation or presentation of information:
    - Pressure to report misleading financial results to meet investor, analyst or lender expectations.
    - Pressure from elected officials on public sector accountants to misrepresent programs or projects to voters.

- Pressure from colleagues to misstate income, expenditure or rates of return to bias decision-making on capital projects and acquisitions.

- Pressure from superiors to approve or process expenditures that are not legitimate business expenses.

- Pressure to suppress internal audit reports containing adverse findings.

See also Section 220, *Preparation and Presentation of Information*.

- Pressure to act without sufficient expertise or due care:

  - Pressure from superiors to inappropriately reduce the extent of work performed.

  - Pressure from superiors to perform a task without sufficient skills or training or within unrealistic deadlines.

  See also Section 230, *Acting with Sufficient Expertise*.

- Pressure related to financial interests:

  - Pressure from superiors, colleagues or others, for example, those who might benefit from participation in compensation or incentive arrangements to manipulate performance indicators.

  See also Section 240, *Financial Interests, Compensation and Incentives Linked to Financial Reporting and Decision Making*.

- Pressure related to inducements:

  - Pressure from others, either internal or external to the employing organization, to offer inducements to influence inappropriately the judgment or decision making process of an individual or organization.

  - Pressure from colleagues to accept a bribe or other inducement, for example to accept inappropriate gifts or entertainment from potential vendors in a bidding process.

  See also Section 250, *Inducements, Including Gifts and Hospitality*.

- Pressure related to non-compliance with laws and regulations:

  - Pressure to structure a transaction to evade tax.

  See also Section 260, *Responding to Non-compliance with Laws and Regulations*.

270.3 A3 Factors that are relevant in evaluating the level of threats created by pressure include:

- The intent of the individual who is exerting the pressure and the nature and extent of the pressure.

- The application of laws, regulations, and professional standards to the circumstances.

- The culture and leadership of the employing organization including the extent to which they reflect or emphasize the importance of ethical behavior and the expectation that employees will act ethically. For example, a corporate culture that tolerates unethical behavior might increase the likelihood that the pressure would result in a threat to compliance with the fundamental principles.

- Policies and procedures, if any, that the employing organization has established, such as ethics or human resources policies that address pressure.

270.3 A4 Discussing the circumstances creating the pressure and consulting with others about those circumstances might assist the professional accountant to evaluate the level of the threat. Such discussion and consultation, which requires being alert to the principle of confidentiality, might include:

- Discussing the matter with the individual who is exerting the pressure to seek to resolve it.

- Discussing the matter with the accountant's superior, if the superior is not the individual exerting the pressure.

- Escalating the matter within the employing organization, including when appropriate, explaining any consequential risks to the organization, for example with:

  - Higher levels of management.

  - Internal or external auditors.

  - Those charged with governance.

- Disclosing the matter in line with the employing organization’s policies, including ethics and whistleblowing policies, using any established mechanism, such as a confidential ethics hotline.

- Consulting with:

  - A colleague, superior, human resources personnel, or another professional accountant;

  - Relevant professional or regulatory bodies or industry associations; or

  - Legal counsel.

270.3 A5 An example of an action that might eliminate threats created by pressure is the professional accountant’s request for a restructure of, or segregation of, certain responsibilities and duties so that the accountant is no longer involved with the individual or entity exerting the pressure.

Documentation

270.4 A1 The professional accountant is encouraged to document:

- The facts.
- The communications and parties with whom these matters were discussed.
- The courses of action considered.
- How the matter was addressed.

PART 3 – PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

PART 3 – PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

SECTION 300

APPLYING THE CONCEPTUAL FRAMEWORK – PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Introduction

300.1 This Part of the Code sets out requirements and application material for professional accountants in public practice when applying the conceptual framework set out in Section 120. It does not describe all of the facts and circumstances, including professional activities, interests and relationships, that could be encountered by professional accountants in public practice, which create or might create threats to compliance with the fundamental principles. Therefore, the conceptual framework requires professional accountants in public practice to be alert for such facts and circumstances.

300.2 The requirements and application material that apply to professional accountants in public practice are set out in:

- Part 3 – *Professional Accountants in Public Practice*, Sections 300 to 399, which applies to all professional accountants in public practice, whether they provide assurance services or not.
- *Independence Standards* as follows:
  - Part 4A – *Independence for Audit and Review Engagements*, Sections 400 to 899, which applies to professional accountants in public practice when performing audit and review engagements.
  - Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements*, Sections 900 to 999, which applies to professional accountants in public practice when performing assurance engagements other than audit or review engagements.

300.3 In this Part, the term “professional accountant” refers to individual professional accountants in public practice and their firms.

Requirements and Application Material

General

R300.4 A professional accountant shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

R300.5 When dealing with an ethics issue, the professional accountant shall consider the context in which the issue has arisen or might arise. Where an individual who is a professional accountant in public practice is performing professional activities pursuant to the accountant’s relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with the provisions in Part 2 that apply to these circumstances.

300.5 A1 Examples of situations in which the provisions in Part 2 apply to a professional accountant in public practice include:

- Facing a conflict of interest when being responsible for selecting a vendor for the firm when an immediate family member of the accountant might benefit financially from the contract. The requirements and application material set out in Section 210 apply in these circumstances.

- Preparing or presenting financial information for the accountant's client or firm. The requirements and application material set out in Section 220 apply in these circumstances.

- Being offered an inducement such as being regularly offered complimentary tickets to attend sporting events by a supplier of the firm. The requirements and application material set out in Section 250 apply in these circumstances.

- Facing pressure from an engagement partner to report chargeable hours inaccurately for a client engagement. The requirements and application material set out in Section 270 apply in these circumstances.

Identifying Threats

300.6 A1 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. The categories of threats are described in paragraph 120.6 A3. The following are examples of facts and circumstances within each of those categories of threats that might create threats for a professional accountant when undertaking a professional service:

(a) Self-interest Threats

- A professional accountant having a direct financial interest in a client.

- A professional accountant quoting a low fee to obtain a new engagement and the fee is so low that it might be difficult to perform the professional service in accordance with applicable technical and professional standards for that price.

- A professional accountant having a close business relationship with a client.

- A professional accountant having access to confidential information that might be used for personal gain.

- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the accountant's firm.

(b) Self-review Threats

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after implementing the systems.

- A professional accountant having prepared the original data used to generate records that are the subject matter of the assurance engagement.

(c) Advocacy Threats

- A professional accountant promoting the interests of, or shares in, a client.
- A professional accountant acting as an advocate on behalf of a client in litigation or disputes with third parties.
- A professional accountant lobbying in favor of legislation on behalf of a client.

(d) Familiarity Threats

- A professional accountant having a close or immediate family member who is a director or officer of the client.
- A director or officer of the client, or an employee in a position to exert significant influence over the subject matter of the engagement, having recently served as the engagement partner.
- An audit team member having a long association with the audit client.

(e) Intimidation Threats

- A professional accountant being threatened with dismissal from a client engagement or the firm because of a disagreement about a professional matter.
- A professional accountant feeling pressured to agree with the judgment of a client because the client has more expertise on the matter in question.
- A professional accountant being informed that a planned promotion will not occur unless the accountant agrees with an inappropriate accounting treatment.
- A professional accountant having accepted a significant gift from a client and being threatened that acceptance of this gift will be made public.

Evaluating Threats

300.7 A1 The conditions, policies and procedures described in paragraph 120.6 A1 and 120.8 A2 might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level. Such conditions, policies and procedures might relate to:

(a) The client and its operating environment; and

(b) The firm and its operating environment.

300.7 A2 The professional accountant's evaluation of the level of a threat is also impacted by the nature and scope of the professional service.

The Client and its Operating Environment

300.7 A3 The professional accountant's evaluation of the level of a threat might be impacted by whether the client is:

(a) An audit client and whether the audit client is a public interest entity;

(b) An assurance client that is not an audit client; or

(c) A non-assurance client.

For example, providing a non-assurance service to an audit client that is a public interest entity might be perceived to result in a higher level of threat to compliance with the principle of objectivity with respect to the audit.

300.7 A4 The corporate governance structure, including the leadership of a client might promote compliance with the fundamental principles. Accordingly, a professional accountant's evaluation of the level of a threat might also be impacted by a client's operating environment. For example:

- The client requires appropriate individuals other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that facilitate objective choices in tendering non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

The Firm and its Operating Environment

300.7 A5 A professional accountant's evaluation of the level of a threat might be impacted by the work environment within the accountant's firm and its operating environment. For example:

- Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that assurance team members will act in the public interest.
- Policies or procedures for establishing and monitoring compliance with the fundamental principles by all personnel.
- Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.
- Management of the reliance on revenue received from a single client.
- The engagement partner having authority within the firm for decisions concerning compliance with the fundamental principles, including decisions about accepting or providing services to a client.
- Educational, training and experience requirements.
- Processes to facilitate and address internal and external concerns or complaints.

Consideration of New Information or Changes in Facts and Circumstances

300.7 A6 New information or changes in facts and circumstances might:

(a) Impact the level of a threat; or

(b) Affect the professional accountant's conclusions about whether safeguards applied continue to address identified threats as intended.

In these situations, actions that were already implemented as safeguards might no longer be effective in addressing threats. Accordingly, the application of the conceptual framework requires that the professional accountant re-evaluate and address the threats accordingly. (Ref: Paras. R120.9 and R120.10).

300.7 A7 Examples of new information or changes in facts and circumstances that might impact the level of a threat include:

- When the scope of a professional service is expanded.
- When the client becomes a listed entity or acquires another business unit.
- When the firm merges with another firm.
- When the professional accountant is jointly engaged by two clients and a dispute emerges between the two clients.
- When there is a change in the professional accountant's personal or immediate family relationships.

Addressing Threats

300.8 A1 Paragraphs R120.10 to 120.10 A2 set out requirements and application material for addressing threats that are not at an acceptable level.

Examples of Safeguards

300.8 A2 Safeguards vary depending on the facts and circumstances. Examples of actions that in certain circumstances might be safeguards to address threats include:

- Assigning additional time and qualified personnel to required tasks when an engagement has been accepted might address a self-interest threat.
- Having an appropriate reviewer who was not a member of the team review the work performed or advise as necessary might address a self-review threat.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats.
- Disclosing to clients any referral fees or commission arrangements received for recommending services or products might address a self-interest threat.
- Separating teams when dealing with matters of a confidential nature might address a self-interest threat.

300.8 A3 The remaining sections of Part 3 and *Independence Standards* describe certain threats that might arise during the course of performing professional services and include examples of actions that might address threats.

Appropriate Reviewer

300.8 A4 An appropriate reviewer is a professional with the necessary knowledge, skills, experience and authority to review, in an objective manner, the relevant work performed or service provided. Such an individual might be a professional accountant.

Communicating with Those Charged with Governance

R300.9 When communicating with those charged with governance in accordance with the Code, a professional accountant shall determine the appropriate individual(s) within the entity's governance structure with whom to communicate. If the accountant communicates with a subgroup of those charged with governance, the accountant shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

300.9 A1 In determining with whom to communicate, a professional accountant might consider:

(a) The nature and importance of the circumstances; and

(b) The matter to be communicated.

300.9 A2 Examples of a subgroup of those charged with governance include an audit committee or an individual member of those charged with governance.

R300.10 If a professional accountant communicates with individuals who have management responsibilities as well as governance responsibilities, the accountant shall be satisfied that communication with those individuals adequately informs all of those in a governance role with whom the accountant would otherwise communicate.

300.10 A1 In some circumstances, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters are communicated to individual(s) with management responsibilities, and those individual(s) also have governance responsibilities, the professional accountant has satisfied the requirement to communicate with those charged with governance.

SECTION 310

CONFLICTS OF INTEREST

Introduction

310.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

310.2 A conflict of interest creates threats to compliance with the principle of objectivity and might create threats to compliance with the other fundamental principles. Such threats might be created when:

(a) A professional accountant provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or

(b) The interests of a professional accountant with respect to a particular matter and the interests of the client for whom the accountant provides a professional service related to that matter are in conflict.

310.3 This section sets out specific requirements and application material relevant to applying the conceptual framework to conflicts of interest. When a professional accountant provides an audit, review or other assurance service, independence is also required in accordance with *Independence Standards*.

Requirements and Application Material

General

R310.4 A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.

310.4 A1 Examples of circumstances that might create a conflict of interest include:

- Providing a transaction advisory service to a client seeking to acquire an audit client, where the firm has obtained confidential information during the course of the audit that might be relevant to the transaction.
- Providing advice to two clients at the same time where the clients are competing to acquire the same company and the advice might be relevant to the parties' competitive positions.
- Providing services to a seller and a buyer in relation to the same transaction.
- Preparing valuations of assets for two parties who are in an adversarial position with respect to the assets.
- Representing two clients in the same matter who are in a legal dispute with each other, such as during divorce proceedings, or the dissolution of a partnership.
- In relation to a license agreement, providing an assurance report for a licensor on the royalties due while advising the licensee on the amounts payable.

- Advising a client to invest in a business in which, for example, the spouse of the professional accountant has a financial interest.

- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a major competitor of the client.

- Advising a client on acquiring a business which the firm is also interested in acquiring.

- Advising a client on buying a product or service while having a royalty or commission agreement with a potential seller of that product or service.

Conflict Identification

General

R310.5 Before accepting a new client relationship, engagement, or business relationship, a professional accountant shall take reasonable steps to identify circumstances that might create a conflict of interest, and therefore a threat to compliance with one or more of the fundamental principles. Such steps shall include identifying:

(a) The nature of the relevant interests and relationships between the parties involved; and

(b) The service and its implication for relevant parties.

310.5 A1 An effective conflict identification process assists a professional accountant when taking reasonable steps to identify interests and relationships that might create an actual or potential conflict of interest, both before determining whether to accept an engagement and throughout the engagement. Such a process includes considering matters identified by external parties, for example clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of the accountant being able to address threats created by the conflict of interest.

310.5 A2 An effective process to identify actual or potential conflicts of interest will take into account factors such as:

- The nature of the professional services provided.

- The size of the firm.

- The size and nature of the client base.

- The structure of the firm, for example, the number and geographic location of offices.

310.5 A3 More information on client acceptance is set out in Section 320, *Professional Appointments*.

Changes in Circumstances

R310.6 A professional accountant shall remain alert to changes over time in the nature of services, interests and relationships that might create a conflict of interest while performing an engagement.

310.6 A1 The nature of services, interests and relationships might change during the engagement. This is particularly true when a professional accountant is asked to conduct an engagement in a situation that might become adversarial, even though the parties who engage the accountant initially might not be involved in a dispute.

Network Firms

R310.7 If the firm is a member of a network, a professional accountant shall consider conflicts of interest that the accountant has reason to believe might exist or arise due to interests and relationships of a network firm.

310.7 A1 Factors to consider when identifying interests and relationships involving a network firm include:

- The nature of the professional services provided.
- The clients served by the network.
- The geographic locations of all relevant parties.

Threats Created by Conflicts of Interest

310.8 A1 In general, the more direct the connection between the professional service and the matter on which the parties' interests conflict, the more likely the level of the threat is not at an acceptable level.

310.8 A2 Factors that are relevant in evaluating the level of a threat created by a conflict of interest include measures that prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. These measures include:

- The existence of separate practice areas for specialty functions within the firm, which might act as a barrier to the passing of confidential client information between practice areas.
- Policies and procedures to limit access to client files.
- Confidentiality agreements signed by personnel and partners of the firm.
- Separation of confidential information physically and electronically.
- Specific and dedicated training and communication.

310.8 A3 Examples of actions that might be safeguards to address threats created by a conflict of interest include:

- Having separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality.
- Having an appropriate reviewer, who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.

Disclosure and Consent

General

R310.9 A professional accountant shall exercise professional judgment to determine whether the nature and significance of a conflict of interest are such that specific disclosure and explicit consent are necessary when addressing the threat created by the conflict of interest.

310.9 A1 Factors to consider when determining whether specific disclosure and explicit consent are necessary include:

- The circumstances creating the conflict of interest.
- The parties that might be affected.
- The nature of the issues that might arise.
- The potential for the particular matter to develop in an unexpected manner.

310.9 A2 Disclosure and consent might take different forms, for example:

- General disclosure to clients of circumstances where, as is common commercial practice, the professional accountant does not provide professional services exclusively to any one client (for example, in a particular professional service and market sector). This enables the client to provide general consent accordingly. For example, an accountant might make general disclosure in the standard terms and conditions for the engagement.
- Specific disclosure to affected clients of the circumstances of the particular conflict in sufficient detail to enable the client to make an informed decision about the matter and to provide explicit consent accordingly. Such disclosure might include a detailed presentation of the circumstances and a comprehensive explanation of any planned safeguards and the risks involved.
- Consent might be implied by clients' conduct in circumstances where the professional accountant has sufficient evidence to conclude that clients know the circumstances at the outset and have accepted the conflict of interest if they do not raise an objection to the existence of the conflict.

310.9 A3 It is generally necessary:

(a) To disclose the nature of the conflict of interest and how any threats created were addressed to clients affected by a conflict of interest; and

(b) To obtain consent of the affected clients to perform the professional services when safeguards are applied to address the threat.

310.9 A4 If such disclosure or consent is not in writing, the professional accountant is encouraged to document:

(a) The nature of the circumstances giving rise to the conflict of interest;

(b) The safeguards applied to address the threats when applicable; and

(c) The consent obtained.

When Explicit Consent is Refused

R310.10 If a professional accountant has determined that explicit consent is necessary in accordance with paragraph R310.9 and the client has refused to provide consent, the accountant shall either:

(a) End or decline to perform professional services that would result in the conflict of interest; or

(b) End relevant relationships or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level.

Confidentiality

General

R310.11 A professional accountant shall remain alert to the principle of confidentiality, including when making disclosures or sharing information within the firm or network and seeking guidance from third parties.

310.11 A1 Subsection 114 sets out requirements and application material relevant to situations that might create a threat to compliance with the principle of confidentiality.

When Disclosure to Obtain Consent would Breach Confidentiality

R310.12 When making specific disclosure for the purpose of obtaining explicit consent would result in a breach of confidentiality, and such consent cannot therefore be obtained, the firm shall only accept or continue an engagement if:

(a) The firm does not act in an advocacy role for one client in an adversarial position against another client in the same matter;

(b) Specific measures are in place to prevent disclosure of confidential information between the engagement teams serving the two clients; and

(c) The firm is satisfied that a reasonable and informed third party would be likely to conclude that it is appropriate for the firm to accept or continue the engagement because a restriction on the firm's ability to provide the professional service would produce a disproportionate adverse outcome for the clients or other relevant third parties.

310.12 A1 A breach of confidentiality might arise, for example, when seeking consent to perform:

- A transaction-related service for a client in a hostile takeover of another client of the firm.
- A forensic investigation for a client regarding a suspected fraud, where the firm has confidential information from its work for another client who might be involved in the fraud.

Documentation

R310.13 In the circumstances set out in paragraph R310.12, the professional accountant shall document:

(a) The nature of the circumstances, including the role that the accountant is to undertake;

(b) The specific measures in place to prevent disclosure of information between the engagement teams serving the two clients; and

(c) Why it is appropriate to accept or continue the engagement.

SECTION 320

PROFESSIONAL APPOINTMENTS

Introduction

320.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

320.2 Acceptance of a new client relationship or changes in an existing engagement might create a threat to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Client and Engagement Acceptance

General

320.3 A1 Threats to compliance with the principles of integrity or professional behavior might be created, for example, from questionable issues associated with the client (its owners, management or activities). Issues that, if known, might create such a threat include client involvement in illegal activities, dishonesty, questionable financial reporting practices or other unethical behavior.

320.3 A2 Factors that are relevant in evaluating the level of such a threat include:

- Knowledge and understanding of the client, its owners, management and those charged with governance and business activities.
- The client's commitment to address the questionable issues, for example, through improving corporate governance practices or internal controls.

320.3 A3 A self-interest threat to compliance with the principle of professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies to perform the professional services.

320.3 A4 Factors that are relevant in evaluating the level of such a threat include:

- An appropriate understanding of:
  - The nature of the client's business;
  - The complexity of its operations;
  - The requirements of the engagement; and
  - The purpose, nature and scope of the work to be performed.
- Knowledge of relevant industries or subject matter.
- Experience with relevant regulatory or reporting requirements.

- The existence of quality control policies and procedures designed to provide reasonable assurance that engagements are accepted only when they can be performed competently.

320.3 A5 Examples of actions that might be safeguards to address a self-interest threat include:

- Assigning sufficient engagement personnel with the necessary competencies.
- Agreeing on a realistic time frame for the performance of the engagement.
- Using experts where necessary.

Changes in a Professional Appointment

General

R320.4 A professional accountant shall determine whether there are any reasons for not accepting an engagement when the accountant:

(a) Is asked by a potential client to replace another accountant;

(b) Considers tendering for an engagement held by another accountant; or

(c) Considers undertaking work that is complementary or additional to that of another accountant.

320.4 A1 There might be reasons for not accepting an engagement. One such reason might be if a threat created by the facts and circumstances cannot be addressed by applying safeguards. For example, there might be a self-interest threat to compliance with the principle of professional competence and due care if a professional accountant accepts the engagement before knowing all the relevant facts.

320.4 A2 If a professional accountant is asked to undertake work that is complementary or additional to the work of an existing or predecessor accountant, a self-interest threat to compliance with the principle of professional competence and due care might be created, for example, as a result of incomplete information.

320.4 A3 A factor that is relevant in evaluating the level of such a threat is whether tenders state that, before accepting the engagement, contact with the existing or predecessor accountant will be requested. This contact gives the proposed accountant the opportunity to inquire whether there are any reasons why the engagement should not be accepted.

320.4 A4 Examples of actions that might be safeguards to address such a self-interest threat include:

- Asking the existing or predecessor accountant to provide any known information of which, in the existing or predecessor accountant's opinion, the proposed accountant needs to be aware before deciding whether to accept the engagement. For example, inquiry might reveal previously undisclosed pertinent facts and might indicate disagreements with the existing or predecessor accountant that might influence the decision to accept the appointment.

- Obtaining information from other sources such as through inquiries of third parties or background investigations regarding senior management or those charged with governance of the client.

Communicating with the Existing or Predecessor Accountant

320.5 A1 A proposed accountant will usually need the client's permission, preferably in writing, to initiate discussions with the existing or predecessor accountant.

R320.6 If unable to communicate with the existing or predecessor accountant, the proposed accountant shall take other reasonable steps to obtain information about any possible threats.

Communicating with the Proposed Accountant

R320.7 When an existing or predecessor accountant is asked to respond to a communication from a proposed accountant, the existing or predecessor accountant shall:

(a) Comply with relevant laws and regulations governing the request; and

(b) Provide any information honestly and unambiguously.

320.7 A1 An existing or predecessor accountant is bound by confidentiality. Whether the existing or predecessor accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and:

(a) Whether the existing or predecessor accountant has permission from the client for the discussion; and

(b) The legal and ethics requirements relating to such communications and disclosure, which might vary by jurisdiction.

320.7 A2 Circumstances where a professional accountant is or might be required to disclose confidential information, or when disclosure might be appropriate, are set out in paragraph 114.1 A1 of the Code.

Changes in Audit or Review Appointments

R320.8 In the case of an audit or review of financial statements, a professional accountant shall request the existing or predecessor accountant to provide known information regarding any facts or other information of which, in the existing or predecessor accountant's opinion, the proposed accountant needs to be aware before deciding whether to accept the engagement. Except for the circumstances involving non-compliance or suspected non-compliance with laws and regulations set out in paragraphs R360.21 and R360.22:

(a) If the client consents to the existing or predecessor accountant disclosing any such facts or other information, the existing or predecessor accountant shall provide the information honestly and unambiguously; and

(b) If the client fails or refuses to grant the existing or predecessor accountant permission to discuss the client's affairs with the proposed accountant, the existing or predecessor accountant shall disclose this fact to the proposed accountant, who shall carefully consider such failure or refusal when determining whether to accept the appointment.

Client and Engagement Continuance

R320.9 For a recurring client engagement, a professional accountant shall periodically review whether to continue with the engagement.

320.9 A1 Potential threats to compliance with the fundamental principles might be created after acceptance which, had they been known earlier, would have caused the professional accountant to decline the engagement. For example, a self-interest threat to compliance with the principle of integrity might be created by improper earnings management or balance sheet valuations.

Using the Work of an Expert

R320.10 When a professional accountant intends to use the work of an expert, the accountant shall determine whether the use is warranted.

320.10 A1 Factors to consider when a professional accountant intends to use the work of an expert include the reputation and expertise of the expert, the resources available to the expert, and the professional and ethics standards applicable to the expert. This information might be gained from prior association with the expert or from consulting others.

Additional requirements are set out in Section 200 "Changes in a Professional Appointment" and Section 300 "Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong" under Chapter C of the Code.

SECTION 321

SECOND OPINIONS

Introduction

321.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

321.2 Providing a second opinion to an entity that is not an existing client might create a self-interest or other threat to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

321.3 A1 A professional accountant might be asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to (a) specific circumstances, or (b) transactions by or on behalf of a company or an entity that is not an existing client. A threat, for example, a self-interest threat to compliance with the principle of professional competence and due care, might be created if the second opinion is not based on the same facts that the existing or predecessor accountant had, or is based on inadequate evidence.

321.3 A2 A factor that is relevant in evaluating the level of such a self-interest threat is the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment.

321.3 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- With the client's permission, obtaining information from the existing or predecessor accountant.
- Describing the limitations surrounding any opinion in communications with the client.
- Providing the existing or predecessor accountant with a copy of the opinion.

When Permission to Communicate is Not Provided

R321.4 If an entity seeking a second opinion from a professional accountant will not permit the accountant to communicate with the existing or predecessor accountant, the accountant shall determine whether the accountant may provide the second opinion sought.

SECTION 330

FEES AND OTHER TYPES OF REMUNERATION

Introduction

330.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

330.2 The level and nature of fee and other remuneration arrangements might create a self-interest threat to compliance with one or more of the fundamental principles. This section sets out specific application material relevant to applying the conceptual framework in such circumstances.

Application Material

Level of Fees

330.3 A1 The level of fees quoted might impact a professional accountant's ability to perform professional services in accordance with professional standards.

330.3 A2 A professional accountant might quote whatever fee is considered appropriate. Quoting a fee lower than another accountant is not in itself unethical. However, the level of fees quoted creates a self-interest threat to compliance with the principle of professional competence and due care if the fee quoted is so low that it might be difficult to perform the engagement in accordance with applicable technical and professional standards.

330.3 A3 Factors that are relevant in evaluating the level of such a threat include:

- Whether the client is aware of the terms of the engagement and, in particular, the basis on which fees are charged and which professional services the quoted fee covers.
- Whether the level of the fee is set by an independent third party such as a regulatory body.

330.3 A4 Examples of actions that might be safeguards to address such a self-interest threat include:

- Adjusting the level of fees or the scope of the engagement.
- Having an appropriate reviewer review the work performed.

Contingent Fees

330.4 A1 Contingent fees are used for certain types of non-assurance services. However, contingent fees might create threats to compliance with the fundamental principles, particularly a self-interest threat to compliance with the principle of objectivity, in certain circumstances.

330.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the engagement.
- The range of possible fee amounts.

- The basis for determining the fee.
- Disclosure to intended users of the work performed by the professional accountant and the basis of remuneration.
- Quality control policies and procedures.
- Whether an independent third party is to review the outcome or result of the transaction.
- Whether the level of the fee is set by an independent third party such as a regulatory body.

330.4 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the work performed by the professional accountant.
- Obtaining an advance written agreement with the client on the basis of remuneration.

330.4 A4 Requirements and application material related to contingent fees for services provided to audit or review clients and other assurance clients are set out in *Independence Standards*.

Referral Fees or Commissions

330.5 A1 A self-interest threat to compliance with the principles of objectivity and professional competence and due care is created if a professional accountant pays or receives a referral fee or receives a commission relating to a client. Such referral fees or commissions include, for example:

- A fee paid to another professional accountant for the purposes of obtaining new client work when the client continues as a client of the existing accountant but requires specialist services not offered by that accountant.
- A fee received for referring a continuing client to another professional accountant or other expert where the existing accountant does not provide the specific professional service required by the client.
- A commission received from a third party (for example, a software vendor) in connection with the sale of goods or services to a client.

330.5 A2 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining an advance agreement from the client for commission arrangements in connection with the sale by another party of goods or services to the client might address a self-interest threat.
- Disclosing to clients any referral fees or commission arrangements paid to, or received from, another professional accountant or third party for recommending services or products might address a self-interest threat.

330.5 A3 Application material under the POBO governing acceptance of any advantage (e.g. gift, loan, fee, commission, employment, service, favour) by someone who is in an agent-principal relationship with another person is set out under paragraphs 250.5 A1 to 250.5 A3.

Purchase or Sale of a Firm

330.6 A1 A professional accountant may purchase all or part of another firm on the basis that payments will be made to individuals formerly owning the firm or to their heirs or estates. Such payments are not referral fees or commissions for the purposes of this section.

SECTION 340

INDUCEMENTS, INCLUDING GIFTS AND HOSPITALITY

Introduction

340.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

340.2 Offering or accepting inducements might create a self-interest, familiarity or intimidation threat to compliance with the fundamental principles, particularly the principles of integrity, objectivity and professional behavior.

340.3 This section sets out requirements and application material relevant to applying the conceptual framework in relation to the offering and accepting of inducements when performing professional services that does not constitute non-compliance with laws and regulations. This section also requires a professional accountant to comply with relevant laws and regulations when offering or accepting inducements.

Requirements and Application Material

General

340.4 A1 An inducement is an object, situation, or action that is used as a means to influence another individual's behavior, but not necessarily with the intent to improperly influence that individual's behavior. Inducements can range from minor acts of hospitality between professional accountants and existing or prospective clients to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:

- Gifts.
- Hospitality.
- Entertainment.
- Political or charitable donations.
- Appeals to friendship and loyalty.
- Employment or other commercial opportunities.
- Preferential treatment, rights or privileges.

Inducements Prohibited by Laws and Regulations

R340.5 In many jurisdictions, there are laws and regulations, such as those related to bribery and corruption, that prohibit the offering or accepting of inducements in certain circumstances. The professional accountant shall obtain an understanding of relevant laws and regulations and comply with them when the accountant encounters such circumstances.

Inducements Not Prohibited by Laws and Regulations

340.6 A1 The offering or accepting of inducements that is not prohibited by laws and regulations might still create threats to compliance with the fundamental principles.

Inducements with Intent to Improperly Influence Behavior

R340.7 A professional accountant shall not offer, or encourage others to offer, any inducement that is made, or which the accountant considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behavior of the recipient or of another individual.

R340.8 A professional accountant shall not accept, or encourage others to accept, any inducement that the accountant concludes is made, or considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behavior of the recipient or of another individual.

340.9 A1 An inducement is considered as improperly influencing an individual's behavior if it causes the individual to act in an unethical manner. Such improper influence can be directed either towards the recipient or towards another individual who has some relationship with the recipient. The fundamental principles are an appropriate frame of reference for a professional accountant in considering what constitutes unethical behavior on the part of the accountant and, if necessary by analogy, other individuals.

340.9 A2 A breach of the fundamental principle of integrity arises when a professional accountant offers or accepts, or encourages others to offer or accept, an inducement where the intent is to improperly influence the behavior of the recipient or of another individual.

340.9 A3 The determination of whether there is actual or perceived intent to improperly influence behavior requires the exercise of professional judgment. Relevant factors to consider might include:

- The nature, frequency, value and cumulative effect of the inducement.
- Timing of when the inducement is offered relative to any action or decision that it might influence.
- Whether the inducement is a customary or cultural practice in the circumstances, for example, offering a gift on the occasion of a religious holiday or wedding.
- Whether the inducement is an ancillary part of a professional service, for example, offering or accepting lunch in connection with a business meeting.
- Whether the offer of the inducement is limited to an individual recipient or available to a broader group. The broader group might be internal or external to the firm, such as other suppliers to the client.
- The roles and positions of the individuals at the firm or the client offering or being offered the inducement.
- Whether the professional accountant knows, or has reason to believe, that accepting the inducement would breach the policies and procedures of the client.

- The degree of transparency with which the inducement is offered.
- Whether the inducement was required or requested by the recipient.
- The known previous behavior or reputation of the offeror.

Consideration of Further Actions

340.10 A1 If the professional accountant becomes aware of an inducement offered with actual or perceived intent to improperly influence behavior, threats to compliance with the fundamental principles might still be created even if the requirements in paragraphs R340.7 and R340.8 are met.

340.10 A2 Examples of actions that might be safeguards to address such threats include:

- Informing senior management of the firm or those charged with governance of the client regarding the offer.
- Amending or terminating the business relationship with the client.

Inducements with No Intent to Improperly Influence Behavior

340.11 A1 The requirements and application material set out in the conceptual framework apply when a professional accountant has concluded there is no actual or perceived intent to improperly influence the behavior of the recipient or of another individual.

340.11 A2 If such an inducement is trivial and inconsequential, any threats created will be at an acceptable level.

340.11 A3 Examples of circumstances where offering or accepting such an inducement might create threats even if the professional accountant has concluded there is no actual or perceived intent to improperly influence behavior include:

(a) Self-interest threats

- A professional accountant is offered hospitality from the prospective acquirer of a client while providing corporate finance services to the client.

(b) Familiarity threats

- A professional accountant regularly takes an existing or prospective client to sporting events.

(c) Intimidation threats

- A professional accountant accepts hospitality from a client, the nature of which could be perceived to be inappropriate were it to be publicly disclosed.

340.11 A4 Relevant factors in evaluating the level of such threats created by offering or accepting such an inducement include the same factors set out in paragraph 340.9 A3 for determining intent.

340.11 A5 Examples of actions that might eliminate threats created by offering or accepting such an inducement include:

- Declining or not offering the inducement.
- Transferring responsibility for the provision of any professional services to the client to another individual who the professional accountant has no reason to believe would be, or would be perceived to be, improperly influenced when providing the services.

340.11 A6 Examples of actions that might be safeguards to address such threats created by offering or accepting such an inducement include:

- Being transparent with senior management of the firm or of the client about offering or accepting an inducement.
- Registering the inducement in a log monitored by senior management of the firm or another individual responsible for the firm's ethics compliance or maintained by the client.
- Having an appropriate reviewer, who is not otherwise involved in providing the professional service, review any work performed or decisions made by the professional accountant with respect to the client from which the accountant accepted the inducement.
- Donating the inducement to charity after receipt and appropriately disclosing the donation, for example, to a member of senior management of the firm or the individual who offered the inducement.
- Reimbursing the cost of the inducement, such as hospitality, received.
- As soon as possible, returning the inducement, such as a gift, after it was initially accepted.

Immediate or Close Family Members

R340.12 A professional accountant shall remain alert to potential threats to the accountant's compliance with the fundamental principles created by the offering of an inducement:

(a) By an immediate or close family member of the accountant to an existing or prospective client of the accountant.

(b) To an immediate or close family member of the accountant by an existing or prospective client of the accountant.

R340.13 Where the professional accountant becomes aware of an inducement being offered to or made by an immediate or close family member and concludes there is intent to improperly influence the behavior of the accountant or of an existing or prospective client of the accountant, or considers a reasonable and informed third party would be likely to conclude such intent exists, the accountant shall advise the immediate or close family member not to offer or accept the inducement.

340.13 A1 The factors set out in paragraph 340.9 A3 are relevant in determining whether there is actual or perceived intent to improperly influence the behavior of the professional accountant or of the existing or prospective client. Another factor that is relevant is the nature or closeness of the relationship, between:

(a) The accountant and the immediate or close family member;

(b) The immediate or close family member and the existing or prospective client; and

(c) The accountant and the existing or prospective client.

For example, the offer of employment, outside of the normal recruitment process, to the spouse of the accountant by a client for whom the accountant is providing a business valuation for a prospective sale might indicate such intent.

340.13 A2 The application material in paragraph 340.10 A2 is also relevant in addressing threats that might be created when there is actual or perceived intent to improperly influence the behavior of the professional accountant, or of the existing or prospective client even if the immediate or close family member has followed the advice given pursuant to paragraph R340.13.

Application of the Conceptual Framework

340.14 A1 Where the professional accountant becomes aware of an inducement offered in the circumstances addressed in paragraph R340.12, threats to compliance with the fundamental principles might be created where:

(a) The immediate or close family member offers or accepts the inducement contrary to the advice of the accountant pursuant to paragraph R340.13; or

(b) The accountant does not have reason to believe an actual or perceived intent to improperly influence the behavior of the accountant or of the existing or prospective client exists.

340.14 A2 The application material in paragraphs 340.11 A1 to 340.11 A6 is relevant for the purposes of identifying, evaluating and addressing such threats. Factors that are relevant in evaluating the level of threats in these circumstances also include the nature or closeness of the relationships set out in paragraph 340.13 A1.

Other Considerations

340.15 A1 If a professional accountant encounters or is made aware of inducements that might result in non-compliance or suspected non-compliance with laws and regulations by a client or individuals working for or under the direction of the client, the requirements and application material in Section 360 apply.

340.15 A2 If a firm, network firm or an audit team member is being offered gifts or hospitality from an audit client, the requirement and application material set out in Section 420 apply.

340.15 A3 If a firm or an assurance team member is being offered gifts or hospitality from an assurance client, the requirement and application material set out in Section 906 apply.

SECTION 350

CUSTODY OF CLIENT ASSETS

Introduction

350.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

350.2 Holding client assets creates a self-interest or other threat to compliance with the principles of professional behavior and objectivity. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Before Taking Custody

R350.3 A professional accountant shall not assume custody of client money or other assets unless permitted to do so by law and in accordance with any conditions under which such custody may be taken.

R350.4 As part of client and engagement acceptance procedures related to assuming custody of client money or assets, a professional accountant shall:

(a) Make inquiries about the source of the assets; and

(b) Consider related legal and regulatory obligations.

350.4 A1 Inquiries about the source of client assets might reveal, for example, that the assets were derived from illegal activities, such as money laundering. In such circumstances, a threat would be created and the provisions of Section 360 would apply.

After Taking Custody

R350.5 A professional accountant entrusted with money or other assets belonging to others shall:

(a) Comply with the laws and regulations relevant to holding and accounting for the assets;

(b) Keep the assets separately from personal or firm assets;

(c) Use the assets only for the purpose for which they are intended; and

(d) Be ready at all times to account for the assets and any income, dividends, or gains generated, to any individuals entitled to that accounting.

***Additional requirements are set out in Section 1000 "Clients' Monies" under Chapter C of the Code*.**

SECTION 360

RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

Introduction

360.1 Professional accountants are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

360.2 A self-interest or intimidation threat to compliance with the principles of integrity and professional behavior is created when a professional accountant becomes aware of non-compliance or suspected non-compliance with laws and regulations.

360.3 A professional accountant might encounter or be made aware of non-compliance or suspected non-compliance in the course of providing a professional service to a client. This section guides the accountant in assessing the implications of the matter and the possible courses of action when responding to non-compliance or suspected non-compliance with:

(a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client's financial statements; and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's financial statements, but compliance with which might be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties.

Objectives of the Professional Accountant in Relation to Non-compliance with Laws and Regulations

360.4 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, the objectives of the professional accountant are:

(a) To comply with the principles of integrity and professional behavior;

(b) By alerting management or, where appropriate, those charged with governance of the client, to seek to:

(i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or

(ii) Deter the commission of the non-compliance where it has not yet occurred; and

(c) To take such further action as appropriate in the public interest.

Requirements and Application Material

General

360.5 A1 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:

(a) A client;

(b) Those charged with governance of a client;

(c) Management of a client; or

(d) Other individuals working for or under the direction of a client.

360.5 A2 Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

360.5 A3 Non-compliance might result in fines, litigation or other consequences for the client, potentially materially affecting its financial statements. Importantly, such non-compliance might have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public. For the purposes of this section, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.

R360.6 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance. These legal or regulatory provisions might differ from or go beyond the provisions in this section. When encountering such non-compliance or suspected non-compliance, the accountant shall obtain an understanding of those legal or regulatory provisions and comply with them, including:

(a) Any requirement to report the matter to an appropriate authority; and

(b) Any prohibition on alerting the client.

360.6 A1 A prohibition on alerting the client might arise, for example, pursuant to anti-money laundering legislation.

360.7 A1 This section applies regardless of the nature of the client, including whether or not it is a public interest entity.

360.7 A2 A professional accountant who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this section. Whether a matter is clearly inconsequential is to be judged with respect to its nature and its impact, financial or otherwise, on the client, its stakeholders and the general public.

360.7 A3 This section does not address:

(a) Personal misconduct unrelated to the business activities of the client; and

(b) Non-compliance by parties other than those specified in paragraph 360.5 A1. This includes, for example, circumstances where a professional accountant has been engaged by a client to perform a due diligence assignment on a third party entity and the identified or suspected non-compliance has been committed by that third-party.

The accountant might nevertheless find the guidance in this section helpful in considering how to respond in these situations.

Responsibilities of Management and Those Charged with Governance

360.8 A1 Management, with the oversight of those charged with governance, is responsible for ensuring that the client's business activities are conducted in accordance with laws and regulations. Management and those charged with governance are also responsible for identifying and addressing any non-compliance by:

(a) The client;

(b) An individual charged with governance of the entity;

(c) A member of management; or

(d) Other individuals working for or under the direction of the client.

Responsibilities of All Professional Accountants

R360.9 Where a professional accountant becomes aware of a matter to which this section applies, the steps that the accountant takes to comply with this section shall be taken on a timely basis. In taking timely steps, the accountant shall have regard to the nature of the matter and the potential harm to the interests of the entity, investors, creditors, employees or the general public.

Audits of Financial Statements

Obtaining an Understanding of the Matter

R360.10 If a professional accountant engaged to perform an audit of financial statements becomes aware of information concerning non-compliance or suspected non-compliance, the accountant shall obtain an understanding of the matter. This understanding shall include the nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur.

360.10 A1 The professional accountant might become aware of the non-compliance or suspected non-compliance in the course of performing the engagement or through information provided by other parties.

360.10 A2 The professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, the accountant is not expected to have a level of knowledge of laws and regulations greater than that which is required to undertake the engagement. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

360.10 A3 Depending on the nature and significance of the matter, the professional accountant might consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

R360.11 If the professional accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall discuss the matter with the appropriate level of management and, where appropriate, those charged with governance.

360.11 A1 The purpose of the discussion is to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also might prompt management or those charged with governance to investigate the matter.

360.11 A2 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:

- The nature and circumstances of the matter.
- The individuals actually or potentially involved.
- The likelihood of collusion.
- The potential consequences of the matter.
- Whether that level of management is able to investigate the matter and take appropriate action.

360.11 A3 The appropriate level of management is usually at least one level above the individual or individuals involved or potentially involved in the matter. In the context of a group, the appropriate level might be management at an entity that controls the client.

360.11 A4 The professional accountant might also consider discussing the matter with internal auditors, where applicable.

R360.12 If the professional accountant believes that management is involved in the non-compliance or suspected non-compliance, the accountant shall discuss the matter with those charged with governance.

Addressing the Matter

R360.13 In discussing the non-compliance or suspected non-compliance with management and, where appropriate, those charged with governance, the professional accountant shall advise them to take appropriate and timely actions, if they have not already done so, to:

(a) Rectify, remediate or mitigate the consequences of the non-compliance;

(b) Deter the commission of the non-compliance where it has not yet occurred; or

(c) Disclose the matter to an appropriate authority where required by law or regulation or where considered necessary in the public interest.

R360.14 The professional accountant shall consider whether management and those charged with governance understand their legal or regulatory responsibilities with respect to the non-compliance or suspected non-compliance.

360.14 A1 If management and those charged with governance do not understand their legal or regulatory responsibilities with respect to the matter, the professional accountant might suggest appropriate sources of information or recommend that they obtain legal advice.

R360.15 The professional accountant shall comply with applicable:

(a) Laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority; and

(b) Requirements under auditing standards, including those relating to:

- Identifying and responding to non-compliance, including fraud.
- Communicating with those charged with governance.
- Considering the implications of the non-compliance or suspected non-compliance for the auditor's report.

360.15 A1 Some laws and regulations might stipulate a period within which reports of non-compliance or suspected non-compliance are to be made to an appropriate authority.

Communication with Respect to Groups

R360.16 Where a professional accountant becomes aware of non-compliance or suspected non-compliance in relation to a component of a group in either of the following two situations, the accountant shall communicate the matter to the group engagement partner unless prohibited from doing so by law or regulation:

(a) The accountant is, for purposes of an audit of the group financial statements, requested by the group engagement team to perform work on financial information related to the component; or

(b) The accountant is engaged to perform an audit of the component's financial statements for purposes other than the group audit, for example, a statutory audit.

The communication to the group engagement partner shall be in addition to responding to the matter in accordance with the provisions of this section.

360.16 A1 The purpose of the communication is to enable the group engagement partner to be informed about the matter and to determine, in the context of the group audit, whether and, if so, how to address it in accordance with the provisions in this section. The communication requirement in paragraph R360.16 applies regardless of whether the group engagement partner's firm or network is the same as or different from the professional accountant's firm or network.

R360.17 Where the group engagement partner becomes aware of non-compliance or suspected non-compliance in the course of an audit of group financial statements, the group engagement partner shall consider whether the matter might be relevant to one or more components:

(a) Whose financial information is subject to work for purposes of the audit of the group financial statements; or

(b) Whose financial statements are subject to audit for purposes other than the group audit, for example, a statutory audit.

This consideration shall be in addition to responding to the matter in the context of the group audit in accordance with the provisions of this section.

R360.18 If the non-compliance or suspected non-compliance might be relevant to one or more of the components specified in paragraph R360.17(a) and (b), the group engagement partner shall take steps to have the matter communicated to those performing work at the components, unless prohibited from doing so by law or regulation. If necessary, the group engagement partner shall arrange for appropriate inquiries to be made (either of management or from publicly available information) as to whether the relevant component(s) specified in paragraph R360.17(b) is subject to audit and, if so, to ascertain to the extent practicable the identity of the auditor.

360.18 A1 The purpose of the communication is to enable those responsible for work at the components to be informed about the matter and to determine whether and, if so, how to address it in accordance with the provisions in this section. The communication requirement applies regardless of whether the group engagement partner's firm or network is the same as or different from the firms or networks of those performing work at the components.

Determining Whether Further Action Is Needed

R360.19 The professional accountant shall assess the appropriateness of the response of management and, where applicable, those charged with governance.

360.19 A1 Relevant factors to consider in assessing the appropriateness of the response of management and, where applicable, those charged with governance include whether:

- The response is timely.
- The non-compliance or suspected non-compliance has been adequately investigated.
- Action has been, or is being, taken to rectify, remediate or mitigate the consequences of any non-compliance.
- Action has been, or is being, taken to deter the commission of any non-compliance where it has not yet occurred.
- Appropriate steps have been, or are being, taken to reduce the risk of re-occurrence, for example, additional controls or training.
- The non-compliance or suspected non-compliance has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

R360.20 In light of the response of management and, where applicable, those charged with governance, the professional accountant shall determine if further action is needed in the public interest.

360.20 A1 The determination of whether further action is needed, and the nature and extent of it, will depend on various factors, including:

- The legal and regulatory framework.
- The urgency of the situation.
- The pervasiveness of the matter throughout the client.
- Whether the professional accountant continues to have confidence in the integrity of management and, where applicable, those charged with governance.
- Whether the non-compliance or suspected non-compliance is likely to recur.
- Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the general public.

360.20 A2 Examples of circumstances that might cause the professional accountant no longer to have confidence in the integrity of management and, where applicable, those charged with governance include situations where:

- The accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
- The accountant is aware that they have knowledge of such non-compliance and, contrary to legal or regulatory requirements, have not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

R360.21 The professional accountant shall exercise professional judgment in determining the need for, and nature and extent of, further action. In making this determination, the accountant shall take into account whether a reasonable and informed third party would be likely to conclude that the accountant has acted appropriately in the public interest.

360.21 A1 Further action that the professional accountant might take includes:

- Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.
- Withdrawing from the engagement and the professional relationship where permitted by law or regulation.

360.21 A2 Withdrawing from the engagement and the professional relationship is not a substitute for taking other actions that might be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there might be limitations as to the further actions available to the accountant. In such circumstances, withdrawal might be the only available course of action.

R360.22 Where the professional accountant has withdrawn from the professional relationship pursuant to paragraphs R360.20 and 360.21 A1, the accountant shall, on request by the proposed accountant pursuant to paragraph R320.8, provide all relevant facts and other information concerning the identified or suspected non-compliance to the proposed accountant. The predecessor accountant shall do so, even in the circumstances addressed in paragraph R320.8(b) where the client fails or refuses to grant the predecessor accountant permission to discuss the client's affairs with the proposed accountant, unless prohibited by law or regulation.

360.22 A1 The facts and other information to be provided are those that, in the predecessor accountant's opinion, the proposed accountant needs to be aware of before deciding whether to accept the audit appointment. Section 320 addresses communications from proposed accountants.

R360.23 If the proposed accountant is unable to communicate with the predecessor accountant, the proposed accountant shall take reasonable steps to obtain information about the circumstances of the change of appointment by other means.

360.23 A1 Other means to obtain information about the circumstances of the change of appointment include inquiries of third parties or background investigations of management or those charged with governance.

360.24 A1 As assessment of the matter might involve complex analysis and judgments, the professional accountant might consider:

- Consulting internally.
- Obtaining legal advice to understand the accountant's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with a regulatory or professional body.

Determining Whether to Disclose the Matter to an Appropriate Authority

360.25 A1 Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

360.25 A2 The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm that is or might be caused by the matter to investors, creditors, employees or the general public. For example, the professional accountant might determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The entity is engaged in bribery (for example, of local or foreign government officials for purposes of securing large contracts).
- The entity is regulated and the matter is of such significance as to threaten its license to operate.
- The entity is listed on a securities exchange and the matter might result in adverse consequences to the fair and orderly market in the entity's securities or pose a systemic risk to the financial markets.

- It is likely that the entity would sell products that are harmful to public health or safety.

- The entity is promoting a scheme to its clients to assist them in evading taxes.

360.25 A3 The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken. The appropriate authority will depend on the nature of the matter. For example, the appropriate authority would be a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.

- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.

- Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.

R360.26 If the professional accountant determines that disclosure of the non-compliance or suspected non-compliance to an appropriate authority is an appropriate course of action in the circumstances, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions. The accountant shall also consider whether it is appropriate to inform the client of the accountant's intentions before disclosing the matter.

Imminent Breach

R360.27 In exceptional circumstances, the professional accountant might become aware of actual or intended conduct that the accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code.

Documentation

R360.28 In relation to non-compliance or suspected non-compliance that falls within the scope of this section, the professional accountant shall document:

- How management and, where applicable, those charged with governance have responded to the matter.

- The courses of action the accountant considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party test.

- How the accountant is satisfied that the accountant has fulfilled the responsibility set out in paragraph R360.20.

360.28 A1 This documentation is in addition to complying with the documentation requirements under applicable auditing standards. HKSAs, for example, require a professional accountant performing an audit of financial statements to:

- Prepare documentation sufficient to enable an understanding of significant matters arising during the audit, the conclusions reached, and significant professional judgments made in reaching those conclusions;
- Document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place; and
- Document identified or suspected non-compliance and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.

Professional Services Other than Audits of Financial Statements

Obtaining an Understanding of the Matter and Addressing It with Management and Those Charged with Governance

R360.29 If a professional accountant engaged to provide a professional service other than an audit of financial statements becomes aware of information concerning non-compliance or suspected non-compliance, the accountant shall seek to obtain an understanding of the matter. This understanding shall include the nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might be about to occur.

360.29 A1 The professional accountant is expected to apply knowledge and expertise, and exercise professional judgment. However, the accountant is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional service for which the accountant was engaged. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

360.29 A2 Depending on the nature and significance of the matter, the professional accountant might consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

R360.30 If the professional accountant identifies or suspects that non-compliance has occurred or might occur, the accountant shall discuss the matter with the appropriate level of management. If the accountant has access to those charged with governance, the accountant shall also discuss the matter with them where appropriate.

360.30 A1 The purpose of the discussion is to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also might prompt management or those charged with governance to investigate the matter.

360.30 A2 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:

- The nature and circumstances of the matter.
- The individuals actually or potentially involved.
- The likelihood of collusion.
- The potential consequences of the matter.
- Whether that level of management is able to investigate the matter and take appropriate action.

Communicating the Matter to the Entity's External Auditor

R360.31 If the professional accountant is performing a non-audit service for:

(a) An audit client of the firm; or

(b) A component of an audit client of the firm,

the accountant shall communicate the non-compliance or suspected non-compliance within the firm, unless prohibited from doing so by law or regulation. The communication shall be made in accordance with the firm's protocols or procedures. In the absence of such protocols and procedures, it shall be made directly to the audit engagement partner.

R360.32 If the professional accountant is performing a non-audit service for:

(a) An audit client of a network firm; or

(b) A component of an audit client of a network firm,

the accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the network firm. Where the communication is made, it shall be made in accordance with the network's protocols or procedures. In the absence of such protocols and procedures, it shall be made directly to the audit engagement partner.

R360.33 If the professional accountant is performing a non-audit service for a client that is not:

(a) An audit client of the firm or a network firm; or

(b) A component of an audit client of the firm or a network firm,

the accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the firm that is the client's external auditor, if any.

Relevant Factors to Consider

360.34 A1 Factors relevant to considering the communication in accordance with paragraphs R360.31 to R360.33 include:

- Whether doing so would be contrary to law or regulation.

- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the non-compliance or suspected non-compliance.

- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.

- Whether management or those charged with governance have already informed the entity's external auditor about the matter.

- The likely materiality of the matter to the audit of the client's financial statements or, where the matter relates to a component of a group, its likely materiality to the audit of the group financial statements.

Purpose of Communication

360.35 A1 In the circumstances addressed in paragraphs R360.31 to R360.33, the purpose of the communication is to enable the audit engagement partner to be informed about the non-compliance or suspected non-compliance and to determine whether and, if so, how to address it in accordance with the provisions of this section.

Considering Whether Further Action Is Needed

R360.36 The professional accountant shall also consider whether further action is needed in the public interest.

360.36 A1 Whether further action is needed, and the nature and extent of it, will depend on factors such as:

- The legal and regulatory framework.

- The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.

- The urgency of the situation.

- The involvement of management or those charged with governance in the matter.

- The likelihood of substantial harm to the interests of the client, investors, creditors, employees or the general public.

360.36 A2 Further action by the professional accountant might include:

- Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.

- Withdrawing from the engagement and the professional relationship where permitted by law or regulation.

360.36 A3 In considering whether to disclose to an appropriate authority, relevant factors to take into account include:

- Whether doing so would be contrary to law or regulation.

- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the non-compliance or suspected non-compliance.

- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.

R360.37 If the professional accountant determines that disclosure of the non-compliance or suspected non-compliance to an appropriate authority is an appropriate course of action in the circumstances, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code. When making such disclosure, the accountant shall act in good faith and exercise caution when making statements and assertions. The accountant shall also consider whether it is appropriate to inform the client of the accountant's intentions before disclosing the matter.

Imminent Breach

R360.38 In exceptional circumstances, the professional accountant might become aware of actual or intended conduct that the accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. If disclosure is made, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code.

Seeking Advice

360.39 A1 The professional accountant might consider:

- Consulting internally.
- Obtaining legal advice to understand the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with a regulatory or professional body.

Documentation

360.40 A1 In relation to non-compliance or suspected non-compliance that falls within the scope of this section, the professional accountant is encouraged to document:

- The matter.
- The results of discussion with management and, where applicable, those charged with governance and other parties.
- How management and, where applicable, those charged with governance have responded to the matter.
- The courses of action the accountant considered, the judgments made and the decisions that were taken.
- How the accountant is satisfied that the accountant has fulfilled the responsibility set out in paragraph R360.36.

Additional requirements are set out in Section 400 "Unlawful Acts or Defaults by Clients of Members" under Chapter C of the Code and "Guidelines on Anti-Money Laundering and Counter-Terrorist Financing for Professional Accountants" under Chapter F of the Code.

PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

INDEPENDENCE STANDARDS (PARTS 4A AND 4B)

PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

SECTION 400

APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

Introduction

General

400.1 It is in the public interest and required by the Code that professional accountants in public practice be independent when performing audit or review engagements.

400.2 This Part applies to both audit and review engagements. The terms “audit,” “audit team,” “audit engagement,” “audit client,” and “audit report” apply equally to review, review team, review engagement, review client, and review engagement report.

400.3 In this Part, the term “professional accountant refers to individual professional accountants in public practice and their firms.

400.4 HKSQC 1 requires a firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including network firm personnel), maintain independence where required by relevant ethics requirements. HKSAs and HKSREs establish responsibilities for engagement partners and engagement teams at the level of the engagement for audits and reviews, respectively. The allocation of responsibilities within a firm will depend on its size, structure and organization. Many of the provisions of this Part do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to “firm” for ease of reference. Firms assign responsibility for a particular action to an individual or a group of individuals (such as an audit team), in accordance with HKSQC 1. In addition, an individual professional accountant remains responsible for compliance with any provisions that apply to that accountant’s activities, interests or relationships.

400.5 Independence is linked to the principles of objectivity and integrity. It comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm’s, or an audit team member’s, integrity, objectivity or professional skepticism has been compromised.

In this Part, references to an individual or firm being “independent” mean that the individual or firm has complied with the provisions of this Part.

400.6 When performing audit engagements, the Code requires firms to comply with the fundamental principles and be independent. This Part sets out specific requirements and application material on how to apply the conceptual framework to maintain independence when performing such engagements. The conceptual

framework set out in Section 120 applies to independence as it does to the fundamental principles set out in Section 110.

400.7 This Part describes:

(a) Facts and circumstances, including professional activities, interests and relationships, that create or might create threats to independence;

(b) Potential actions, including safeguards, that might be appropriate to address any such threats; and

(c) Some situations where the threats cannot be eliminated or there can be no safeguards to reduce them to an acceptable level.

Public Interest Entities

400.8 Some of the requirements and application material set out in this Part reflect the extent of public interest in certain entities which are defined to be public interest entities. Firms are encouraged 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 might include financial institutions, such as banks and insurance companies, and pension funds.
- Size.
- Number of employees.

Reports that Include a Restriction on Use and Distribution

400.9 An audit report might include a restriction on use and distribution. If it does and the conditions set out in Section 800 are met, then the independence requirements in this Part may be modified as provided in Section 800.

Assurance Engagements other than Audit and Review Engagements

400.10 Independence standards for assurance engagements that are not audit or review engagements are set out in Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements*.

Requirements and Application Material

General

R400.11 A firm performing an audit engagement shall be independent.

R400.12 A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an audit engagement.

[Paragraphs 400.13 to 400.19 are intentionally left blank]

Related Entities

R400.20 As defined, an audit client that is a listed entity includes all of its related entities. For all other entities, references to an audit client in this Part include related entities over which the client has direct or indirect control. When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence.

[Paragraphs 400.21 to 400.29 are intentionally left blank]

Period During which Independence is Required

R400.30 Independence, as required by this Part, shall be maintained during both:

(a) The engagement period; and

(b) The period covered by the financial statements.

400.30 A1 The engagement period starts when the audit team begins to perform the audit. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final audit report.

R400.31 If an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion, the firm shall determine whether any threats to independence are created by:

(a) Financial or business relationships with the audit client during or after the period covered by the financial statements but before accepting the audit engagement; or

(b) Previous services provided to the audit client by the firm or a network firm.

400.31 A1 Threats to independence are created if a non-assurance service was provided to an audit client during, or after the period covered by the financial statements, but before the audit team begins to perform the audit, and the service would not be permitted during the engagement period.

400.31 A2 Examples of actions that might be safeguards to address such threats include:

- Using professionals who are not audit team members to perform the service.
- Having an appropriate reviewer review the audit and non-assurance work as appropriate.

- Engaging another firm outside of the network to evaluate the results of the non-assurance service or having another firm outside of the network re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

[Paragraphs 400.32 to 400.39 are intentionally left blank]

Communication with those Charged with Governance

400.40 A1 Paragraphs R300.9 and R300.10 set out requirements with respect to communicating with those charged with governance.

400.40 A2 Even when not required by the Code, applicable professional standards, laws or regulations, regular communication is encouraged between a firm and those charged with governance of the client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication enables those charged with governance to:

(a) Consider the firm's judgments in identifying and evaluating threats;

(b) Consider how threats have been addressed including the appropriateness of safeguards when they are available and capable of being applied; and

(c) Take appropriate action.

Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

[Paragraphs 400.41 to 400.49 are intentionally left blank]

Network Firms

400.50 A1 Firms frequently form larger structures with other firms and entities to enhance their ability to provide professional services. Whether these larger structures create a network depends on the particular facts and circumstances. It does not depend on whether the firms and entities are legally separate and distinct.

R400.51 A network firm shall be independent of the audit clients of the other firms within the network as required by this Part.

400.51 A1 The independence requirements in this Part 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.

R400.52 When associated with a larger structure of other firms and entities, a firm shall:

(a) Exercise professional judgment to determine whether a network is created by such a larger structure;

(b) Consider whether a reasonable and informed third party would be likely to conclude that the other firms and entities in the larger structure are associated in such a way that a network exists; and

(c) Apply such judgment consistently throughout such a larger structure.

R400.53 When determining whether a network is created by a larger structure of firms and other entities, a firm shall conclude that a network exists when such a larger structure is aimed at co-operation and:

(a) It is clearly aimed at profit or cost sharing among the entities within the structure. (Ref: Para. 400.53 A2);

(b) The entities within the structure share common ownership, control or management. (Ref: Para. 400.53 A3);

(c) The entities within the structure share common quality control policies and procedures. (Ref: Para. 400.53 A4);

(d) The entities within the structure share a common business strategy. (Ref: Para. 400.53 A5);

(e) The entities within the structure share the use of a common brand name. (Ref: Para. 400.53 A6, 400.53 A7); or

(f) The entities within the structure share a significant part of professional resources. (Ref: Para 400.53 A8, 400.53 A9).

400.53 A1 There might be other arrangements between firms and entities within a larger structure that constitute a network, in addition to those arrangements described in paragraph R400.53. However, a larger structure might be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network.

400.53 A2 The sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity jointly to provide a service or develop a product does not in itself create a network. (Ref: Para. R400.53(a)).

400.53 A3 Common ownership, control or management might be achieved by contract or other means. (Ref: Para. R400.53(b)).

400.53 A4 Common quality control policies and procedures are those designed, implemented and monitored across the larger structure. (Ref: Para. R400.53(c)).

400.53 A5 Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service. (Ref: Para. R400.53(d)).

400.53 A6 A common brand name includes common initials or a common name. A firm is using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name when a partner of the firm signs an audit report. (Ref: Para. R400.53(e)).

400.53 A7 Even if a firm does not belong to a network and does not use a common brand name as part of its firm name, it might appear to belong to a network if its stationery or promotional materials refer to the firm being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such membership, a perception might be created that the firm belongs to a network. (Ref: Para. R400.53(e)).

400.53 A8 Professional resources include:

- Common systems that enable firms to exchange information such as client data, billing and time records.
- Partners and other personnel.
- Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements.
- Audit methodology or audit manuals.
- Training courses and facilities. (Ref: Para. R400.53(f)).

400.53 A9 Whether the shared professional resources are significant depends on the circumstances. For example:

- The shared resources might be limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information. In such circumstances, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor.
- The shared resources might involve the exchange of personnel or information, such as where personnel are drawn from a shared pool, or where a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow. In such circumstances, a reasonable and informed third party is more likely to conclude that the shared resources are significant. (Ref: Para. R400.53(f)).

R400.54 If a firm or a network sells a component of its practice, and the component continues to use all or part of the firm's or network's name for a limited time, the relevant entities shall determine how to disclose that they are not network firms when presenting themselves to outside parties.

400.54 A1 The agreement for the sale of a component of a practice might provide that, for a limited period of time, the sold component can continue to use all or part of the name of the firm or the network, even though it is no longer connected to the firm or the network. In such circumstances, while the two entities might be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at cooperation. The two entities are therefore not network firms.

[Paragraphs 400.55 to 400.59 are intentionally left blank]

General Documentation of Independence for Audit and Review Engagements

R400.60 A firm shall document conclusions regarding compliance with this Part, and the substance of any relevant discussions that support those conclusions. In particular:

(a) When safeguards are applied to address a threat, the firm shall document the nature of the threat and the safeguards in place or applied; and

(b) When a threat required significant analysis and the firm concluded that the threat was already at an acceptable level, the firm shall document the nature of the threat and the rationale for the conclusion.

400.60 A1 Documentation provides evidence of the firm's judgments in forming conclusions regarding compliance with this Part. However, a lack of documentation does not determine whether a firm considered a particular matter or whether the firm is independent.

[Paragraphs 400.61 to 400.69 are intentionally left blank]

Mergers and Acquisitions

When a Client Merger Creates a Threat

400.70 A1 An entity might become a related entity of an audit client because of a merger or acquisition. A threat to independence and, therefore, to the ability of a firm to continue an audit engagement might be created by previous or current interests or relationships between a firm or network firm and such a related entity.

R400.71 In the circumstances set out in paragraph 400.70 A1,

(a) The firm shall identify and evaluate previous and current interests and relationships with the related entity that, taking into account any actions taken to address the threat, might affect its independence and therefore its ability to continue the audit engagement after the effective date of the merger or acquisition; and

(b) Subject to paragraph R400.72, the firm shall take steps to end any interests or relationships that are not permitted by the Code by the effective date of the merger or acquisition.

R400.72 As an exception to paragraph R400.71(b), if the interest or relationship cannot reasonably be ended by the effective date of the merger or acquisition, the firm shall:

(a) Evaluate the threat that is created by the interest or relationship; and

(b) Discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be ended by the effective date and the evaluation of the level of the threat.

400.72 A1 In some circumstances, it might not be reasonably possible to end an interest or relationship creating a threat by the effective date of the merger or acquisition. This might be because the firm provides a non-assurance service to the related entity, which the entity is not able to transition in an orderly manner to another provider by that date.

400.72 A2 Factors that are relevant in evaluating the level of a threat created by mergers and acquisitions when there are interests and relationships that cannot reasonably be ended include:

- The nature and significance of the interest or relationship.
- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent).
- The length of time until the interest or relationship can reasonably be ended.

R400.73 If, following the discussion set out in paragraph R400.72(b), those charged with governance request the firm to continue as the auditor, the firm shall do so only if:

(a) The interest or relationship will be ended as soon as reasonably possible but no later than six months after the effective date of the merger or acquisition;

(b) Any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted by Section 600 and its subsections, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review; and

(c) Transitional measures will be applied, as necessary, and discussed with those charged with governance.

400.73 A1 Examples of such transitional measures include:

- Having a professional accountant review the audit or non-assurance work as appropriate.
- Having a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, perform a review that is equivalent to an engagement quality control review.
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

R400.74 The firm might have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and might be able to complete the remaining audit procedures within a short period of time. In such circumstances, if those charged with governance request the firm to complete the audit while continuing with an interest or relationship identified in paragraph 400.70 A1, the firm shall only do so if it:

(a) Has evaluated the level of the threat and discussed the results with those charged with governance;

(b) Complies with the requirements of paragraph R400.73(a) to (c); and

(c) Ceases to be the auditor no later than the date that the audit report is issued.

If Objectivity Remains Compromised

R400.75 Even if all the requirements of paragraphs R400.71 to R400.74 could be met, the firm shall determine whether the circumstances identified in paragraph 400.70 A1 create a threat that cannot be addressed such that objectivity would be compromised. If so, the firm shall cease to be the auditor.

Documentation

R400.76 The firm shall document:

(a) Any interests or relationships identified in paragraph 400.70 A1 that will not be ended by the effective date of the merger or acquisition and the reasons why they will not be ended;

(b) The transitional measures applied;

(c) The results of the discussion with those charged with governance; and

(d) The reasons why the previous and current interests and relationships do not create a threat such that objectivity would be compromised.

[Paragraphs 400.77 to 400.79 are intentionally left blank.]

Breach of an Independence Provision for Audit and Review Engagements

When a Firm Identifies a Breach

R400.80 If a firm concludes that a breach of a requirement in this Part has occurred, the firm shall:

(a) End, suspend or eliminate the interest or relationship that created the breach and address the consequences of the breach;

(b) Consider whether any legal or regulatory requirements apply to the breach and, if so:

(i) Comply with those requirements; and

(ii) Consider reporting the breach to a professional or regulatory body or oversight authority if such reporting is common practice or expected in the relevant jurisdiction;

(c) Promptly communicate the breach in accordance with its policies and procedures to:

(i) The engagement partner;

(ii) Those with responsibility for the policies and procedures relating to independence;

(iii) Other relevant personnel in the firm and, where appropriate, the network; and

(iv) Those subject to the independence requirements in Part 4A who need to take appropriate action;

(d) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an audit report; and

(e) Depending on the significance of the breach, determine:

(i) Whether to end the audit engagement; or

(ii) Whether it is possible to take action that satisfactorily addresses the consequences of the breach and whether such action can be taken and is appropriate in the circumstances.

In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party would be likely to conclude that the firm's objectivity would be compromised, and therefore, the firm would be unable to issue an audit report.

400.80 A1 A breach of a provision of this Part might occur despite the firm having policies and procedures designed to provide it with reasonable assurance that independence is maintained. It might be necessary to end the audit engagement because of the breach.

400.80 A2 The significance and impact of a breach on the firm's objectivity and ability to issue an audit report will depend on factors such as:

- The nature and duration of the breach.
- The number and nature of any previous breaches with respect to the current audit engagement.
- Whether an audit team member had knowledge of the interest or relationship that created the breach.
- Whether the individual who created the breach is an audit team member or another individual for whom there are independence requirements.
- If the breach relates to an audit team member, the role of that individual.
- If the breach was created by providing a professional service, the impact of that service, if any, on the accounting records or the amounts recorded in the financial statements on which the firm will express an opinion.
- The extent of the self-interest, advocacy, intimidation or other threats created by the breach.

400.80 A3 Depending upon the significance of the breach, examples of actions that the firm might consider to address the breach satisfactorily include:

- Removing the relevant individual from the audit team.
- Using different individuals to conduct an additional review of the affected audit work or to re-perform that work to the extent necessary.
- Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary.
- If the breach relates to a non-assurance service that affects the accounting records or an amount recorded in the financial statements, engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

R400.81 If the firm determines that action cannot be taken to address the consequences of the breach satisfactorily, the firm shall inform those charged with governance as soon as possible and take the steps necessary to end the audit engagement in compliance with any applicable legal or regulatory requirements. Where ending the engagement is not permitted by laws or regulations, the firm shall comply with any reporting or disclosure requirements.

R400.82 If the firm determines that action can be taken to address the consequences of the breach satisfactorily, the firm shall discuss with those charged with governance:

(a) The significance of the breach, including its nature and duration;

(b) How the breach occurred and how it was identified;

(c) The action proposed or taken and why the action will satisfactorily address the consequences of the breach and enable the firm to issue an audit report;

(d) The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion; and

(e) Any steps proposed or taken by the firm to reduce or avoid the risk of further breaches occurring.

Such discussion shall take place as soon as possible unless an alternative timing is specified by those charged with governance for reporting less significant breaches.

Communication of Breaches to Those Charged with Governance

400.83 A1 Paragraphs R300.9 and R300.10 set out requirements with respect to communicating with those charged with governance.

R400.84 With respect to breaches, the firm shall communicate in writing to those charged with governance:

(a) All matters discussed in accordance with paragraph R400.82 and obtain the concurrence of those charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach; and

(b) A description of:

(i) The firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained; and

(ii) Any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring.

R400.85 If those charged with governance do not concur that the action proposed by the firm in accordance with paragraph R400.80(e)(ii) satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to end the audit engagement in accordance with paragraph R400.81.

Breaches Before the Previous Audit Report Was Issued

R400.86 If the breach occurred prior to the issuance of the previous audit report, the firm shall comply with the provisions of Part 4A in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period.

R400.87 The firm shall also:

(a) Consider the impact of the breach, if any, on the firm's objectivity in relation to any previously issued audit reports, and the possibility of withdrawing such audit reports; and

(b) Discuss the matter with those charged with governance.

Documentation

R400.88 In complying with the requirements in paragraphs R400.80 to R400.87, the firm shall document:

(a) The breach;

(b) The actions taken;

(c) The key decisions made;

(d) All the matters discussed with those charged with governance; and

(e) Any discussions with a professional or regulatory body or oversight authority.

R400.89 If the firm continues with the audit engagement, it shall document:

(a) The conclusion that, in the firm's professional judgment, objectivity has not been compromised; and

(b) The rationale for why the action taken satisfactorily addressed the consequences of the breach so that the firm could issue an audit report.

SECTION 410

FEES

Introduction

410.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

410.2 The nature and level of fees or other types of remuneration might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Fees – Relative Size

All Audit Clients

410.3 A1 When the total fees generated from an audit client by the firm expressing the audit opinion represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client create a self-interest or intimidation threat.

410.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The operating structure of the firm.
- Whether the firm is well established or new.
- The significance of the client qualitatively and/or quantitatively to the firm.

410.3 A3 An example of an action that might be a safeguard to address such a self-interest or intimidation threat is increasing the client base in the firm to reduce dependence on the audit client.

410.3 A4 A self-interest or intimidation threat is also created when the fees generated by a firm from an audit client represent a large proportion of the revenue of one partner or one office of the firm.

410.3 A5 Factors that are relevant in evaluating the level of such threats include:

- The significance of the client qualitatively and/or quantitatively to the partner or office.
- The extent to which the compensation of the partner, or the partners in the office, is dependent upon the fees generated from the client.

410.3 A6 Examples of actions that might be safeguards to address such self-interest or intimidation threats include:

- Increasing the client base of the partner or the office to reduce dependence on the audit client.
- Having an appropriate reviewer who did not take part in the audit engagement review the work.

Audit Clients that are Public Interest Entities

R410.4 Where an audit client is a public interest entity and, for two consecutive years, the total fees from the client and its related entities represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the firm shall:

(a) Disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm; and

(b) Discuss whether either of the following actions might be a safeguard to address the threat created by the total fees received by the firm from the client, and if so, apply it:

(i) Prior to the audit opinion being issued on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement; or a professional body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or

(ii) After the audit opinion on the second year's financial statements has been issued, and before the audit opinion being issued on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

R410.5 When the total fees described in paragraph R410.4 significantly exceed 15%, the firm shall determine whether the level of the threat is such that a post-issuance review would not reduce the threat to an acceptable level. If so, the firm shall have a pre-issuance review performed.

R410.6 If the fees described in paragraph R410.4 continue to exceed 15%, the firm shall each year:

(a) Disclose to and discuss with those charged with governance the matters set out in paragraph R410.4; and

(b) Comply with paragraphs R410.4(b) and R410.5.

Fees – Overdue

410.7 A1 A self-interest threat might be created if a significant part of fees is not paid before the audit report for the following year is issued. It is generally expected that the firm will require payment of such fees before such audit report is issued. The requirements and application material set out in Section 511 with respect to loans and guarantees might also apply to situations where such unpaid fees exist.

410.7 A2 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining partial payment of overdue fees.
- Having an appropriate reviewer who did not take part in the audit engagement review the work performed.

R410.8 When a significant part of fees due from an audit client remains unpaid for a long time, the firm shall determine:

(a) Whether the overdue fees might be equivalent to a loan to the client; and

(b) Whether it is appropriate for the firm to be re-appointed or continue the audit engagement.

Contingent Fees

410.9 A1 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed. A contingent fee charged through an intermediary is an example of an indirect contingent fee. In this section, a fee is not regarded as being contingent if established by a court or other public authority.

R410.10 A firm shall not charge directly or indirectly a contingent fee for an audit engagement.

R410.11 A firm or network firm shall not charge directly or indirectly a contingent fee for a non-assurance service provided to an audit client, if:

(a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;

(b) The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or

(c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements.

410.12 A1 Paragraphs R410.10 and R410.11 preclude a firm or a network firm from entering into certain contingent fee arrangements with an audit client. Even if a contingent fee arrangement is not precluded when providing a non-assurance service to an audit client, a self-interest threat might still be created.

410.12 A2 Factors that are relevant in evaluating the level of such a threat include:

- The range of possible fee amounts.
- Whether an appropriate authority determines the outcome on which the contingent fee depends.
- Disclosure to intended users of the work performed by the firm and the basis of remuneration.
- The nature of the service.
- The effect of the event or transaction on the financial statements.

410.12 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the work performed by the firm.
- Obtaining an advance written agreement with the client on the basis of remuneration.

SECTION 411

COMPENSATION AND EVALUATION POLICIES

Introduction

411.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

411.2 A firm's evaluation or compensation policies might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

411.3 A1 When an audit team member for a particular audit client is evaluated on or compensated for selling non-assurance services to that audit client, the level of the self-interest threat will depend on:

(a) What proportion of the compensation or evaluation is based on the sale of such services;

(b) The role of the individual on the audit team; and

(c) Whether the sale of such non-assurance services influences promotion decisions.

411.3 A2 Examples of actions that might eliminate such a self-interest threat include:

- Revising the compensation plan or evaluation process for that individual.
- Removing that individual from the audit team.

411.3 A3 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review the work of the audit team member.

R411.4 A firm shall not evaluate or compensate a key audit partner based on that partner's success in selling non-assurance services to the partner's audit client. This requirement does not preclude normal profit-sharing arrangements between partners of a firm.

SECTION 420

GIFTS AND HOSPITALITY

Introduction

420.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

420.2 Accepting gifts and hospitality from an audit client might create a self-interest, familiarity or intimidation threat. This section sets out a specific requirement and application material relevant to applying the conceptual framework in such circumstances.

Requirement and Application Material

R420.3 A firm, network firm or an audit team member shall not accept gifts and hospitality from an audit client, unless the value is trivial and inconsequential.

420.3 A1 Where a firm, network firm or audit team member is offering or accepting an inducement to or from an audit client, the requirements and application material set out in Section 340 apply and non-compliance with these requirements might create threats to independence.

420.3 A2 The requirements set out in Section 340 relating to offering or accepting inducements do not allow a firm, network firm or audit team member to accept gifts and hospitality where the intent is to improperly influence behavior even if the value is trivial and inconsequential.

SECTION 430

ACTUAL OR THREATENED LITIGATION

Introduction

430.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

430.2 When litigation with an audit client occurs, or appears likely, self-interest and intimidation threats are created. This section sets out specific application material relevant to applying the conceptual framework in such circumstances.

Application Material

General

430.3 A1 The relationship between client management and audit team members must be characterized by complete candor and full disclosure regarding all aspects of a client's operations. Adversarial positions might result from actual or threatened litigation between an audit client and the firm, a network firm or an audit team member. Such adversarial positions might affect management's willingness to make complete disclosures and create self-interest and intimidation threats.

430.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The materiality of the litigation.
- Whether the litigation relates to a prior audit engagement.

430.3 A3 If the litigation involves an audit team member, an example of an action that might eliminate such self-interest and intimidation threats is removing that individual from the audit team.

430.3 A4 An example of an action that might be a safeguard to address such self-interest and intimidation threats is to have an appropriate reviewer review the work performed.

SECTION 510

FINANCIAL INTERESTS

Introduction

510.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

510.2 Holding a financial interest in an audit client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

510.3 A1 A financial interest might be held directly or indirectly through an intermediary such as a collective investment vehicle, an estate or a trust. When a beneficial owner has control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be direct. Conversely, when a beneficial owner has no control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be indirect.

510.3 A2 This section contains references to the "materiality" of a financial interest. In determining whether such an interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

510.3 A3 Factors that are relevant in evaluating the level of a self-interest threat created by holding a financial interest in an audit client include:

- The role of the individual holding the financial interest.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest.

Financial Interests Held by the Firm, a Network Firm, Audit Team Members and Others

R510.4 Subject to paragraph R510.5, a direct financial interest or a material indirect financial interest in the audit client shall not be held by:

(a) The firm or a network firm;

(b) An audit team member, or any of that individual's immediate family;

(c) Any other partner in the office in which an engagement partner practices in connection with the audit engagement, or any of that other partner's immediate family; or

(d) Any other partner or managerial employee who provides non-audit services to the audit client, except for any whose involvement is minimal, or any of that individual's immediate family.

510.4 A1 The office in which the engagement partner practices in connection with an audit engagement is not necessarily the office to which that partner is assigned. When the engagement partner is located in a different office from that of the other audit team members, professional judgment is needed to determine the office in which the partner practices in connection with the engagement.

R510.5 As an exception to paragraph R510.4, an immediate family member identified in subparagraphs R510.4(c) or (d) may hold a direct or material indirect financial interest in an audit client, provided that:

(a) The family member received the financial interest because of employment rights, for example through pension or share option plans, and, when necessary, the firm addresses the threat created by the financial interest; and

(b) The family member disposes of or forfeits the financial interest as soon as practicable when the family member has or obtains the right to do so, or in the case of a stock option, when the family member obtains the right to exercise the option.

Financial Interests in an Entity Controlling an Audit Client

R510.6 When an entity has a controlling interest in an audit client and the client is material to the entity, neither the firm, nor a network firm, nor an audit team member, nor any of that individual's immediate family shall hold a direct or material indirect financial interest in that entity.

Financial Interests Held as Trustee

R510.7 Paragraph R510.4 shall also apply to a financial interest in an audit client held in a trust for which the firm, network firm or individual acts as trustee, unless:

(a) None of the following is a beneficiary of the trust: the trustee, the audit team member or any of that individual's immediate family, the firm or a network firm;

(b) The interest in the audit client held by the trust is not material to the trust;

(c) The trust is not able to exercise significant influence over the audit client; and

(d) None of the following can significantly influence any investment decision involving a financial interest in the audit client: the trustee, the audit team member or any of that individual's immediate family, the firm or a network firm.

Financial Interests in Common with the Audit Client

R510.8 **(a)** A firm, or a network firm, or an audit team member, or any of that individual's immediate family shall not hold a financial interest in an entity when an audit client also has a financial interest in that entity, unless:

(i) The financial interests are immaterial to the firm, the network firm, the audit team member and that individual's immediate family member and the audit client, as applicable; or

(ii) The audit client cannot exercise significant influence over the entity.

(b) Before an individual who has a financial interest described in paragraph R510.8(a) can become an audit team member, the individual or that individual's immediate family member shall either:

(i) Dispose of the interest; or

(ii) Dispose of enough of the interest so that the remaining interest is no longer material.

Financial Interests Received Unintentionally

R510.9 If a firm, a network firm or a partner or employee of the firm or a network firm, or any of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an audit client by way of an inheritance, gift, as a result of a merger or in similar circumstances and the interest would not otherwise be permitted to be held under this section, then:

(a) If the interest is received by the firm or a network firm, or an audit team member or any of that individual's immediate family, the financial interest shall be disposed of immediately, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; or

(b) **(i)** If the interest is received by an individual who is not an audit team member, or by any of that individual's immediate family, the financial interest shall be disposed of as soon as possible, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; and

(ii) Pending the disposal of the financial interest, when necessary the firm shall address the threat created.

Financial Interests – Other Circumstances

Immediate Family

510.10 A1 A self-interest, familiarity, or intimidation threat might be created if an audit team member, or any of that individual's immediate family, or the firm or a network firm has a financial interest in an entity when a director or officer or controlling owner of the audit client is also known to have a financial interest in that entity.

510.10 A2 Factors that are relevant in evaluating the level of such threats include:

- The role of the individual on the audit team.
- Whether ownership of the entity is closely or widely held.
- Whether the interest allows the investor to control or significantly influence the entity.
- The materiality of the financial interest.

510.10 A3 An example of an action that might eliminate such a self-interest, familiarity, or intimidation threat is removing the audit team member with the financial interest from the audit team.

510.10 A4 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review the work of the audit team member.

Close Family

510.10 A5 A self-interest threat might be created if an audit team member knows that a close family member has a direct financial interest or a material indirect financial interest in the audit client.

510.10 A6 Factors that are relevant in evaluating the level of such a threat include:

- The nature of the relationship between the audit team member and the close family member.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest to the close family member.

510.10 A7 Examples of actions that might eliminate such a self-interest threat include:

- Having the close family member dispose, as soon as practicable, of all of the financial interest or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.
- Removing the individual from the audit team.

510.10 A8 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review the work of the audit team member.

Other Individuals

510.10 A9 A self-interest threat might be created if an audit team member knows that a financial interest in the audit client is held by individuals such as:

- Partners and professional employees of the firm or network firm, apart from those who are specifically not permitted to hold such financial interests by paragraph R510.4, or their immediate family members.
- Individuals with a close personal relationship with an audit team member.

510.10 A10 Factors that are relevant in evaluating the level of such a threat include:

- The firm's organizational, operating and reporting structure.
- The nature of the relationship between the individual and the audit team member.

510.10 A11 An example of an action that might eliminate such a self-interest threat is removing the audit team member with the personal relationship from the audit team.

510.10 A12 Examples of actions that might be safeguards to address such a self-interest threat include:

- Excluding the audit team member from any significant decision-making concerning the audit engagement.
- Having an appropriate reviewer review the work of the audit team member.

Retirement Benefit Plan of a Firm or Network Firm

510.10 A13 A self-interest threat might be created if a retirement benefit plan of a firm or a network firm holds a direct or material indirect financial interest in an audit client.

SECTION 511

LOANS AND GUARANTEES

Introduction

511.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

511.2 A loan or a guarantee of a loan with an audit client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

511.3 A1 This section contains references to the "materiality" of a loan or guarantee. In determining whether such a loan or guarantee is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Loans and Guarantees with an Audit Client

R511.4 A firm, a network firm, an audit team member, or any of that individual's immediate family shall not make or guarantee a loan to an audit client unless the loan or guarantee is immaterial to:

(a) The firm, the network firm or the individual making the loan or guarantee, as applicable; and

(b) The client.

Loans and Guarantees with an Audit Client that is a Bank or Similar Institution

R511.5 A firm, a network firm, an audit team member, or any of that individual's immediate family shall not accept a loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

511.5 A1 Examples of loans include mortgages, bank overdrafts, car loans, and credit card balances.

511.5 A2 Even if a firm or network firm receives a loan from an audit client that is a bank or similar institution under normal lending procedures, terms and conditions, the loan might create a self-interest threat if it is material to the audit client or firm receiving the loan.

511.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having the work reviewed by an appropriate reviewer, who is not an audit team member, from a network firm that is not a beneficiary of the loan.

Deposits or Brokerage Accounts

R511.6 A firm, a network firm, an audit team member, or any of that individual's immediate family shall not have deposits or a brokerage account with an audit client that is a bank, broker or similar institution, unless the deposit or account is held under normal commercial terms.

Loans and Guarantees with an Audit Client that is Not a Bank or Similar Institution

R511.7 A firm, a network firm, an audit team member, or any of that individual's immediate family shall not accept a loan from, or have a borrowing guaranteed by, an audit client that is not a bank or similar institution, unless the loan or guarantee is immaterial to:

(a) The firm, the network firm, or the individual receiving the loan or guarantee, as applicable; and

(b) The client.

SECTION 520

BUSINESS RELATIONSHIPS

Introduction

520.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

520.2 A close business relationship with an audit client or its management might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

520.3 A1 This section contains references to the "materiality" of a financial interest and the "significance" of a business relationship. In determining whether such a financial interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

520.3 A2 Examples of a close business relationship arising from a commercial relationship or common financial interest include:

- Having a financial interest in a joint venture with either the client or a controlling owner, director or officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm or a network firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm or a network firm distributes or markets the client's products or services, or the client distributes or markets the firm or a network firm's products or services.

Firm, Network Firm, Audit Team Member or Immediate Family Business Relationships

R520.4 A firm, a network firm or an audit team member shall not have a close business relationship with an audit client or its management unless any financial interest is immaterial and the business relationship is insignificant to the client or its management and the firm, the network firm or the audit team member, as applicable.

520.4 A1 A self-interest or intimidation threat might be created if there is a close business relationship between the audit client or its management and the immediate family of an audit team member.

Common Interests in Closely-Held Entities

R520.5 A firm, a network firm, an audit team member, or any of that individual's immediate family shall not have a business relationship involving the holding of an interest in a closely-held entity when an audit client or a director or officer of the client, or any group thereof, also holds an interest in that entity, unless:

(a) The business relationship is insignificant to the firm, the network firm, or the individual as applicable, and the client;

(b) The financial interest is immaterial to the investor or group of investors; and

(c) The financial interest does not give the investor, or group of investors, the ability to control the closely-held entity.

Buying Goods or Services

520.6 A1 The purchase of goods and services from an audit client by a firm, a network firm, an audit team member, or any of that individual's immediate family does not usually create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions might be of such a nature and magnitude that they create a self-interest threat.

520.6 A2 Examples of actions that might eliminate such a self-interest threat include:

- Eliminating or reducing the magnitude of the transaction.
- Removing the individual from the audit team.

SECTION 521

FAMILY AND PERSONAL RELATIONSHIPS

Introduction

521.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

521.2 Family or personal relationships with client personnel might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

521.3 A1 A self-interest, familiarity or intimidation threat might be created by family and personal relationships between an audit team member and a director or officer or, depending on their role, certain employees of the audit client.

521.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The individual's responsibilities on the audit team.
- The role of the family member or other individual within the client, and the closeness of the relationship.

Immediate Family of an Audit Team Member

521.4 A1 A self-interest, familiarity or intimidation threat is created when an immediate family member of an audit team member is an employee in a position to exert significant influence over the client's financial position, financial performance or cash flows.

521.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position held by the immediate family member.
- The role of the audit team member.

521.4 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the audit team.

521.4 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the audit team so that the audit team member does not deal with matters that are within the responsibility of the immediate family member.

R521.5 An individual shall not participate as an audit team member when any of that individual's immediate family:

(a) Is a director or officer of the audit client;

(b) Is an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion; or

(c) Was in such position during any period covered by the engagement or the financial statements.

Close Family of an Audit Team Member

521.6 A1 A self-interest, familiarity or intimidation threat is created when a close family member of an audit team member is:

(a) A director or officer of the audit client; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

521.6 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the audit team member and the close family member.
- The position held by the close family member.
- The role of the audit team member.

521.6 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the audit team.

521.6 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the audit team so that the audit team member does not deal with matters that are within the responsibility of the close family member.

Other Close Relationships of an Audit Team Member

R521.7 An audit team member shall consult in accordance with firm policies and procedures if the audit team member has a close relationship with an individual who is not an immediate or close family member, but who is:

(a) A director or officer of the audit client; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

521.7 A1 Factors that are relevant in evaluating the level of a self-interest, familiarity or intimidation threat created by such a relationship include:

- The nature of the relationship between the individual and the audit team member.
- The position the individual holds with the client.

- The role of the audit team member.

521.7 A2 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the audit team.

521.7 A3 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the audit team so that the audit team member does not deal with matters that are within the responsibility of the individual with whom the audit team member has a close relationship.

Relationships of Partners and Employees of the Firm

R521.8 Partners and employees of the firm shall consult in accordance with firm policies and procedures if they are aware of a personal or family relationship between:

(a) A partner or employee of the firm or network firm who is not an audit team member; and

(b) A director or officer of the audit client or an employee of the audit client in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

521.8 A1 Factors that are relevant in evaluating the level of a self-interest, familiarity or intimidation threat created by such a relationship include:

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client.
- The degree of interaction of the partner or employee of the firm with the audit team.
- The position of the partner or employee within the firm.
- The position the individual holds with the client.

521.8 A2 Examples of actions that might be safeguards to address such self-interest, familiarity or intimidation threats include:

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the audit engagement.
- Having an appropriate reviewer review the relevant audit work performed.

SECTION 522

RECENT SERVICE WITH AN AUDIT CLIENT

Introduction

522.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

522.2 If an audit team member has recently served as a director or officer, or employee of the audit client, a self-interest, self-review or familiarity threat might be created. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service During Period Covered by the Audit Report

R522.3 The audit team shall not include an individual who, during the period covered by the audit report:

(a) Had served as a director or officer of the audit client; or

(b) Was an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

Service Prior to Period Covered by the Audit Report

522.4 A1 A self-interest, self-review or familiarity threat might be created if, before the period covered by the audit report, an audit team member:

(a) Had served as a director or officer of the audit client; or

(b) Was an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements on which the firm will express an opinion.

For example, a threat would be created if a decision made or work performed by the individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the current audit engagement.

522.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position the individual held with the client.
- The length of time since the individual left the client.
- The role of the audit team member.

522.4 A3 An example of an action that might be a safeguard to address such a self-interest, self-review or familiarity threat is having an appropriate reviewer review the work performed by the audit team member.

SECTION 523

SERVING AS A DIRECTOR OR OFFICER OF AN AUDIT CLIENT

Introduction

523.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

523.2 Serving as a director or officer of an audit client creates self-review and self-interest threats. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service as Director or Officer

R523.3 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.

Service as Company Secretary

R523.4 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 preparing minutes and maintaining statutory returns.

523.4 A1 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. Therefore, a threat is created if a partner or employee of the firm or a network firm serves as Company Secretary for an audit client. (More information on providing non-assurance services to an audit client is set out in Section 600, *Provision of Non-assurance Services to an Audit Client*.)

SECTION 524

EMPLOYMENT WITH AN AUDIT CLIENT

Introduction

524.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

524.2 Employment relationships with an audit client might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

All Audit Clients

524.3 A1 A familiarity or intimidation threat might be created if any of the following individuals have been an audit team member or partner of the firm or a network firm:

- A director or officer of the audit client.
- An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

Former Partner or Audit Team Member Restrictions

R524.4 The firm shall ensure that no significant connection remains between the firm or a network firm and:

(a) A former partner who has joined an audit client of the firm; or

(b) A former audit team member who has joined the audit client,

if either has joined the audit client as:

(i) A director or officer; or

(ii) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

A significant connection remains between the firm or a network firm and the individual, unless:

(a) The individual is not entitled to any benefits or payments from the firm or network firm that are not made in accordance with fixed pre-determined arrangements;

(b) Any amount owed to the individual is not material to the firm or the network firm; and

(c) The individual does not continue to participate or appear to participate in the firm's or the network firm's business or professional activities.

524.4 A1 Even if the requirements of paragraph R524.4 are met, a familiarity or intimidation threat might still be created.

524.4 A2 A familiarity or intimidation threat might also be created if a former partner of the firm or network firm has joined an entity in one of the positions described in paragraph 524.3 A1 and the entity subsequently becomes an audit client of the firm.

524.4 A3 Factors that are relevant in evaluating the level of such threats include:

- The position the individual has taken at the client.
- Any involvement the individual will have with the audit team.
- The length of time since the individual was an audit team member or partner of the firm or network firm.
- The former position of the individual within the audit team, firm or network firm. An example is whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

524.4 A4 Examples of actions that might be safeguards to address such familiarity or intimidation threats include:

- Modifying the audit plan.
- Assigning to the audit team individuals who have sufficient experience relative to the individual who has joined the client.
- Having an appropriate reviewer review the work of the former audit team member.

Audit Team Members Entering Employment with a Client

R524.5 A firm or network firm shall have policies and procedures that require audit team members to notify the firm or network firm when entering employment negotiations with an audit client.

524.5 A1 A self-interest threat is created when an audit team member participates in the audit engagement while knowing that the audit team member will, or might, join the client at some time in the future.

524.5 A2 An example of an action that might eliminate such a self-interest threat is removing the individual from the audit team.

524.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review any significant judgments made by that individual while on the team.

Audit Clients that are Public Interest Entities

Key Audit Partners

R524.6 Subject to paragraph R524.8, if an individual who was a key audit partner with respect to an audit client that is a public interest entity joins the client as:

(a) A director or officer; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion,

independence is compromised unless, subsequent to the individual ceasing to be a key audit partner:

(i) The audit client has issued audited financial statements covering a period of not less than twelve months; and

(ii) The individual was not an audit team member with respect to the audit of those financial statements.

Senior or Managing Partner (Chief Executive or Equivalent) of the Firm

R524.7 Subject to paragraph R524.8, if an individual who was the Senior or Managing Partner (Chief Executive or equivalent) of the firm joins an audit client that is a public interest entity as:

(a) A director or officer; or

(b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion,

independence is compromised, unless twelve months have passed since the individual was the Senior or Managing Partner (Chief Executive or equivalent) of the firm.

Business Combinations

R524.8 As an exception to paragraphs R524.6 and R524.7, independence is not compromised if the circumstances set out in those paragraphs arise as a result of a business combination and:

(a) The position was not taken in contemplation of the business combination;

(b) Any benefits or payments due to the former partner from the firm or a network firm have been settled in full, unless made in accordance with fixed pre-determined arrangements and any amount owed to the partner is not material to the firm or network firm as applicable;

(c) The former partner does not continue to participate or appear to participate in the firm's or network firm's business or professional activities; and

(d) The firm discusses the former partner's position held with the audit client with those charged with governance.

SECTION 525

TEMPORARY PERSONNEL ASSIGNMENTS

Introduction

525.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

525.2 The loan of personnel to an audit client might create a self-review, advocacy or familiarity threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

525.3 A1 Examples of actions that might be safeguards to address threats created by the loan of personnel by a firm or a network firm to an audit client include:

- Conducting an additional review of the work performed by the loaned personnel might address a self-review threat.
- Not including the loaned personnel as an audit team member might address a familiarity or advocacy threat.
- Not giving the loaned personnel audit responsibility for any function or activity that the personnel performed during the loaned personnel assignment might address a self-review threat.

525.3 A2 When familiarity and advocacy threats are created by the loan of personnel by a firm or a network firm to an audit client, such that the firm or the network firm becomes too closely aligned with the views and interests of management, safeguards are often not available.

R525.4 A firm or network firm shall not loan personnel to an audit client unless:

(a) Such assistance is provided only for a short period of time;

(b) The personnel are not involved in providing non-assurance services that would not be permitted under Section 600 and its subsections; and

(c) The personnel do not assume management responsibilities and the audit client is responsible for directing and supervising the activities of the personnel.

SECTION 540

LONG ASSOCIATION OF PERSONNEL (INCLUDING PARTNER ROTATION) WITH AN AUDIT CLIENT

Introduction

540.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

540.2 When an individual is involved in an audit engagement over a long period of time, familiarity and self-interest threats might be created. This section sets out requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

All Audit Clients

540.3 A1 Although an understanding of an audit client and its environment is fundamental to audit quality, a familiarity threat might be created as a result of an individual's long association as an audit team member with:

(a) The audit client and its operations;

(b) The audit client's senior management; or

(c) The financial statements on which the firm will express an opinion or the financial information which forms the basis of the financial statements.

540.3 A2 A self-interest threat might be created as a result of an individual's concern about losing a longstanding client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance. Such a threat might influence the individual's judgment inappropriately.

540.3 A3 Factors that are relevant to evaluating the level of such familiarity or self-interest threats include:

(a) In relation to the individual:

- The overall length of the individual's relationship with the client, including if such relationship existed while the individual was at a prior firm.
- How long the individual has been an engagement team member, and the nature of the roles performed.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the audit, for example, by making key decisions or directing the work of other engagement team members.

- The closeness of the individual's personal relationship with senior management or those charged with governance.

- The nature, frequency and extent of the interaction between the individual and senior management or those charged with governance.

(b) In relation to the audit client:

- The nature or complexity of the client's accounting and financial reporting issues and whether they have changed.

- Whether there have been any recent changes in senior management or those charged with governance.

- Whether there have been any structural changes in the client's organization which impact the nature, frequency and extent of interactions the individual might have with senior management or those charged with governance.

540.3 A4 The combination of two or more factors might increase or reduce the level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an individual and a member of the client's senior management would be reduced by the departure of that member of the client's senior management.

540.3 A5 An example of an action that might eliminate the familiarity and self-interest threats created by an individual being involved in an audit engagement over a long period of time would be rotating the individual off the audit team.

540.3 A6 Examples of actions that might be safeguards to address such familiarity or self-interest threats include:

- Changing the role of the individual on the audit team or the nature and extent of the tasks the individual performs.

- Having an appropriate reviewer who was not an audit team member review the work of the individual.

- Performing regular independent internal or external quality reviews of the engagement.

R540.4 If a firm decides that the level of the threats created can only be addressed by rotating the individual off the audit team, the firm shall determine an appropriate period during which the individual shall not:

(a) Be a member of the engagement team for the audit engagement;

(b) Provide quality control for the audit engagement; or

(c) Exert direct influence on the outcome of the audit engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to be addressed. In the case of a public interest entity, paragraphs R540.5 to R540.20 also apply.

Audit Clients that are Public Interest Entities

R540.5 Subject to paragraphs R540.7 to R540.9, in respect of an audit of a public interest entity, an individual shall not act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years (the "time-on" period):

(a) The engagement partner;

(b) The individual appointed as responsible for the engagement quality control review; or

(c) Any other key audit partner role.

After the time-on period, the individual shall serve a "cooling-off" period in accordance with the provisions in paragraphs R540.11 to R540.19.

R540.6 In calculating the time-on period, the count of years shall not be restarted unless the individual ceases to act in any one of the roles in paragraph R540.5(a) to (c) for a minimum period. This minimum period is a consecutive period equal to at least the cooling-off period determined in accordance with paragraphs R540.11 to R540.13 as applicable to the role in which the individual served in the year immediately before ceasing such involvement.

540.6 A1 For example, an individual who served as engagement partner for four years followed by three years off can only act thereafter as a key audit partner on the same audit engagement for three further years (making a total of seven cumulative years). Thereafter, that individual is required to cool off in accordance with paragraph R540.14.

R540.7 As an exception to paragraph R540.5, key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, and with the concurrence of those charged with governance, be permitted to serve an additional year as a key audit partner as long as the threat to independence can be eliminated or reduced to an acceptable level.

540.7 A1 For example, a key audit partner may remain in that role on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner. In such circumstances, this will involve the firm discussing with those charged with governance the reasons why the planned rotation cannot take place and the need for any safeguards to reduce any threat created.

R540.8 If an audit client becomes a public interest entity, a firm shall take into account the length of time an individual has served the audit client as a key audit partner before the client becomes a public interest entity in determining the timing of the rotation. If the individual has served the audit client as a key audit partner for a period of five cumulative years or less when the client becomes a public interest entity, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served. As an exception to paragraph R540.5, if the individual has served the audit client as a key audit partner for a period of six or more cumulative years when the client becomes a public interest entity, the individual may continue to serve in that capacity with the concurrence of those charged with governance for a maximum of two additional years before rotating off the engagement.

R540.9 When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners might not be possible. As an exception to paragraph R540.5, if an independent regulatory body in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such exemption. This is provided that the independent regulatory body has specified other requirements which are to be applied, such as the length of time that the key audit partner may be exempted from rotation or a regular independent external review.

Other Considerations Relating to the Time-on Period

R540.10 In evaluating the threats created by an individual's long association with an audit engagement, a firm shall give particular consideration to the roles undertaken and the length of an individual's association with the audit engagement prior to the individual becoming a key audit partner.

540.10 A1 There might be situations where the firm, in applying the conceptual framework, concludes that it is not appropriate for an individual who is a key audit partner to continue in that role even though the length of time served as a key audit partner is less than seven years.

Cooling-off Period

R540.11 If the individual acted as the engagement partner for seven cumulative years, the cooling-off period shall be five consecutive years.

R540.12 Where the individual has been appointed as responsible for the engagement quality control review and has acted in that capacity for seven cumulative years, the cooling-off period shall be three consecutive years.

R540.13 If the individual has acted as a key audit partner other than in the capacities set out in paragraphs R540.11 and R540.12 for seven cumulative years, the cooling-off period shall be two consecutive years.

Service in a combination of key audit partner roles

R540.14 If the individual acted in a combination of key audit partner roles and served as the engagement partner for four or more cumulative years, the cooling-off period shall be five consecutive years.

R540.15 Subject to paragraph R540.16(a), if the individual acted in a combination of key audit partner roles and served as the key audit partner responsible for the engagement quality control review for four or more cumulative years, the cooling-off period shall be three consecutive years.

R540.16 If an individual has acted in a combination of engagement partner and engagement quality control review roles for four or more cumulative years during the time-on period, the cooling-off period shall:

(a) As an exception to paragraph R540.15, be five consecutive years where the individual has been the engagement partner for three or more years; or

(b) Be three consecutive years in the case of any other combination.

R540.17 If the individual acted in any combination of key audit partner roles other than those addressed in paragraphs R540.14 to R540.16, the cooling-off period shall be two consecutive years.

Service at a Prior Firm

R540.18 In determining the number of years that an individual has been a key audit partner as set out in paragraph R540.5, the length of the relationship shall, where relevant, include time while the individual was a key audit partner on that engagement at a prior firm.

Shorter Cooling-off Period Established by Law or Regulation

R540.19 Where a legislative or regulatory body (or organization authorized or recognized by such legislative or regulatory body) has established a cooling-off period for an engagement partner of less than five consecutive years, the higher of that period or three years may be substituted for the cooling-off period of five consecutive years specified in paragraphs R540.11, R540.14 and R540.16(a) provided that the applicable time-on period does not exceed seven years.

Restrictions on Activities During the Cooling-off Period

R540.20 For the duration of the relevant cooling-off period, the individual shall not:

(a) Be an engagement team member or provide quality control for the audit engagement;

(b) Consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events affecting the audit engagement (other than discussions with the engagement team limited to work undertaken or conclusions reached in the last year of the individual's time-on period where this remains relevant to the audit);

(c) Be responsible for leading or coordinating the professional services provided by the firm or a network firm to the audit client, or overseeing the relationship of the firm or a network firm with the audit client; or

(d) Undertake any other role or activity not referred to above with respect to the audit client, including the provision of non-assurance services that would result in the individual:

(i) Having significant or frequent interaction with senior management or those charged with governance; or

(ii) Exerting direct influence on the outcome of the audit engagement.

540.20 A1 The provisions of paragraph R540.20 are not intended to prevent the individual from assuming a leadership role in the firm or a network firm, such as that of the Senior or Managing Partner (Chief Executive or equivalent).

SECTION 600

PROVISION OF NON-ASSURANCE SERVICES TO AN AUDIT CLIENT

Introduction

600.1 Firms are required to comply with the fundamental principles, be independent, and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

600.2 Firms and network firms might provide a range of non-assurance services to their audit clients, consistent with their skills and expertise. Providing non-assurance services to audit clients might create threats to compliance with the fundamental principles and threats to independence.

600.3 This section sets out requirements and application material relevant to applying the conceptual framework to identify, evaluate and address threats to independence when providing non-assurance services to audit clients. The subsections that follow set out specific requirements and application material relevant when a firm or network firm provides certain non-assurance services to audit clients and indicate the types of threats that might be created as a result. Some of the subsections include requirements that expressly prohibit a firm or network firm from providing certain services to an audit client in certain circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

General

R600.4 Before a firm or a network firm accepts an engagement to provide a non-assurance service to an audit client, the firm shall determine whether providing such a service might create a threat to independence.

600.4 A1 The requirements and application material in this section assist the firm in analyzing certain types of non-assurance services and the related threats that might be created if a firm or network firm provides non-assurance services to an audit client.

600.4 A2 New business practices, the evolution of financial markets and changes in information technology, are among the developments that make it impossible to draw up an all-inclusive list of non-assurance services that might be provided to an audit client. As a result, the Code does not include an exhaustive list of all non-assurance services that might be provided to an audit client.

Evaluating Threats

600.5 A1 Factors that are relevant in evaluating the level of threats created by providing a non-assurance service to an audit client include:

- The nature, scope and purpose of the service.
- The degree of reliance that will be placed on the outcome of the service as part of the audit.
- The legal and regulatory environment in which the service is provided.
- Whether the outcome of the service will affect matters reflected in the financial statements on which the firm will express an opinion, and, if so:

- The extent to which the outcome of the service will have a material effect on the financial statements.
- The degree of subjectivity involved in determining the appropriate amounts or treatment for those matters reflected in the financial statements.

- The level of expertise of the client's management and employees with respect to the type of service provided.
- The extent of the client's involvement in determining significant matters of judgment.
- The nature and extent of the impact of the service, if any, on the systems that generate information that forms a significant part of the client's:
  - Accounting records or financial statements on which the firm will express an opinion.
  - Internal controls over financial reporting.
- Whether the client is a public interest entity. For example, providing a non-assurance service to an audit client that is a public interest entity might be perceived to result in a higher level of a threat.

600.5 A2 Subsections 601 to 610 include examples of additional factors that are relevant in evaluating the level of threats created by providing the non-assurance services set out in those subsections.

Materiality in Relation to Financial Statements

600.5 A3 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 HKSA 320, *Materiality in Planning and Performing an Audit,* and in relation to a review in HKSRE 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.

Multiple Non-assurance Services Provided to the Same Audit Client

600.5 A4 A firm or network firm might provide multiple non-assurance services to an audit client. In these circumstances the consideration of the combined effect of threats created by providing those services is relevant to the firm's evaluation of threats.

Addressing Threats

600.6 A1 Subsections 601 to 610 include examples of actions, including safeguards, that might address threats to independence created by providing those non-assurance services when threats are not at an acceptable level. Those examples are not exhaustive.

600.6 A2 Some of the subsections include requirements that expressly prohibit a firm or network firm from providing certain services to an audit client in certain circumstances because the threats created cannot be addressed by applying safeguards.

600.6 A3 Paragraph 120.10 A2 includes a description of safeguards. In relation to providing non-assurance services to audit clients, safeguards are actions, individually or in combination, that the firm takes that effectively reduce threats to independence to an acceptable level. In some situations, when a threat is created by providing a non-assurance service to an audit client, safeguards might not be available. In such situations, the application of the conceptual framework set out in Section 120 requires the firm to decline or end the non-assurance service or the audit engagement.

Prohibition on Assuming Management Responsibilities

R600.7 A firm or a network firm shall not assume a management responsibility for an audit client.

600.7 A1 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.

600.7 A2 Providing a non-assurance service to an audit client creates self-review and self-interest threats if the firm or network firm assumes a management responsibility when performing the service. Assuming a management responsibility also creates a familiarity threat and might create an advocacy threat because the firm or network firm becomes too closely aligned with the views and interests of management.

600.7 A3 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 responsibility for:
    - The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
    - Designing, implementing, monitoring or maintaining internal control.

600.7 A4 Providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility. (Ref: Para. R600.7 to 600.7 A3).

R600.8 To avoid assuming a management responsibility when providing any non-assurance service to 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 services. Such an individual, preferably within senior management, would understand:

(i) The objectives, nature and results of the services; 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 services.

(b) Provides oversight of the services and evaluates the adequacy of the results of the service performed for the client's purpose.

(c) Accepts responsibility for the actions, if any, to be taken arising from the results of the services.

Providing Non-Assurance Services to an Audit Client that Later Becomes a Public Interest Entity

R600.9 A non-assurance service provided, either currently or previously, by a firm or a network firm to an audit client compromises the firm's independence when the client becomes a public interest entity unless:

(a) The previous non-assurance service complies with the provisions of this section that relate to audit clients that are not public interest entities;

(b) Non-assurance services currently in progress that are not permitted under this section for audit clients that are public interest entities are ended before, or as soon as practicable after, the client becomes a public interest entity; and

(c) The firm addresses threats that are created that are not at an acceptable level.

Considerations for Certain Related Entities

R600.10 This section includes requirements that prohibit firms and network firms from assuming management responsibilities or providing certain non-assurance services to audit clients. As an exception to those requirements, a firm or network firm may assume management responsibilities or provide certain non-assurance services that would otherwise be prohibited to the following related entities of the client on whose financial statements the firm will express an opinion:

(a) An entity that has direct or indirect control over the client;

(b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; or

(c) An entity which is under common control with the client,

provided that all of the following conditions are met:

(i) The firm or a network firm does not express an opinion on the financial statements of the related entity;

(ii) The firm or a network firm does not assume a management responsibility, directly or indirectly, for the entity on whose financial statements the firm will express an opinion;

(iii) The services do not create a self-review threat because the results of the services will not be subject to audit procedures; and

(iv) The firm addresses other threats created by providing such services that are not at an acceptable level.

SUBSECTION 601 – ACCOUNTING AND BOOKKEEPING SERVICES

Introduction

601.1 Providing accounting and bookkeeping services to an audit client might create a self-review threat.

601.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing an audit client with accounting and bookkeeping services. This subsection includes requirements that prohibit firms and network firms from providing certain accounting and bookkeeping services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

601.3 A1 Accounting and bookkeeping services comprise a broad range of services including:

- Preparing accounting records and financial statements.
- Recording transactions.
- Payroll services.

601.3 A2 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. These responsibilities include:

- Determining accounting policies and the accounting treatment in accordance with those policies.

- Preparing or changing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction. Examples include:
    - Purchase orders.
    - Payroll time records.
    - Customer orders.
- Originating or changing journal entries.
- Determining or approving the account classifications of transactions.

601.3 A3 The audit process necessitates dialogue between the firm and the management of the audit client, which might involve:

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

These 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.

601.3 A4 Similarly, the client might request technical assistance on matters such as resolving account reconciliation problems or analyzing and accumulating information for regulatory reporting. In addition, the client might request technical advice on accounting issues such as the conversion of existing financial statements from one financial reporting framework to another. Examples include:

- Complying with group accounting policies.
- Transitioning to a different financial reporting framework such as Hong Kong Financial Reporting Standards.

Such services do not usually create threats provided neither the firm nor network firm assumes a management responsibility for the client.

Accounting and Bookkeeping Services that are Routine or Mechanical

601.4 A1 Accounting and bookkeeping services that are routine or mechanical in nature require little or no professional judgment. Some examples of these 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.
- 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.

Audit Clients that are Not Public Interest Entities

R601.5 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 created by providing such services that are not at an acceptable level.

601.5 A1 Examples of actions that might be safeguards to address a self-review threat created when providing accounting and bookkeeping services of a routine and mechanical nature to an audit client 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.

Audit Clients that are Public Interest Entities

R601.6 Subject to paragraph R601.7, a firm or a network firm shall not provide to an audit client that is 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.

R601.7 As an exception to paragraph R601.6, a firm or network firm may provide accounting and bookkeeping services 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 audit team members and:

(a) 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

(b) The service relates to matters that are collectively immaterial to the financial statements of the division or related entity.

SUBSECTION 602 – ADMINISTRATIVE SERVICES

Introduction

602.1 Providing administrative services to an audit client does not usually create a threat.

602.2 In addition to the specific application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing administrative services.

Application Material

All Audit Clients

602.3 A1 Administrative services involve assisting clients with their routine or mechanical tasks within the normal course of operations. Such services require little to no professional judgment and are clerical in nature.

602.3 A2 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.

SUBSECTION 603 – VALUATION SERVICES

Introduction

603.1 Providing valuation services to an audit client might create a self-review or advocacy threat.

603.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing valuation services to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain valuation services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

603.3 A1 A valuation comprises the making of assumptions with regard to future developments, the application of appropriate methodologies and techniques, and the combination of both to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.

603.3 A2 If a firm or network firm is requested to perform a valuation to assist an audit client with its tax reporting obligations or for tax planning purposes and the results of the valuation will not have a direct effect on the financial statements, the application material set out in paragraphs 604.9 A1 to 604.9 A5, relating to such services, applies.

603.3 A3 Factors that are relevant in evaluating the level of self-review or advocacy threats created by providing valuation services to an audit client include:

- The use and purpose of the valuation report.
- Whether the valuation report will be made public.
- The extent of the client's involvement in determining and approving the valuation methodology and other significant matters of judgment.

- The degree of subjectivity inherent in the item for valuations involving standard or established methodologies.

- Whether the valuation will have a material effect on the financial statements.

- The extent and clarity of the disclosures related to the valuation in the financial statements.

- The degree of dependence on future events of a nature that might create significant volatility inherent in the amounts involved.

603.3 A4 Examples of actions that might be safeguards to address threats 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 service performed might address a self-review threat.

Audit Clients that are Not Public Interest Entities

R603.4 A firm or a network firm shall not provide a valuation service to an audit client that is not a public interest entity if:

(a) The valuation involves a significant degree of subjectivity; and

(b) The valuation will have a material effect on the financial statements on which the firm will express an opinion.

603.4 A1 Certain valuations do not involve a significant degree of subjectivity. This is likely to be the case when the underlying assumptions are either established by law or regulation, or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.

Audit Clients that are Public Interest Entities

R603.5 A firm or a network firm shall not provide a valuation service to an audit client that is a public interest entity if the valuation service would have a material effect, individually or in the aggregate, on the financial statements on which the firm will express an opinion.

SUBSECTION 604 – TAX SERVICES

Introduction

604.1 Providing tax services to an audit client might create a self-review or advocacy threat.

604.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing a tax service to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain tax services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

604.3 A1 Tax services comprise a broad range of services, including activities such as:

- Tax return preparation.
- Tax calculations for the purpose of preparing the accounting entries.
- Tax planning and other tax advisory services.
- Tax services involving valuations.
- Assistance in the resolution of tax disputes.

While this subsection deals with each type of tax service listed above under separate headings, in practice, the activities involved in providing tax services are often inter-related.

604.3 A2 Factors that are relevant in evaluating the level of threats created by providing any tax service to an audit client include:

- 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.

Tax Return Preparation

All Audit Clients

604.4 A1 Providing tax return preparation services does not usually create a threat.

604.4 A2 Tax return preparation services involve:

- 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 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).

604.4 A3 Tax return preparation services are usually 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 considers appropriate.

Tax Calculations for the Purpose of Preparing Accounting Entries

All Audit Clients

604.5 A1 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.

604.5 A2 In addition to the factors in paragraph 604.3 A2, a factor that is relevant in evaluating the level of the 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.

Audit Clients that are Not Public Interest Entities

604.5 A3 Examples of actions that might be safeguards to address such a self-review threat when the audit client is not a public interest entity 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.

Audit Clients that are Public Interest Entities

R604.6 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 for the purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion.

604.6 A1 The examples of actions that might be safeguards in paragraph 604.5 A3 to address self-review threats are also applicable when preparing tax calculations of current and deferred tax liabilities (or assets) to an audit client that is a public interest entity that are immaterial to the financial statements on which the firm will express an opinion.

Tax Planning and Other Tax Advisory Services

All Audit Clients

604.7 A1 Providing tax planning and other tax advisory services might create a self-review or advocacy threat.

604.7 A2 Tax planning or other tax advisory services comprise a broad range of services, such as advising the client how to structure its affairs in a tax efficient manner or advising on the application of a new tax law or regulation.

604.7 A3 In addition to paragraph 604.3 A2, factors that are relevant in evaluating the level of self-review or advocacy threats created by providing tax planning and other tax advisory services to audit clients 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 private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.

For example, whether the advice provided as a result of the tax planning and other tax advisory services:

- Is clearly supported by a tax authority or other precedent.
- Is an established practice.
- Has a basis in tax law that is likely to prevail.

- 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.

604.7 A4 Examples of actions that might be safeguards to address such threats 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 service performed might address a self-review threat.
- Obtaining pre-clearance from the tax authorities might address self-review or advocacy threats.

When Effectiveness of Tax Advice Is Dependent on a Particular Accounting Treatment or Presentation

R604.8 A firm or a network firm shall not provide tax planning and other tax advisory 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:

(a) The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and

(b) The outcome or consequences of the tax advice will have a material effect on the financial statements on which the firm will express an opinion.

Tax Services Involving Valuations

All Audit Clients

604.9 A1 Providing tax valuation services to an audit client might create a self-review or advocacy threat.

604.9 A2 A firm or a network firm might perform a valuation for tax purposes only, where the result of the valuation will not have a direct effect on the financial statements (that is, the financial statements are only affected through accounting entries related to tax). This would not usually create threats if the effect on the financial statements is immaterial or the valuation is subject to external review by a tax authority or similar regulatory authority.

604.9 A3 If the valuation that is performed for tax purposes is not subject to an external review and the effect is material to the financial statements, in addition to paragraph 604.3 A2, the following factors are relevant in evaluating the level of self-review or advocacy threats created by providing those services to an audit client:

- The extent to which the valuation methodology is supported by tax law or regulation, other precedent or established practice.
- The degree of subjectivity inherent in the valuation.
- The reliability and extent of the underlying data.

604.9 A4 Examples of actions that might be safeguards to address threats 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 service performed might address a self-review threat.
- Obtaining pre-clearance from the tax authorities might address self-review or advocacy threats.

604.9 A5 A firm or network firm might also perform a tax valuation to assist an audit client with its tax reporting obligations or for tax planning purposes where the result of the valuation will have a direct effect on the financial statements. In such situations, the requirements and application material set out in Subsection 603 relating to valuation services apply.

Assistance in the Resolution of Tax Disputes

All Audit Clients

604.10 A1 Providing assistance in the resolution of tax disputes to an audit client might create a self-review or advocacy threat.

604.10 A2 A tax dispute might reach a point when the tax authorities have notified an audit 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, for example, before a public tribunal or court.

604.10 A3 In addition to paragraph 604.3 A2, factors that are relevant in evaluating the level of self-review or advocacy threats created by assisting an audit client in the resolution of tax disputes 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 advice that was provided 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.

604.10 A4 Examples of actions that might be safeguards to address threats 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.

Resolution of Tax Matters Involving Acting as An Advocate

R604.11 A firm or a network firm shall not provide tax services that involve assisting in the resolution of tax disputes to an audit client if:

(a) The services involve acting as an advocate for the audit client before a public tribunal or court in the resolution of a tax matter; and

(b) The amounts involved are material to the financial statements on which the firm will express an opinion.

604.11 A1 Paragraph R604.11 does not preclude a firm or network firm from having a continuing advisory role in relation to the matter that is being heard before a public tribunal or court, for example:

- Responding to specific requests for information.
- Providing factual accounts or testimony about the work performed.
- Assisting the client in analyzing the tax issues related to the matter.

604.11 A2 What constitutes a "public tribunal or court" depends on how tax proceedings are heard in the particular jurisdiction.

SUBSECTION 605 – INTERNAL AUDIT SERVICES

Introduction

605.1 Providing internal audit services to an audit client might create a self-review threat.

605.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing an internal audit service to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain internal audit services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

605.3 A1 Internal audit services involve assisting the audit client in the performance of its internal audit activities. Internal audit activities might include:

- 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.

605.3 A2 The scope and objectives of internal audit activities vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance.

R605.4 When providing an internal audit service to an audit client, the firm shall be satisfied that:

(a) The client designates an appropriate and competent resource, preferably within senior management, to:

(i) Be responsible at all times for internal audit activities; and

(ii) Acknowledge responsibility for designing, implementing, monitoring and maintaining internal control.

(b) The client's management or those charged with governance reviews, assesses and approves the scope, risk and frequency of the internal audit services;

(c) The client's management evaluates the adequacy of the internal audit services and the findings resulting from their performance;

(d) The client's management evaluates and determines which recommendations resulting from internal audit services to implement and manages the implementation process; and

(e) The client's management reports to those charged with governance the significant findings and recommendations resulting from the internal audit services.

605.4 A1 Paragraph R600.7 precludes a firm or a network firm from assuming a management responsibility. Performing a significant part of the client's internal audit activities increases the possibility that firm or network firm personnel providing internal audit services will assume a management responsibility.

605.4 A2 Examples of internal audit services that involve assuming management responsibilities include:

- Setting internal audit policies or the strategic direction of internal audit activities.

- Directing and taking responsibility for the actions of the entity's internal audit employees.
- Deciding which recommendations resulting from internal audit activities to implement.
- Reporting the results of the internal audit activities to those charged with governance on behalf of management.
- Performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges.
- Taking responsibility for designing, implementing, monitoring and maintaining internal control.
- Performing outsourced internal audit services, comprising all or a substantial portion of the internal audit function, where the firm or network firm is responsible for determining the scope of the internal audit work; and might have responsibility for one or more of the matters noted above.

605.4 A3 When a firm uses the work of an internal audit function in an audit engagement, HKSAs require the performance of procedures to evaluate the adequacy of that work. Similarly, when a firm or 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 creates 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.

605.4 A4 Factors that are relevant in evaluating the level of such a self-review threat include:

- 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, including in the course of an external audit.

605.4 A5 An example of an action that might be a safeguard to address such a self-review threat is using professionals who are not audit team members to perform the service.

Audit Clients that are Public Interest Entities

R605.5 A firm or a network firm shall not provide internal audit services to an audit client that is a public interest entity, if the services relate to:

(a) A significant part of the internal controls over financial reporting;

(b) Financial accounting systems that generate information that is, individually or in the aggregate, material to the client's accounting records or financial statements on which the firm will express an opinion; or

(c) Amounts or disclosures that are, individually or in the aggregate, material to the financial statements on which the firm will express an opinion.

SUBSECTION 606 – INFORMATION TECHNOLOGY SYSTEMS SERVICES

Introduction

606.1 Providing information technology (IT) systems services to an audit client might create a self-review threat.

606.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing an IT systems service to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain IT systems services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

606.3 A1 Services related to IT systems include the design or implementation of hardware or software systems. The IT systems might:

(a) Aggregate source data;

(b) Form part of the internal control over financial reporting; or

(c) Generate information that affects the accounting records or financial statements, including related disclosures.

However, the IT systems might also involve matters that are unrelated to the audit client's accounting records or the internal control over financial reporting or financial statements.

606.3 A2 Paragraph R600.7 precludes a firm or a network firm from assuming a management responsibility. Providing the following IT systems services to an audit client does not usually create a threat as long as personnel of the firm or network firm do not assume a management responsibility:

(a) Designing or implementing IT systems that are unrelated to internal control over financial reporting;

(b) Designing or implementing IT systems that do not generate information forming a significant part of the accounting records or financial statements;

(c) Implementing "off-the-shelf" accounting or financial information reporting software that was not developed by the firm or network firm, if the customization required to meet the client's needs is not significant; and

(d) Evaluating and making recommendations with respect to an IT system designed, implemented or operated by another service provider or the client.

R606.4 When providing IT systems services to an audit client, the firm or network firm shall be satisfied that:

(a) The client acknowledges its responsibility for establishing and monitoring a system of internal controls;

(b) The client assigns the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system to a competent employee, preferably within senior management;

(c) The client makes all management decisions with respect to the design and implementation process;

(d) The client evaluates the adequacy and results of the design and implementation of the system; and

(e) The client is responsible for operating the system (hardware or software) and for the data it uses or generates.

606.4 A1 Factors that are relevant in evaluating the level of a self-review threat created by providing IT systems services to an audit client include:

- The nature of the service.
- The nature of IT systems and the extent to which they impact or interact with the client's accounting records or financial statements.
- The degree of reliance that will be placed on the particular IT systems as part of the audit.

606.4 A2 An example of an action that might be a safeguard to address such a self-review threat is using professionals who are not audit team members to perform the service.

Audit Clients that are Public Interest Entities

R606.5 A firm or a network firm shall not provide IT systems services to an audit client that is a public interest entity if the services involve designing or implementing IT systems that:

(a) Form a significant part of the internal control over financial reporting; or

(b) Generate information that is significant to the client's accounting records or financial statements on which the firm will express an opinion.

SUBSECTION 607 – LITIGATION SUPPORT SERVICES

Introduction

607.1 Providing certain litigation support services to an audit client might create a self-review or advocacy threat.

607.2 In addition to the specific application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing a litigation support service to an audit client.

Application Material

All Audit Clients

607.3 A1 Litigation support services might include activities such as:

- Assisting with document management and retrieval.
- Acting as a witness, including an expert witness.
- Calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute.

607.3 A2 Factors that are relevant in evaluating the level of self-review or advocacy threats created by providing litigation support services to an audit client include:

- The legal and regulatory environment in which the service is provided, for example, whether an expert witness is chosen and appointed by a court.
- The nature and characteristics of the service.
- The extent to which the outcome of the litigation support service will have a material effect on the financial statements on which the firm will express an opinion.

607.3 A3 An example of an action that might be a safeguard to address such a self-review or advocacy threat is using a professional who was not an audit team member to perform the service.

607.3 A4 If a firm or a network firm provides a litigation support service to an audit client and the service involves estimating damages or other amounts that affect the financial statements on which the firm will express an opinion, the requirements and application material set out in Subsection 603 related to valuation services apply.

SUBSECTION 608 – LEGAL SERVICES

Introduction

608.1 Providing legal services to an audit client might create a self-review or advocacy threat.

608.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing a legal service to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain legal services to audit clients in some circumstances because the threats cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

608.3 A1 Legal services are defined as any services for which the individual providing the services must either:

(a) Have the required legal training to practice law; or

(b) Be admitted to practice law before the courts of the jurisdiction in which such services are to be provided.

Acting in an Advisory Role

608.4 A1 Depending on the jurisdiction, legal advisory services might include a wide and diversified range of service areas including both corporate and commercial services to audit clients, such as:

- Contract support.
- Supporting an audit client in executing a transaction.
- Mergers and acquisitions.
- Supporting and assisting an audit client's internal legal department.
- Legal due diligence and restructuring.

608.4 A2 Factors that are relevant in evaluating the level of self-review or advocacy threats created by providing legal advisory services to an audit client include:

- The materiality of the specific matter in relation to the client's financial statements.
- The complexity of the legal matter and the degree of judgment necessary to provide the service.

608.4 A3 Examples of actions that might be safeguards to address threats include:

- Using professionals who are not audit team members to perform the service might address a self-review or advocacy threat.
- 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.

Acting as General Counsel

R608.5 A partner or employee of the firm or the network firm shall not serve as General Counsel for legal affairs of an audit client.

608.5 A1 The position of General Counsel is usually a senior management position with broad responsibility for the legal affairs of a company.

Acting in an Advocacy Role

R608.6 A firm or a network firm shall not act in an advocacy role for an audit client in resolving a dispute or litigation when the amounts involved are material to the financial statements on which the firm will express an opinion.

608.6 A1 Examples of actions that might be safeguards to address a self-review threat created when acting in an advocacy role for an audit client when the amounts involved are not material to the financial statements on which the firm will express an opinion 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 the service performed.

SUBSECTION 609 – RECRUITING SERVICES

Introduction

609.1 Providing recruiting services to an audit client might create a self-interest, familiarity or intimidation threat.

609.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing a recruiting service to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain types of recruiting services to audit clients in some circumstances because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

609.3 A1 Recruiting services might include activities such as:

- Developing a job description.
- Developing a process for identifying and selecting potential candidates.
- Searching for or seeking out candidates.
- Screening potential candidates for the role by:
  - Reviewing the professional qualifications or competence of applicants and determining their suitability for the position.
  - Undertaking reference checks of prospective candidates.
  - Interviewing and selecting suitable candidates and advising on candidates' competence.
- Determining employment terms and negotiating details, such as salary, hours and other compensation.

609.3 A2 Paragraph R600.7 precludes a firm or a network firm from assuming a management responsibility. Providing the following services does not usually create a threat as long as personnel of the firm or network firm does not assume a management responsibility:

- Reviewing the professional qualifications of a number of applicants and providing advice on their suitability for the position.
- Interviewing candidates and advising on a candidate's competence for financial accounting, administrative or control positions.

R609.4 When a firm or network firm provides recruiting services to an audit client, the firm shall be satisfied that:

(a) The client assigns the responsibility to make all management decisions with respect to hiring the candidate for the position to a competent employee, preferably within senior management; and

(b) The client makes all management decisions with respect to the hiring process, including:

- Determining the suitability of prospective candidates and selecting suitable candidates for the position.
- Determining employment terms and negotiating details, such as salary, hours and other compensation.

609.5 A1 Factors that are relevant in evaluating the level of self-interest, familiarity or intimidation threats created by providing recruiting services to an audit client include:

- The nature of the requested assistance.
- The role of the individual to be recruited.
- Any conflicts of interest or relationships that might exist between the candidates and the firm providing the advice or service.

609.5 A2 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is using professionals who are not audit team members to perform the service.

Recruiting Services that are Prohibited

R609.6 When providing recruiting services to an audit client, the firm or the network firm shall not act as a negotiator on the client's behalf.

R609.7 A firm or a network firm shall not provide a recruiting service to an audit client if the service relates to:

(a) Searching for or seeking out candidates; or

(b) Undertaking reference checks of prospective candidates,

with respect to the following positions:

(i) A director or officer of the entity; or

(ii) A member of senior management in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

SUBSECTION 610 – CORPORATE FINANCE SERVICES

Introduction

610.1 Providing corporate finance services to an audit client might create a self-review or advocacy threat.

610.2 In addition to the specific requirements and application material in this subsection, the requirements and application material in paragraphs 600.1 to R600.10 are relevant to applying the conceptual framework when providing a corporate finance service to an audit client. This subsection includes requirements that prohibit firms and network firms from providing certain corporate finance services in some circumstances to audit clients because the threats created cannot be addressed by applying safeguards.

Requirements and Application Material

All Audit Clients

610.3 A1 Examples of corporate finance services that might create a self-review or advocacy threat include:

- Assisting an audit client in developing corporate strategies.
- Identifying possible targets for the audit client to acquire.
- Advising on disposal transactions.
- Assisting in finance raising transactions.
- Providing structuring advice.
- Providing advice on the structuring of a corporate finance transaction or on financing arrangements that will directly affect amounts that will be reported in the financial statements on which the firm will express an opinion.

610.3 A2 Factors that are relevant in evaluating the level of such threats created by providing corporate finance services to an audit client include:

- The degree of subjectivity involved in determining the appropriate treatment for the outcome or consequences of the corporate finance advice in the financial statements.
- The extent to which:
    - The outcome of the corporate finance advice will directly affect amounts recorded in the financial statements.
    - The amounts are material to the financial statements.

- Whether the effectiveness of the corporate finance advice depends on a particular accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.

610.3 A3 Examples of actions that might be safeguards to address threats 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 service performed might address a self-review threat.

Corporate Finance Services that are Prohibited

R610.4 A firm or a network firm shall not provide corporate finance services to an audit client that involve promoting, dealing in, or underwriting the audit client's shares.

R610.5 A firm or a network firm shall not provide corporate finance advice to an audit client where the effectiveness of such advice depends on a particular accounting treatment or presentation in the financial statements on which the firm will express an opinion and:

(a) The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and

(b) The outcome or consequences of the corporate finance advice will have a material effect on the financial statements on which the firm will express an opinion.

SECTION 800

REPORTS ON SPECIAL PURPOSE FINANCIAL STATEMENTS THAT INCLUDE A RESTRICTION ON USE AND DISTRIBUTION (AUDIT AND REVIEW ENGAGEMENTS)

Introduction

800.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

800.2 This section sets out certain modifications to Part 4A which are permitted in certain circumstances involving audits of special purpose financial statements where the report includes a restriction on use and distribution. In this section, an engagement to issue a restricted use and distribution report in the circumstances set out in paragraph R800.3 is referred to as an "eligible audit engagement."

Requirements and Application Material

General

R800.3 When a firm intends to issue a report on an audit of special purpose financial statements which includes a restriction on use and distribution, the independence requirements set out in Part 4A shall be eligible for the modifications that are permitted by this section, but only if:

(a) The firm communicates with the intended users of the report regarding the modified independence requirements that are to be applied in providing the service; and

(b) The intended users of the report understand the purpose and limitations of the report and explicitly agree to the application of the modifications.

800.3 A1 The intended users of the report might obtain an understanding of the purpose and limitations of the report by participating, either directly, or indirectly through a representative who has authority to act for the intended users, in establishing the nature and scope of the engagement. In either case, this participation helps the

firm to communicate with intended users about independence matters, including the circumstances that are relevant to applying the conceptual framework. It also allows the firm to obtain the agreement of the intended users to the modified independence requirements.

R800.4 Where the intended users are a class of users who are not specifically identifiable by name at the time the engagement terms are established, the firm shall subsequently make such users aware of the modified independence requirements agreed to by their representative.

800.4 A1 For example, where the intended users are a class of users such as lenders in a syndicated loan arrangement, the firm might describe the modified independence requirements in an engagement letter to the representative of the lenders. The representative might then make the firm's engagement letter available to the members of the group of lenders to meet the requirement for the firm to make such users aware of the modified independence requirements agreed to by the representative.

R800.5 When the firm performs an eligible audit engagement, any modifications to Part 4A shall be limited to those set out in paragraphs R800.7 to R800.14. The firm shall not apply these modifications when an audit of financial statements is required by law or regulation.

R800.6 If the firm also issues an audit report that does not include a restriction on use and distribution for the same client, the firm shall apply Part 4A to that audit engagement.

Public Interest Entities

R800.7 When the firm performs an eligible audit engagement, the firm does not need to apply the independence requirements set out in Part 4A that apply only to public interest entity audit engagements.

Related Entities

R800.8 When the firm performs an eligible audit engagement, references to "audit client" in Part 4A do not need to include its related entities. However, when the audit team knows or has reason to believe that a relationship or circumstance involving a related entity of the client is relevant to the evaluation of the firm's independence of the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence.

Networks and Network Firms

R800.9 When the firm performs an eligible audit engagement, the specific requirements regarding network firms set out in Part 4A do not need to be applied. However, when the firm knows or has reason to believe that threats to independence are created by any interests and relationships of a network firm, the firm shall evaluate and address any such threat.

Financial Interests, Loans and Guarantees, Close Business Relationships, and Family and Personal Relationships

R800.10 When the firm performs an eligible audit engagement:

(a) The relevant provisions set out in Sections 510, 511, 520, 521, 522, 524 and 525 need apply only to the members of the engagement team, their immediate family members and, where applicable, close family members;

(b) The firm shall identify, evaluate and address any threats to independence created by interests and relationships, as set out in Sections 510, 511, 520, 521, 522, 524 and 525, between the audit client and the following audit team members:

(i) Those who provide consultation regarding technical or industry specific issues, transactions or events; and

(ii) Those who provide quality control for the engagement, including those who perform the engagement quality control review; and

(c) The firm shall evaluate and address any threats that the engagement team has reason to believe are created by interests and relationships between the audit client and others within the firm who can directly influence the outcome of the audit engagement.

800.10 A1 Others within a firm who can directly influence the outcome of the audit engagement include those who recommend the compensation, or who provide direct supervisory, management or other oversight, of the audit engagement partner in connection with the performance of the audit engagement including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent).

R800.11 When the firm performs an eligible audit engagement, the firm shall evaluate and address any threats that the engagement team has reason to believe are created by financial interests in the audit client held by individuals, as set out in paragraphs R510.4(c) and (d), R510.5, R510.7 and 510.10 A5 and A9.

R800.12 When the firm performs an eligible audit engagement, the firm, in applying the provisions set out in paragraphs R510.4(a), R510.6 and R510.7 to interests of the firm, shall not hold a material direct or a material indirect financial interest in the audit client.

Employment with an Audit Client

R800.13 When the firm performs an eligible audit engagement, the firm shall evaluate and address any threats created by any employment relationships as set out in paragraphs 524.3 A1 to 524.5 A3.

Providing Non-Assurance Services

R800.14 If the firm performs an eligible audit engagement and provides a non-assurance service to the audit client, the firm shall comply with Sections 410 to 430 and Section 600, including its subsections, subject to paragraphs R800.7 to R800.9.

PART 4B – INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

PART 4B – INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

SECTION 900

APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

Introduction

General

900.1 This Part applies to assurance engagements other than audit and review engagements (referred to as "assurance engagements" in this Part). Examples of such engagements include:

- An audit of specific elements, accounts or items of a financial statement.
- Performance assurance on a company's key performance indicators.

900.2 In this Part, the term "professional accountant" refers to individual professional accountants in public practice and their firms.

900.3 HKSQC 1 requires a firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements maintain independence where required by relevant ethics standards. HKSAEs establish responsibilities for engagement partners and engagement teams at the level of the engagement. The allocation of responsibilities within a firm will depend on its size, structure and organization. Many of the provisions of Part 4B do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to "firm" for ease of reference. Firms assign responsibility for a particular action to an individual or a group of individuals (such as an assurance team) in accordance with HKSQC 1. In addition, an individual professional accountant remains responsible for compliance with any provisions that apply to that accountant's activities, interests or relationships.

900.4 Independence is linked to the principles of objectivity and integrity. It comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an assurance team member's integrity, objectivity or professional skepticism has been compromised.

In this Part, references to an individual or firm being "independent" mean that the individual or firm has complied with the provisions of this Part.

900.5 When performing assurance engagements, the Code requires firms to comply with the fundamental principles and be independent. This Part sets out specific requirements and application material on how to apply the conceptual framework to maintain independence when performing such engagements. The conceptual framework set out in Section 120 applies to independence as it does to the fundamental principles set out in Section 110.

900.6 This Part describes:

(a) Facts and circumstances, including professional activities, interests and relationships, that create or might create threats to independence;

(b) Potential actions, including safeguards, that might be appropriate to address any such threats; and

(c) Some situations where the threats cannot be eliminated or there can be no safeguards to reduce the threats to an acceptable level.

Description of Other Assurance Engagements

900.7 Assurance engagements are designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria. In an assurance engagement, the firm expresses a conclusion designed to enhance the degree of confidence of the intended users (other than the responsible party) about the outcome of the evaluation or measurement of a subject matter against criteria. The Assurance Framework describes the elements and objectives of an assurance engagement and identifies engagements to which HKSAEs apply. For a description of the elements and objectives of an assurance engagement, refer to the Assurance Framework.

900.8 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term "subject matter information" is used to mean the outcome of the evaluation or measurement of a subject matter. For example, the Assurance Framework states that an assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO or CoCo (criteria), to internal control, a process (subject matter).

900.9 Assurance engagements might be assertion-based or direct reporting. In either case, they involve three separate parties: a firm, a responsible party and intended users.

900.10 In an assertion-based assurance engagement, the evaluation or measurement of the subject matter is performed by the responsible party. The subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.

900.11 In a direct reporting assurance engagement, the firm:

(a) Directly performs the evaluation or measurement of the subject matter; or

(b) Obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

Reports that Include a Restriction on Use and Distribution

900.12 An assurance report might include a restriction on use and distribution. If it does and the conditions set out in Section 990 are met, then the independence requirements in this Part may be modified as provided in Section 990.

Audit and Review Engagements

900.13 Independence standards for audit and review engagements are set out in Part 4A – *Independence for Audit and Review Engagements*. If a firm performs both an assurance engagement and an audit or review engagement for the same client, the requirements in Part 4A continue to apply to the firm, a network firm and the audit or review team members.

Requirements and Application Material

General

R900.14 A firm performing an assurance engagement shall be independent.

R900.15 A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an assurance engagement.

Network firms

R900.16 When a firm has reason to believe that interests and relationships of a network firm create a threat to the firm's independence, the firm shall evaluate and address any such threat.

900.16 A1 Network firms are discussed in paragraphs 400.50 A1 to 400.54 A1.

Related Entities

R900.17 When the assurance team knows or has reason to believe that a relationship or circumstance involving a related entity of the assurance client is relevant to the evaluation of the firm's independence from the client, the assurance team shall include that related entity when identifying, evaluating and addressing threats to independence.

Types of Assurance Engagements

Assertion-based Assurance Engagements

R900.18 When performing an assertion-based assurance engagement:

(a) The assurance team members and the firm shall be independent of the assurance client (the party responsible for the subject matter information, and which might be responsible for the subject matter) as set out in this Part. The independence requirements set out in this Part prohibit certain relationships between assurance team members and (i) directors or officers, and (ii) individuals at the client in a position to exert significant influence over the subject matter information;

(b) The firm shall apply the conceptual framework set out in Section 120 to relationships with individuals at the client in a position to exert significant influence over the subject matter of the engagement; and

(c) The firm shall evaluate and address any threats that the firm has reason to believe are created by network firm interests and relationships.

R900.19 When performing an assertion-based assurance engagement where the responsible party is responsible for the subject matter information but not the subject matter:

(a) The assurance team members and the firm shall be independent of the party responsible for the subject matter information (the assurance client); and

(b) The firm shall evaluate and address any threats the firm has reason to believe are created by interests and relationships between an assurance team member, the firm, a network firm and the party responsible for the subject matter.

900.19 A1 In the majority of assertion-based assurance engagements, the responsible party is responsible for both the subject matter information and the subject matter. However, in some engagements, the responsible party might not be responsible for the subject matter. An example might be when a firm is engaged to perform an assurance engagement regarding a report that an environmental consultant has prepared about a company's sustainability practices for distribution to intended users. In this case, the environmental consultant is the responsible party for the subject matter information but the company is responsible for the subject matter (the sustainability practices).

Direct Reporting Assurance Engagements

R900.20 When performing a direct reporting assurance engagement:

(a) The assurance team members and the firm shall be independent of the assurance client (the party responsible for the subject matter); and

(b) The firm shall evaluate and address any threats to independence the firm has reason to believe are created by network firm interests and relationships.

Multiple Responsible Parties

900.21 A1 In some assurance engagements, whether assertion-based or direct reporting, there might be several responsible parties. In determining whether it is necessary to apply the provisions in this Part to each responsible party in such engagements, the firm may take into account certain matters. These matters include whether an interest or relationship between the firm, or an assurance team member, and a particular responsible party would create a threat to independence that is not trivial and inconsequential in the context of the subject matter information. This determination will take into account factors such as:

(a) The materiality of the subject matter information (or of the subject matter) for which the particular responsible party is responsible.

(b) The degree of public interest associated with the engagement.

If the firm determines that the threat created by any such interest or relationship with a particular responsible party would be trivial and inconsequential, it might not be necessary to apply all of the provisions of this section to that responsible party.

[Paragraphs 900.22 to 900.29 are intentionally left blank]

Period During which Independence is Required

R900.30 Independence, as required by this Part, shall be maintained during both:

(a) The engagement period; and

(b) The period covered by the subject matter information.

900.30 A1 The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final assurance report.

R900.31 If an entity becomes an assurance client during or after the period covered by the subject matter information on which the firm will express a conclusion, the firm shall determine whether any threats to independence are created by:

(a) Financial or business relationships with the assurance client during or after the period covered by the subject matter information but before accepting the assurance engagement; or

(b) Previous services provided to the assurance client.

R900.32 Threats to independence are created if a non-assurance service was provided to the assurance client during, or after the period covered by the subject matter information, but before the assurance team begins to perform assurance services, and the service would not be permitted during the engagement period. In such circumstances, the firm shall evaluate and address any threat to independence created by the service. If the threats are not at an acceptable level, the firm shall only accept the assurance engagement if the threats are reduced to an acceptable level.

900.32 A1 Examples of actions that might be safeguards to address such threats include:

- Using professionals who are not assurance team members to perform the service.
- Having an appropriate reviewer review the assurance and non-assurance work as appropriate.

R900.33 If a non-assurance service that would not be permitted during the engagement period has not been completed and it is not practical to complete or end the service before the commencement of professional services in connection with the assurance engagement, the firm shall only accept the assurance engagement if:

(a) The firm is satisfied that:

(i) The non-assurance service will be completed within a short period of time; or

(ii) The client has arrangements in place to transition the service to another provider within a short period of time;

(b) The firm applies safeguards when necessary during the service period; and

(c) The firm discusses the matter with those charged with governance.

[Paragraphs 900.34 to 900.39 are intentionally left blank]

General Documentation of Independence for Assurance Engagements Other than Audit and Review Engagements

R900.40 A firm shall document conclusions regarding compliance with this Part, and the substance of any relevant discussions that support those conclusions. In particular:

(a) When safeguards are applied to address a threat, the firm shall document the nature of the threat and the safeguards in place or applied; and

(b) When a threat required significant analysis and the firm concluded that the threat was already at an acceptable level, the firm shall document the nature of the threat and the rationale for the conclusion.

900.40 A1 Documentation provides evidence of the firm's judgments in forming conclusions regarding compliance with this Part. However, a lack of documentation does not determine whether a firm considered a particular matter or whether the firm is independent.

[Paragraphs 900.41 to 900.49 are intentionally left blank]

Breach of an Independence Provision for Assurance Engagements Other than Audit and Review Engagements

When a Firm Identifies a Breach

R900.50 If a firm concludes that a breach of a requirement in this Part has occurred, the firm shall:

(a) End, suspend or eliminate the interest or relationship that created the breach;

(b) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an assurance report; and

(c) Determine whether action can be taken that satisfactorily addresses the consequences of the breach.

In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party would be likely to conclude that the firm's objectivity would be compromised, and therefore, the firm would be unable to issue an assurance report.

R900.51 If the firm determines that action cannot be taken to address the consequences of the breach satisfactorily, the firm shall, as soon as possible, inform the party that engaged the firm or those charged with governance, as appropriate. The firm shall also take the steps necessary to end the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to ending the assurance engagement.

R900.52 If the firm determines that action can be taken to address the consequences of the breach satisfactorily, the firm shall discuss the breach and the action it has taken or proposes to take with the party that engaged the firm or those charged with governance, as appropriate. The firm shall discuss the breach and the proposed action on a timely basis, taking into account the circumstances of the engagement and the breach.

R900.53 If the party that engaged the firm does not, or those charged with governance do not concur that the action proposed by the firm in accordance with paragraph R900.50(c) satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to end the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to ending the assurance engagement

Documentation

R900.54 In complying with the requirements in paragraphs R900.50 to R900.53, the firm shall document:

(a) The breach;

(b) The actions taken;

(c) The key decisions made; and

(d) All the matters discussed with the party that engaged the firm or those charged with governance.

R900.55 If the firm continues with the assurance engagement, it shall document:

(a) The conclusion that, in the firm's professional judgment, objectivity has not been compromised; and

(b) The rationale for why the action taken satisfactorily addressed the consequences of the breach so that the firm could issue an assurance report.

SECTION 905

FEES

Introduction

905.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

905.2 The nature and level of fees or other types of remuneration might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Fees—Relative Size

905.3 A1 When the total fees generated from an assurance client by the firm expressing the conclusion in an assurance engagement represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client create a self-interest or intimidation threat.

905.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The operating structure of the firm.
- Whether the firm is well established or new.
- The significance of the client qualitatively and/or quantitatively to the firm.

905.3 A3 An example of an action that might be a safeguard to address such a self-interest or intimidation threat is increasing the client base in the firm to reduce dependence on the assurance client.

905.3 A4 A self-interest or intimidation threat is also created when the fees generated by the firm from an assurance client represent a large proportion of the revenue from an individual partner's clients.

905.3 A5 Examples of actions that might be safeguards to address such a self-interest or intimidation threat include:

- Increasing the client base of the partner to reduce dependence on the assurance client.
- Having an appropriate reviewer who was not an assurance team member review the work.

Fees—Overdue

905.4 A1 A self-interest threat might be created if a significant part of fees is not paid before the assurance report, if any, for the following period is issued. It is generally expected that the firm will require payment of such fees before any such report is issued. The requirements and application material set out in Section 911 with respect to loans and guarantees might also apply to situations where such unpaid fees exist.

905.4 A2 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining partial payment of overdue fees.
- Having an appropriate reviewer who did not take part in the assurance engagement review the work performed.

R905.5 When a significant part of fees due from an assurance client remains unpaid for a long time, the firm shall determine:

(a) Whether the overdue fees might be equivalent to a loan to the client; and

(b) Whether it is appropriate for the firm to be re-appointed or continue the assurance engagement.

Contingent Fees

905.6 A1 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed. A contingent fee charged through an intermediary is an example of an indirect contingent fee. In this section, a fee is not regarded as being contingent if established by a court or other public authority.

R905.7 A firm shall not charge directly or indirectly a contingent fee for an assurance engagement.

R905.8 A firm shall not charge directly or indirectly a contingent fee for a non-assurance service provided to an assurance client if the outcome of the non-assurance service, and therefore, the amount of the fee, is dependent on a future or contemporary judgment related to a matter that is material to the subject matter information of the assurance engagement.

905.9 A1 Paragraphs R905.7 and R905.8 preclude a firm from entering into certain contingent fee arrangements with an assurance client. Even if a contingent fee arrangement is not precluded when providing a non-assurance service to an assurance client, a self-interest threat might still be created.

905.9 A2 Factors that are relevant in evaluating the level of such a threat include:

- The range of possible fee amounts.
- Whether an appropriate authority determines the outcome on which the contingent fee depends.
- Disclosure to intended users of the work performed by the firm and the basis of remuneration.
- The nature of the service.
- The effect of the event or transaction on the subject matter information.

905.9 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the relevant assurance work.

- Obtaining an advance written agreement with the client on the basis of remuneration.

SECTION 906

GIFTS AND HOSPITALITY

Introduction

906.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

906.2 Accepting gifts and hospitality from an assurance client might create a self-interest, familiarity or intimidation threat. This section sets out a specific requirement and application material relevant to applying the conceptual framework in such circumstances.

Requirement and Application Material

R906.3 A firm or an assurance team member shall not accept gifts and hospitality from an assurance client, unless the value is trivial and inconsequential.

906.3 A1 Where a firm or assurance team member is offering or accepting an inducement to or from an assurance client, the requirements and application material set out in Section 340 apply and non-compliance with these requirements might create threats to independence.

906.3 A2 The requirements set out in Section 340 relating to offering or accepting inducements do not allow a firm or assurance team member to accept gifts and hospitality where the intent is to improperly influence behavior even if the value is trivial and inconsequential.

SECTION 907

ACTUAL OR THREATENED LITIGATION

Introduction

907.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

907.2 When litigation with an assurance client occurs, or appears likely, self-interest and intimidation threats are created. This section sets out specific application material relevant to applying the conceptual framework in such circumstances.

Application Material

General

907.3 A1 The relationship between client management and assurance team members must be characterized by complete candor and full disclosure regarding all aspects of a client's operations. Adversarial positions might result from actual or threatened litigation between an assurance client and the firm or an assurance team member. Such adversarial positions might affect management's willingness to make complete disclosures and create self-interest and intimidation threats.

907.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The materiality of the litigation.
- Whether the litigation relates to a prior assurance engagement.

907.3 A3 If the litigation involves an assurance team member, an example of an action that might eliminate such self-interest and intimidation threats is removing that individual from the assurance team.

907.3 A4 An example of an action that might be a safeguard to address such self-interest and intimidation threats is having an appropriate reviewer review the work performed.

SECTION 910

FINANCIAL INTERESTS

Introduction

910.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

910.2 Holding a financial interest in an assurance client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

910.3 A1 A financial interest might be held directly or indirectly through an intermediary such as a collective investment vehicle, an estate or a trust. When a beneficial owner has control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be direct. Conversely, when a beneficial owner has no control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be indirect.

910.3 A2 This section contains references to the "materiality" of a financial interest. In determining whether such an interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

910.3 A3 Factors that are relevant in evaluating the level of a self-interest threat created by holding a financial interest in an assurance client include:

- The role of the individual holding the financial interest.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest.

Financial Interests Held by the Firm, Assurance Team Members and Immediate Family

R910.4 A direct financial interest or a material indirect financial interest in the assurance client shall not be held by:

(a) The firm; or

(b) An assurance team member or any of that individual's immediate family.

Financial Interests in an Entity Controlling an Assurance Client

R910.5 When an entity has a controlling interest in the assurance client and the client is material to the entity, neither the firm, nor an assurance team member, nor any of that individual's immediate family shall hold a direct or material indirect financial interest in that entity.

Financial Interests Held as Trustee

R910.6 Paragraph R910.4 shall also apply to a financial interest in an assurance client held in a trust for which the firm or individual acts as trustee unless:

(a) None of the following is a beneficiary of the trust: the trustee, the assurance team member or any of that individual's immediate family, or the firm;

(b) The interest in the assurance client held by the trust is not material to the trust;

(c) The trust is not able to exercise significant influence over the assurance client; and

(d) None of the following can significantly influence any investment decision involving a financial interest in the assurance client: the trustee, the assurance team member or any of that individual's immediate family, or the firm.

Financial Interests Received Unintentionally

R910.7 If a firm, an assurance team member, or any of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an assurance client by way of an inheritance, gift, as a result of a merger, or in similar circumstances and the interest would not otherwise be permitted to be held under this section, then:

(a) If the interest is received by the firm, the financial interest shall be disposed of immediately, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; or

(b) If the interest is received by an assurance team member, or by any of that individual's immediate family, the individual who received the financial interest shall immediately dispose of the financial interest, or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.

Financial Interests – Other Circumstances

Close Family

910.8 A1 A self-interest threat might be created if an assurance team member knows that a close family member has a direct financial interest or a material indirect financial interest in the assurance client.

910.8 A2 Factors that are relevant in evaluating the level of such a threat include:

- The nature of the relationship between the assurance team member and the close family member.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest to the close family member.

910.8 A3 Examples of actions that might eliminate such a self-interest threat include:

- Having the close family member dispose, as soon as practicable, of all of the financial interest or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.

- Removing the individual from the assurance team.

910.8 A4 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review the work of the assurance team member.

Other Individuals

910.8 A5 A self-interest threat might be created if an assurance team member knows that a financial interest is held in the assurance client by individuals such as:

- Partners and professional employees of the firm, apart from those who are specifically not permitted to hold such financial interests by paragraph R910.4, or their immediate family members.

- Individuals with a close personal relationship with an assurance team member.

910.8 A6 An example of an action that might eliminate such a self-interest threat is removing the assurance team member with the personal relationship from the assurance team.

910.8 A7 Examples of actions that might be safeguards to address such a self-interest threat include:

- Excluding the assurance team member from any significant decision-making concerning the assurance engagement.

- Having an appropriate reviewer review the work of the assurance team member.

SECTION 911

LOANS AND GUARANTEES

Introduction

911.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

911.2 A loan or a guarantee of a loan with an assurance client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

911.3 A1 This section contains references to the "materiality" of a loan or guarantee. In determining whether such a loan or guarantee is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Loans and Guarantees with an Assurance Client

R911.4 A firm, an assurance team member, or any of that individual's immediate family shall not make or guarantee a loan to an assurance client unless the loan or guarantee is immaterial to both:

(a) The firm or the individual making the loan or guarantee, as applicable; and

(b) The client.

Loans and Guarantees with an Assurance Client that is a Bank or Similar Institution

R911.5 A firm, an assurance team member, or any of that individual's immediate family shall not accept a loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

911.5 A1 Examples of loans include mortgages, bank overdrafts, car loans and credit card balances.

911.5 A2 Even if a firm receives a loan from an assurance client that is a bank or similar institution under normal lending procedures, terms and conditions, the loan might create a self-interest threat if it is material to the assurance client or firm receiving the loan.

911.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having the work reviewed by an appropriate reviewer, who is not an assurance team member, from a network firm that is not a beneficiary of the loan.

Deposit or Brokerage Accounts

R911.6 A firm, an assurance team member, or any of that individual's immediate family shall not have deposits or a brokerage account with an assurance client that is a bank, broker, or similar institution, unless the deposit or account is held under normal commercial terms.

Loans and Guarantees with an Assurance Client that is not a Bank or Similar Institution

R911.7 A firm or an assurance team member, or any of that individual's immediate family, shall not accept a loan from, or have a borrowing guaranteed by, an assurance client that is not a bank or similar institution, unless the loan or guarantee is immaterial to both:

(a) The firm, or the individual receiving the loan or guarantee, as applicable; and

(b) The client.

SECTION 920

BUSINESS RELATIONSHIPS

Introduction

920.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

920.2 A close business relationship with an assurance client or its management might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

920.3 A1 This section contains references to the "materiality" of a financial interest and the "significance" of a business relationship. In determining whether such a financial interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

920.3 A2 Examples of a close business relationship arising from a commercial relationship or common financial interest include:

- Having a financial interest in a joint venture with either the client or a controlling owner, director or officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm distributes or markets the client's products or services, or the client distributes or markets the firm's products or services.

Firm, Assurance Team Member or Immediate Family Business Relationships

R920.4 A firm or an assurance team member shall not have a close business relationship with an assurance client or its management unless any financial interest is immaterial and the business relationship is insignificant to the client or its management and the firm or the assurance team member, as applicable.

920.4 A1 A self-interest or intimidation threat might be created if there is a close business relationship between the assurance client or its management and the immediate family of an assurance team member.

Buying Goods or Services

920.5 A1 The purchase of goods and services from an assurance client by a firm, or an assurance team member, or any of that individual's immediate family does not usually create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions might be of such a nature and magnitude that they create a self-interest threat.

920.5 A2 Examples of actions that might eliminate such a self-interest threat include:

- Eliminating or reducing the magnitude of the transaction.
- Removing the individual from the assurance team.

SECTION 921

FAMILY AND PERSONAL RELATIONSHIPS

Introduction

921.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

921.2 Family or personal relationships with client personnel might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

921.3 A1 A self-interest, familiarity or intimidation threat might be created by family and personal relationships between an assurance team member and a director or officer or, depending on their role, certain employees of the assurance client.

921.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The individual's responsibilities on the assurance team.
- The role of the family member or other individual within the client, and the closeness of the relationship.

Immediate Family of an Assurance Team Member

921.4 A1 A self-interest, familiarity or intimidation threat is created when an immediate family member of an assurance team member is an employee in a position to exert significant influence over the subject matter of the engagement.

921.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position held by the immediate family member.
- The role of the assurance team member.

921.4 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.4 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the immediate family member.

R921.5 An individual shall not participate as an assurance team member when any of that individual's immediate family:

(a) Is a director or officer of the assurance client;

(b) Is an employee in a position to exert significant influence over the subject matter information of the assurance engagement; or

(c) Was in such a position during any period covered by the engagement or the subject matter information.

Close Family of an Assurance Team Member

921.6 A1 A self-interest, familiarity or intimidation threat is created when a close family member of an assurance team member is:

(a) A director or officer of the assurance client; or

(b) An employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.6 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the assurance team member and the close family member.
- The position held by the close family member.
- The role of the assurance team member.

921.6 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.6 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the close family member.

Other Close Relationships of an Assurance Team Member

R921.7 An assurance team member shall consult in accordance with firm policies and procedures if the assurance team member has a close relationship with an individual who is not an immediate or close family member, but who is:

(a) A director or officer of the assurance client; or

(b) An employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.7 A1 Factors that are relevant in evaluating the level of a self-interest, familiarity or intimidation threat created by such relationships include:

- The nature of the relationship between the individual and the assurance team member.
- The position the individual holds with the client.
- The role of the assurance team member.

921.7 A2 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.7 A3 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the individual with whom the assurance team member has a close relationship.

Relationships of Partners and Employees of the Firm

921.8 A1 A self-interest, familiarity or intimidation threat might be created by a personal or family relationship between:

(a) A partner or employee of the firm who is not an assurance team member; and

(b) A director or officer of the assurance client or an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.8 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client.
- The degree of interaction of the partner or employee of the firm with the assurance team.
- The position of the partner or employee within the firm.
- The role of the individual within the client.

921.8 A3 Examples of actions that might be safeguards to address such self-interest, familiarity or intimidation threats include:

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the assurance engagement.
- Having an appropriate reviewer review the relevant assurance work performed.

SECTION 922

RECENT SERVICE WITH AN ASSURANCE CLIENT

Introduction

922.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

922.2 If an assurance team member has recently served as a director or officer or employee of the assurance client, a self-interest, self-review or familiarity threat might be created. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service During the Period Covered by the Assurance Report

R922.3 The assurance team shall not include an individual who, during the period covered by the assurance report:

(a) Had served as a director or officer of the assurance client; or

(b) Was an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

Service Prior to the Period Covered by the Assurance Report

922.4 A1 A self-interest, self-review or familiarity threat might be created if, before the period covered by the assurance report, an assurance team member:

(a) Had served as a director or officer of the assurance client; or

(b) Was an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

For example, a threat would be created if a decision made or work performed by the individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the current assurance engagement.

922.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position the individual held with the client.
- The length of time since the individual left the client.
- The role of the assurance team member.

922.4 A3 An example of an action that might be a safeguard to address such a self-interest, self-review or familiarity threat is having an appropriate reviewer review the work performed by the assurance team member.

SECTION 923

SERVING AS A DIRECTOR OR OFFICER OF AN ASSURANCE CLIENT

Introduction

923.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

923.2 Serving as a director or officer of an assurance client creates self-review and self-interest threats. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service as Director or Officer

R923.3 A partner or employee of the firm shall not serve as a director or officer of an assurance client of the firm.

Service as Company Secretary

R923.4 A partner or employee of the firm shall not serve as Company Secretary for an assurance client of the firm unless:

(a) This practice is specifically permitted under local law, professional rules or practice;

(b) Management makes all decisions; and

(c) The duties and activities performed are limited to those of a routine and administrative nature, such as preparing minutes and maintaining statutory returns.

923.4 A1 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. Therefore, a threat is created if a partner or employee of the firm serves as Company Secretary for an assurance client. (More information on providing non-assurance services to an assurance client is set out in Section 950, *Provision of Non-assurances Services to an Assurance Client.)*

SECTION 924

EMPLOYMENT WITH AN ASSURANCE CLIENT

Introduction

924.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

924.2 Employment relationships with an assurance client might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

924.3 A1 A familiarity or intimidation threat might be created if any of the following individuals have been an assurance team member or partner of the firm:

- A director or officer of the assurance client.
- An employee who is in a position to exert significant influence over the subject matter information of the assurance engagement.

Former Partner or Assurance Team Member Restrictions

R924.4 If a former partner has joined an assurance client of the firm or a former assurance team member has joined the assurance client as:

(a) A director or officer; or

(b) An employee in a position to exert significant influence over the subject matter information of the assurance engagement,

the individual shall not continue to participate in the firm's business or professional activities.

924.4 A1 Even if one of the individuals described in paragraph R924.4 has joined the assurance client in such a position and does not continue to participate in the firm's business or professional activities, a familiarity or intimidation threat might still be created.

924.4 A2 A familiarity or intimidation threat might also be created if a former partner of the firm has joined an entity in one of the positions described in paragraph 924.3 A1 and the entity subsequently becomes an assurance client of the firm.

924.4 A3 Factors that are relevant in evaluating the level of such threats include:

- The position the individual has taken at the client.
- Any involvement the individual will have with the assurance team.
- The length of time since the individual was an assurance team member or partner of the firm.

- The former position of the individual within the assurance team or firm. An example is whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

924.4 A4 Examples of actions that might be safeguards to address such a familiarity or intimidation threat include:

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements.
- Making arrangements such that any amount owed to the individual is not material to the firm.
- Modifying the plan for the assurance engagement.
- Assigning to the assurance team individuals who have sufficient experience relative to the individual who has joined the client.
- Having an appropriate reviewer review the work of the former assurance team member.

Assurance Team Members Entering Employment Negotiations with a Client

R924.5 A firm shall have policies and procedures that require assurance team members to notify the firm when entering employment negotiations with an assurance client.

924.5 A1 A self-interest threat is created when an assurance team member participates in the assurance engagement while knowing that the assurance team member will, or might, join the client sometime in the future.

924.5 A2 An example of an action that might eliminate such a self-interest threat is removing the individual from the assurance engagement.

924.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review any significant judgments made by that assurance team member while on the team.

SECTION 940

LONG ASSOCIATION OF PERSONNEL WITH AN ASSURANCE CLIENT

Introduction

940.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

940.2 When an individual is involved in an assurance engagement of a recurring nature over a long period of time, familiarity and self-interest threats might be created. This section sets out requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

940.3 A1 A familiarity threat might be created as a result of an individual's long association with:

(a) The assurance client;

(b) The assurance client's senior management; or

(c) The subject matter and subject matter information of the assurance engagement.

940.3 A2 A self-interest threat might be created as a result of an individual's concern about losing a longstanding assurance client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance. Such a threat might influence the individual's judgment inappropriately.

940.3 A3 Factors that are relevant to evaluating the level of such familiarity or self-interest threats include:

- The nature of the assurance engagement.
- How long the individual has been an assurance team member, the individual's seniority on the team, and the nature of the roles performed, including if such a relationship existed while the individual was at a prior firm.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the assurance engagement, for example, by making key decisions or directing the work of other engagement team members.
- The closeness of the individual's personal relationship with the assurance client or, if relevant, senior management.
- The nature, frequency and extent of interaction between the individual and the assurance client.

- Whether the nature or complexity of the subject matter or subject matter information has changed.

- Whether there have been any recent changes in the individual or individuals who are the responsible party or, if relevant, senior management.

940.3 A4 The combination of two or more factors might increase or reduce the level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an individual and the assurance client would be reduced by the departure of the individual who is the responsible party.

940.3 A5 An example of an action that might eliminate the familiarity and self-interest threats in relation to a specific engagement would be rotating the individual off the assurance team.

940.3 A6 Examples of actions that might be safeguards to address such familiarity or self-interest threats include:

- Changing the role of the individual on the assurance team or the nature and extent of the tasks the individual performs.

- Having an appropriate reviewer who was not an assurance team member review the work of the individual.

- Performing regular independent internal or external quality reviews of the engagement.

R940.4 If a firm decides that the level of the threats created can only be addressed by rotating the individual off the assurance team, the firm shall determine an appropriate period during which the individual shall not:

(a) Be a member of the engagement team for the assurance engagement;

(b) Provide quality control for the assurance engagement; or

(c) Exert direct influence on the outcome of the assurance engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to be addressed.

SECTION 950

PROVISION OF NON-ASSURANCE SERVICES TO ASSURANCE CLIENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENT CLIENTS

Introduction

950.1 Firms are required to comply with the fundamental principles, be independent, and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

950.2 Firms might provide a range of non-assurance services to their assurance clients, consistent with their skills and expertise. Providing certain non-assurance services to assurance clients might create threats to compliance with the fundamental principles and threats to independence. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R950.3 Before a firm accepts an engagement to provide a non-assurance service to an assurance client, the firm shall determine whether providing such a service might create a threat to independence.

950.3 A1 The requirements and application material in this section assist firms in analyzing certain types of non-assurance services and the related threats that might be created when a firm accepts or provides non-assurance services to an assurance client.

950.3 A2 New business practices, the evolution of financial markets and changes in information technology are among the developments that make it impossible to draw up an all-inclusive list of non-assurance services that might be provided to an assurance client. As a result, the Code does not include an exhaustive listing of all non-assurance services that might be provided to an assurance client.

Evaluating Threats

950.4 A1 Factors that are relevant in evaluating the level of threats created by providing a non-assurance service to an assurance client include:

- The nature, scope and purpose of the service.
- The degree of reliance that will be placed on the outcome of the service as part of the assurance engagement.
- The legal and regulatory environment in which the service is provided.
- Whether the outcome of the service will affect matters reflected in the subject matter or subject matter information of the assurance engagement, and, if so:
    - The extent to which the outcome of the service will have a material or significant effect on the subject matter of the assurance engagement.
    - The extent of the assurance client's involvement in determining significant matters of judgment.

- The level of expertise of the client's management and employees with respect to the type of service provided.

Materiality in Relation to an Assurance Client's Information

950.4 A2 The concept of materiality in relation to an assurance client's information is addressed in *Hong Kong Standard on Assurance Engagements (HKSAE) 3000 (Revised), Assurance Engagements other than Audits or Reviews of Historical Financial Information*. 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 or other information needs of users.

Multiple Non-assurance Services Provided to the Same Assurance Client

950.4 A3 A firm might provide multiple non-assurance services to an assurance client. In these circumstances the combined effect of threats created by providing those services is relevant to the firm's evaluation of threats.

Addressing Threats

950.5 A1 Paragraph 120.10 A2 includes a description of safeguards. In relation to providing non-assurance services to assurance clients, safeguards are actions, individually or in combination, that the firm takes that effectively reduce threats to independence to an acceptable level. In some situations, when a threat is created by providing a service to an assurance client, safeguards might not be available. In such situations, the application of the conceptual framework set out in Section 120 requires the firm to decline or end the non-assurance service or the assurance engagement.

Prohibition on Assuming Management Responsibilities

R950.6 A firm shall not assume a management responsibility related to the subject matter or subject matter information of an assurance engagement provided by the firm. If the firm assumes a management responsibility as part of any other service provided to the assurance client, the firm shall ensure that the responsibility is not related to the subject matter or subject matter information of the assurance engagement provided by the firm.

950.6 A1 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.

950.6 A2 Providing a non-assurance service to an assurance client creates self-review and self-interest threats if the firm assumes a management responsibility when performing the service. In relation to providing a service related to the subject matter or subject matter information of an assurance engagement provided by the firm, assuming a management responsibility also creates a familiarity threat and might create an advocacy threat because the firm becomes too closely aligned with the views and interests of management.

950.6 A3 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 other third parties to implement.
- Reporting to those charged with governance on behalf of management.
- Taking responsibility for designing, implementing, monitoring and maintaining internal control.

950.6 A4 Providing advice and recommendations to assist the management of an assurance client in discharging its responsibilities is not assuming a management responsibility. (Ref: Paras. R950.6 to 950.6 A3).

R950.7 To avoid assuming a management responsibility when providing non-assurance services to an assurance client that are related to the subject matter or subject matter information of the assurance engagement, the firm shall be satisfied that client management makes all related 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 services. Such an individual, preferably within senior management, would understand:

(i) The objectives, nature and results of the services; and

(ii) The respective client and firm responsibilities.

However, the individual is not required to possess the expertise to perform or re-perform the services.

(b) Provides oversight of the services and evaluates the adequacy of the results of the service performed for the client's purpose; and

(c) Accepts responsibility for the actions, if any, to be taken arising from the results of the services.

Other Considerations Related to Providing Specific Non-Assurance Services

950.8 A1 A self-review threat might be created if the firm is involved in the preparation of subject matter information which is subsequently the subject matter information of an assurance engagement. Examples of non-assurance services that might create such self-review threats when providing services related to the subject matter information of an assurance engagement include:

(a) Developing and preparing prospective information and subsequently providing assurance on this information.

(b) Performing a valuation that forms part of the subject matter information of an assurance engagement.

SECTION 990

REPORTS THAT INCLUDE A RESTRICTION ON USE AND DISTRIBUTION (ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS)

Introduction

990.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

990.2 This section sets out certain modifications to Part 4B which are permitted in certain circumstances involving assurance engagements where the report includes a restriction on use and distribution. In this section, an engagement to issue a restricted use and distribution assurance report in the circumstances set out in paragraph R990.3 is referred to as an "eligible assurance engagement."

Requirements and Application Material

General

R990.3 When a firm intends to issue a report on an assurance engagement which includes a restriction on use and distribution, the independence requirements set out in Part 4B shall be eligible for the modifications that are permitted by this section, but only if:

(a) The firm communicates with the intended users of the report regarding the modified independence requirements that are to be applied in providing the service; and

(b) The intended users of the report understand the purpose, subject matter information and limitations of the report and explicitly agree to the application of the modifications.

990.3 A1 The intended users of the report might obtain an understanding of the purpose, subject matter information, and limitations of the report by participating, either directly, or indirectly through a representative who has authority to act for the intended users, in establishing the nature and scope of the engagement. In either case, this participation helps the firm to communicate with intended users about independence matters, including the circumstances that are relevant to applying the conceptual framework. It also allows the firm to obtain the agreement of the intended users to the modified independence requirements.

R990.4 Where the intended users are a class of users who are not specifically identifiable by name at the time the engagement terms are established, the firm shall subsequently make such users aware of the modified independence requirements agreed to by their representative.

990.4 A1 For example, where the intended users are a class of users such as lenders in a syndicated loan arrangement, the firm might describe the modified independence requirements in an engagement letter to the representative of the lenders. The representative might then make the firm's engagement letter available to the members of the group of lenders to meet the requirement for the firm to make such users aware of the modified independence requirements agreed to by the representative.

R990.5 When the firm performs an eligible assurance engagement, any modifications to Part 4B shall be limited to those modifications set out in paragraphs R990.7 and R990.8.

R990.6 If the firm also issues an assurance report that does not include a restriction on use and distribution for the same client, the firm shall apply Part 4B to that assurance engagement.

Financial Interests, Loans and Guarantees, Close Business, Family and Personal Relationships

R990.7 When the firm performs an eligible assurance engagement:

(a) The relevant provisions set out in Sections 910, 911, 920, 921, 922 and 924 need apply only to the members of the engagement team, and their immediate and close family members;

(b) The firm shall identify, evaluate and address any threats to independence created by interests and relationships, as set out in Sections 910, 911, 920, 921, 922 and 924, between the assurance client and the following assurance team members;

(i) Those who provide consultation regarding technical or industry specific issues, transactions or events; and

(ii) Those who provide quality control for the engagement, including those who perform the engagement quality control review; and

(c) The firm shall evaluate and address any threats that the engagement team has reason to believe are created by interests and relationships between the assurance client and others within the firm who can directly influence the outcome of the assurance engagement, as set out in Sections 910, 911, 920, 921, 922 and 924.

990.7 A1 Others within the firm who can directly influence the outcome of the assurance engagement include those who recommend the compensation, or who provide direct supervisory, management or other oversight, of the assurance engagement partner in connection with the performance of the assurance engagement.

R990.8 When the firm performs an eligible assurance engagement, the firm shall not hold a material direct or a material indirect financial interest in the assurance client.

GLOSSARY, INCLUDING LISTS OF ABBREVIATIONS

In the *Code of Ethics for Professional Accountants*, the singular shall be construed as including the plural as well as the reverse, and the terms below have the following meanings assigned to them.

In this Glossary, explanations of defined terms are shown in regular font; italics are used for explanations of described terms which have a specific meaning in certain parts of the Code or for additional explanations of defined terms. References are also provided to terms described in the Code.

Acceptable level	A level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.
Advertising	The communication to the public of information as to the services or skills provided by professional accountants in public practice with a view to procuring professional business.
Appropriate reviewer	*An appropriate reviewer is a professional with the necessary knowledge, skills, experience and authority to review, in an objective manner, the relevant work performed or service provided. Such an individual might be a professional accountant.* *This term is described in paragraph 300.8 A4.*
Assurance client	The responsible party that is the person (or persons) who: (a) In a direct reporting engagement, is responsible for the subject matter; or (b) In an assertion-based engagement, is responsible for the subject matter information and might be responsible for the subject matter.
Assurance engagement	An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. (For guidance on assurance engagements, see the *Hong Kong Framework for Assurance Engagements* issued by the Institute. The *Hong Kong Framework for Assurance Engagements* describes the elements and objectives of an assurance engagement and identifies engagements to which *Hong Kong Standards on Auditing* (HKSAs), *Hong Kong Standards on Review Engagements* (HKSREs) and *Hong Kong Standards on Assurance Engagements* (HKSAEs) apply.)

Assurance team	(a) All members of the engagement team for the assurance engagement; (b) All others within a firm who can directly influence the outcome of the assurance engagement, including: (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement; (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and (iii) Those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement.
Audit	*In Part 4A, the term "audit" applies equally to "review."*
Audit client	An entity in respect of which a firm conducts an audit engagement. When the client is a listed entity, audit client will always include its related entities. When the audit client is not a listed entity, audit client includes those related entities over which the client has direct or indirect control. *(See also paragraph R400.20.)* *In Part 4A, the term "audit client" applies equally to "review client."*
Audit engagement	A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared, in all material respects (or give a true and fair view or are presented fairly, in all material respects), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with *Hong Kong Standards on Auditing*. This includes a Statutory Audit, which is an audit required by legislation or other regulation. *In Part 4A, the term "audit engagement" applies equally to "review engagement."*
Audit report	*In Part 4A, the term "audit report" applies equally to "review report."*
Audit team	(a) All members of the engagement team for the audit engagement; (b) All others within a firm who can directly influence the outcome of the audit engagement, including: (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement, including those at all successively senior levels above the engagement partner through to the individual who is the

firm's Senior or Managing Partner (Chief Executive or equivalent);

(ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the engagement; and

(iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and

(c) All those within a network firm who can directly influence the outcome of the audit engagement.

In Part 4A, the term "audit team" applies equally to "review team."

Close family	A parent, child or sibling who is not an immediate family member.
Conceptual framework	*This term is described in Section 120.*
Contingent fee	A fee calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. A fee that is established by a court or other public authority is not a contingent fee.
Cooling-off period	*This term is described in paragraph R540.5 for the purposes of paragraphs R540.11 to R540.19*.
Direct financial interest	A financial interest: (a) Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or (b) Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control, or the ability to influence investment decisions.
Director or officer	Those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title, which might vary from jurisdiction to jurisdiction.
Eligible audit engagement	*This term is described in paragraph 800.2 for the purposes of Section 800*.
Eligible assurance engagement	*This term is described in paragraph 990.2 for the purposes of Section 990.*
Engagement partner	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Engagement period (Audit and Review Engagements)	The engagement period starts when the audit team begins to perform the audit. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final audit report.
Engagement period (Assurance Engagements Other than Audit and Review Engagements)	The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final assurance report.
Engagement quality control review	A process designed to provide an objective evaluation, on or before the report is issued, of the significant judgments the engagement team made and the conclusions it reached in formulating the report.
Engagement team	All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm. The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of HKSA 610 (Revised 2013), *Using the Work of Internal Auditors.*
Existing accountant	A professional accountant in public practice currently holding an audit appointment or carrying out accounting, tax, consulting or similar professional services for a client.
External expert	An individual (who is not a partner or a member of the professional staff, including temporary staff, of the firm or a network firm) or organization possessing skills, knowledge and experience in a field other than accounting or auditing, whose work in that field is used to assist the professional accountant in obtaining sufficient appropriate evidence.
Financial interest	An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.
Financial statements	A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.

Financial statements on which the firm will express an opinion	In the case of a single entity, the financial statements of that entity. In the case of consolidated financial statements, also referred to as group financial statements, the consolidated financial statements.
Firm	(a) A sole practitioner, partnership or corporation of professional accountants; (b) An entity that controls such parties, through ownership, management or other means; and (c) An entity controlled by such parties, through ownership, management or other means. *Paragraphs 400.4 and 900.3 explain how the word "firm" is used to address the responsibility of professional accountants and firms for compliance with Parts 4A and 4B, respectively.*
Fundamental principles	*This term is described in paragraph 110.1 A1.Each of the fundamental principles is, in turn, described in the following paragraphs:* *Integrity* *R111.1* *Objectivity* *R112.1* *Professional competence and due care* *R113.1* *Confidentiality* *R114.1* *Professional behavior* *R115.1*
Historical financial information	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
Immediate family	A spouse (or equivalent) or dependent.
Independence	Independence comprises: (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism. (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's, or an audit or assurance team member's, integrity, objectivity or professional skepticism has been compromised. *As set out in paragraphs 400.5 and 900.4, references to an individual or firm being "independent" mean that the individual or firm has complied with Parts 4A and 4B, as applicable.*

Indirect financial interest	A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control or ability to influence investment decisions.
Inducement	An object, situation, or action that is used as a means to influence another individual's behavior, but not necessarily with the intent to improperly influence that individual's behavior. *Inducements can range from minor acts of hospitality between business colleagues (for professional accountants in business), or between professional accountants and existing or prospective clients (for professional accountants in public practice), to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:* • *Gifts.* • *Hospitality.* • *Entertainment.* • *Political or charitable donations.* • *Appeals to friendship and loyalty.* • *Employment or other commercial opportunities.* • *Preferential treatment, rights or privileges.*
Key audit partner	The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, "other audit partners" might include, for example, audit partners responsible for significant subsidiaries or divisions.
Listed entity	An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
May	*This term is used in the Code to denote permission to take a particular action in certain circumstances, including as an exception to a requirement. It is not used to denote possibility.*
Might	*This term is used in the Code to denote the possibility of a matter arising, an event occurring or a course of action being taken. The term does not ascribe any particular level of possibility or likelihood when used in conjunction with a threat, as the evaluation of the level of a threat depends on the facts and circumstances of any particular matter, event or course of action.*

Network	A larger structure: (a) That is aimed at co-operation; and (b) 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.
Network firm	A firm or entity that belongs to a network. *For further information, see paragraphs 400.50 A1 to 400.54 A1.*
Non-compliance with laws and regulations *(Professional Accountants in Business)*	*Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:* *(a) The professional accountant's employing organization;* *(b) Those charged with governance of the employing organization;* *(c) Management of the employing organization; or* *(d) Other individuals working for or under the direction of the employing organization.* *This term is described in paragraph 260.5 A1.*
Non-compliance with laws and regulations *(Professional Accountants in Public Practice)*	*Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:* *(a) A client;* *(b) Those charged with governance of a client;* *(c) Management of a client; or* *(d) Other individuals working for or under the direction of a client.* *This term is described in paragraph 360.5 A1.*
Office	A distinct sub-group, whether organized on geographical or practice lines.
Predecessor accountant	A professional accountant in public practice who most recently held an audit appointment or carried out accounting, tax, consulting or similar professional services for a client, where there is no existing accountant.

Professional accountant	An individual who is a member of an IFAC member body. *In Part 1, the term "professional accountant" refers to individual professional accountants in business and to professional accountants in public practice and their firms.* *In Part 2, the term "professional accountant" refers to professional accountants in business.* *In Parts 3, 4A and 4B, the term "professional accountant" refers to professional accountants in public practice and their firms.*
Professional accountant in business	A professional accountant working in areas such as commerce, industry, service, the public sector, education, the not-for-profit sector, or in regulatory or professional bodies, who might be an employee, contractor, partner, director (executive or non-executive), owner-manager or volunteer.
Professional accountant in public practice	A professional accountant, irrespective of functional classification (for example, audit, tax or consulting) in a firm that provides professional services. *The term "professional accountant in public practice" is also used to refer to a firm of professional accountants in public practice.*
Professional activity	An activity requiring accountancy or related skills undertaken by a professional accountant, including accounting, auditing, tax, management consulting, and financial management.
Professional services	Professional activities performed for clients.
Proposed accountant	A professional accountant in public practice who is considering accepting an audit appointment or an engagement to perform accounting, tax, consulting or similar professional services for a prospective client (or in some cases, an existing client).
Public interest entity	(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[1c]. 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.*

[1c] 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. Hence, there is no entity falling within this part of the definition under the legislation of Hong Kong.

Reasonable and informed third party Reasonable and informed third party test	*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.* *These terms are described in paragraph R120.5 A4.*
Related entity	An entity that has any of the following relationships with the client: (a) An entity that has direct or indirect control over the client if the client is material to such entity; (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; (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); and (e) An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity.
Review client	An entity in respect of which a firm conducts a review engagement.
Review engagement	An assurance engagement, conducted in accordance with *Hong Kong Standards on Review Engagements* or equivalent, in which a professional accountant in public practice expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the accountant's attention that causes the accountant to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.
Review team	(a) All members of the engagement team for the review engagement; and (b) All others within a firm who can directly influence the outcome of the review engagement, including: (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the review engagement, including those at all successively senior levels above the

engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);

(ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the engagement; and

(iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and

(c) All those within a network firm who can directly influence the outcome of the review engagement.

Safeguards	*Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.* *This term is described in paragraph 120.10 A2.*
Senior professional accountant in business	*Senior professional accountants in business are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources.* *This term is described in paragraph 260.11 A1.*
Substantial harm	*This term is described in paragraphs 260.5 A3 and 360.5 A3.*
Special purpose financial statements	Financial statements prepared in accordance with a financial reporting framework designed to meet the financial information needs of specified users.
Those charged with governance	The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance might include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.
Threats	*This term is described in paragraph 120.6 A3 and includes the following categories:* *Self interest* — *120.6 A3(a)* *Self-review* — *120.6 A3(b)* *Advocacy* — *120.6 A3(c)* *Familiarity* — *120.6 A3(d)*

	Intimidation	*120.6 A3(e)*
Time-on period	*This term is described in paragraph R540.5.*	

LISTS OF ABBREVIATIONS AND STANDARDS REFERRED TO IN THE CODE

LIST OF ABBREVIATIONS

Abbreviation	Explanation
Assurance Framework	Hong Kong Framework for Assurance Engagements
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CoCo	Chartered Professional Accountants of Canada Criteria of Control
HKSAs	Hong Kong Standards on Auditing
HKSAEs	Hong Kong Standards on Assurance Engagements
HKSQCs	Hong Kong Standards on Quality Control
HKSREs	Hong Kong Standards on Review Engagements
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
POBO	Prevention of Bribery Ordinance (Cap. 201)

LIST OF STANDARDS REFERRED TO IN THE CODE

Standard	Full Title
HKSA 320	Materiality In Planning and Performing an Audit
HKSA 610 (Revised 2013)	Using the Work of Internal Auditors
HKSAE 3000 (Revised)	Assurance Engagements Other than Audits or Reviews of Historical Financial Information
HKSQC 1	Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements
HKSRE 2400 (Revised)	Engagements to Review Historical Financial Statements

EFFECTIVE DATE OF CHAPTER A, REQUIREMENTS AND APPLICATION MATERIAL FOR PROFESSIONAL ACCOUNTANTS

Parts 1 – 3

- Parts 1, 2 and 3 of Chapter A will be effective as of 15 June 2019.

Independence Standards (Parts 4A and 4B)

- Part 4A of Chapter A relating to independence for audit and review engagements will be effective for audits and reviews of financial statements for periods beginning on or after 15 June 2019.

- Part 4B of Chapter A relating to independence for assurance engagements with respect to subject matter covering periods will be effective for periods beginning on or after 15 June 2019; otherwise, it will be effective as of 15 June 2019.

Early adoption is permitted.

Long Association Provisions (Section 540)

The effective date of Chapter A of the Code does not override the effective date of the revised Long Association provisions in Sections 290 and 291 as set out in the January 2017 long association close-off document released by the IESBA, which is as follows:

(a) Subject to the transitional provision in (c) below, paragraphs 290.148 to 290.168 are effective for audits of financial statements for periods beginning on or after 15 December 2018. Early adoption is permitted.

(b) For assurance engagements covering periods, paragraphs 291.137 to 291.141 will be effective for periods beginning on or after 15 December 2018; otherwise, they will be effective as of 15 December 2018. Early adoption is permitted.

(c) Paragraph 290.163 shall have effect only for audits of financial statements for periods beginning prior to 15 December 2023. This will facilitate the transition to the required cooling-off period of five consecutive years for engagement partners in those jurisdictions where the legislative body or regulator (or organization authorized or recognized by such legislative body or regulator) has specified a cooling-off period of less than five consecutive years[1d].

[1d] Currently no other legislative body or regulator in Hong Kong has specified separate cooling-off period for professional accountants in public practice in respect of long association of personnel (including partner rotation) with an audit client.

APPENDIX 1

Sample Code of Conduct under the Prevention of Bribery Ordinance

Ethical Commitment

1. The *(name of company)* (hereafter referred to as the Company) regards honesty, integrity and fair play as our core values that must be upheld by all directors and staff[1] of the Company at all times. This Code sets out the basic standard of conduct expected of all directors and staff, and the Company's policy on acceptance of advantage and handling of conflict of interest when dealing with the Company's business.

Prevention of Bribery

2. The Company prohibits all forms of bribery and corruption. All directors and staff are prohibited from soliciting, accepting or offering any bribe in conducting the Company's business or affairs, whether in Hong Kong or elsewhere. In conducting all business or affairs of the Company, they must comply with the Prevention of Bribery Ordinance (POBO) of Hong Kong and must not:

   (a) solicit or accept any advantage from others as a reward for or inducement to doing any act or showing favour in relation to the Company's business or affairs, or offer any advantage to an agent of another as a reward for or inducement to doing any act or showing favour in relation to his principal's business or affairs;

   (b) offer any advantage to any public servant (incl. Government / public body employee) as a reward for or inducement to his performing any act in his official capacity or his showing any favour or providing any assistance in business dealing with the Government / a public body; or

   (c) offer any advantage to any staff of a Government department or public body while they are having business dealing with the latter.

(The relevant provisions of the POBO are at **Annex 1**.)

Acceptance of Advantage

3. It is the Company's policy that directors and staff should not solicit or accept any advantage for themselves or others, from any person, company or organization having business dealings with the Company or any subordinate, except that they may accept (but not solicit) the following when offered on a voluntary basis:

   (a) advertising or promotional gifts or souvenirs of a nominal value; or

   (b) gifts given on festive or special occasions, subject to a maximum limit of $_____ in value; or

   (c) discounts or other special offers given by any person or company to them as customers, on terms and conditions equally applicable to other customers in general.

4. Gifts or souvenirs described in paragraph 3(a) that are presented to directors and staff in official functions are deemed as offers to the Company. The directors and staff

1 "Staff" cover full-time, part-time and temporary staff, except where specified.

concerned should report the acceptance to the Company and seek direction as to how to handle the gifts or souvenirs from *the approving authority*[2] using Form A (**Annex 2**). If a director or staff member wishes to accept any advantage not covered in paragraph 3, he/she should also seek permission from *the approving authority* using Form A.

5. However, a director or staff member should decline an offer of advantage if acceptance could affect his/her objectivity in conducting the Company's business or induce him/her to act against the interest of the Company, or acceptance will likely lead to perception or allegation of impropriety.

6. If a director or staff member has to act on behalf of a client in the course of carrying out the Company's business, he/she should also comply with any additional restrictions on acceptance of advantage that may be set by the client (e.g. directors and staff members performing any duties under a government or public body contract will normally be prohibited from accepting advantages in relation to that contract).

Offer of Advantage

7. Directors and staff are prohibited from offering advantages to any director, staff member or agent of another company or organization, for the purpose of influencing such person in any dealing, or any public official, whether directly or indirectly through a third party, when conducting the Company's business. Even when an offer of advantage carries no intention of improper influence, it should be ascertained that the intended recipient is permitted by his employer/principal to accept it under the relevant circumstance before the advantage is offered.

Entertainment

8. Although entertainment[3] is an acceptable form of business and social behaviour, a director or staff member should avoid accepting lavish or frequent entertainment from persons with whom the Company has business dealing (e.g. suppliers or contractors) or from his/her subordinates to avoid placing himself/herself in a position of obligation.

Records, Accounts and Other Documents

9. Directors and staff should ensure that all records, receipts, accounts or other documents they submit to the Company give a true representation of the facts, events or business transactions as shown in the documents. Intentional use of documents containing false information to deceive or mislead the Company, regardless of whether there is any gain or advantage involved, may constitute an offence under the POBO.

Compliance with Laws of Hong Kong and in Other Jurisdictions

10. Directors or staff must comply with all local laws and regulations when conducting the Company's business, and also those in other jurisdictions when conducting business there[4] or where applicable[5].

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2 Specify the post of the approving authority in the Code and the Form.

3 According to the POBO, "entertainment" means the provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with or provided at the same time as the provision of food or drink.

4 The ***'Business Success: Integrity & Legal Compliance' – Corruption Prevention Guide for SMEs in Guangdong, Hong Kong and Macao*** jointly published by the ICAC, the Guangdong Provincial People's Procuratorate and the Commission Against Corruption of Macao provides guidance on the anti-bribery laws in Hong Kong, Mainland China and Macao. Directors and staff conducting the Company's business there may find it helpful.

5 Some other countries' anti-bribery laws have provisions with extra-territorial effect, e.g. the UK's Bribery Act 2010, the USA's Foreign Corrupt Practices Act.

Conflict of Interest

11. Directors and staff should avoid any conflict of interest situation (i.e. situation where their private interest conflicts with the interest of the Company) or the perception of such conflicts. When actual or potential conflict of interest arises, the director or staff member should make a declaration to *the approving authority* through the reporting channel using Form B (**Annex 3**).

12. Some common examples of conflict of interest are described below but they are by no means exhaustive:

    (a) A staff member involved in a procurement exercise is closely related to or has financial interest in the business of a supplier who is being considered for selection by the Company.

    (b) One of the candidates under consideration in a recruitment or promotion exercise is a family member, a relative or a close personal friend of the staff member involved in the process.

    (c) A director of the Company has financial interest in a company whose quotation or tender is under consideration by the Board.

    (d) A staff member (full-time or part-time) undertaking part-time work with a contractor whom he is responsible for monitoring.

Misuse of Official Position, Company Assets and Information

13. Directors and staff must not misuse their official position in the Company to pursue their own private interests, which include both financial and personal interests and those of their family members, relatives or close personal friends.

14. Directors and staff in charge of or having access to any Company assets, including funds, property, information, and intellectual property, should use them solely for the purpose of conducting the Company's business. Unauthorized use, such as misuse for personal interest, is strictly prohibited.

15. Directors and staff should not disclose any classified information of the Company without authorization or misuse any Company information (e.g. unauthorized sale of the information). Those who have access to or are in control of such information, including information in the Company's computer system, should protect the information from unauthorized disclosure or misuse. Special care should also be taken in the use of any personal data, including directors', staff's and customers' personal data, to ensure compliance with Hong Kong's Personal Data (Privacy) Ordinance.

Outside Employment

16. If a staff member wishes to take up employment outside the Company, he must seek the prior written approval of *the approving authority*. *The approving authority* should consider whether the outside employment would give rise to a conflict of interest with the staff member's duties in the Company or the interest of the Company.

Relationship with Suppliers, Contractors and Customers

Gambling

17. Directors and staff are advised not to engage in frequent gambling activities (e.g. mahjong) with persons having business dealings with the Company.

Loans

18. Directors and staff should not accept any loan from, or through the assistance of, any individual or organization having business dealings with the Company. There is however no restriction on borrowing from licensed banks or financial institutions.

[*The Company may wish to include other guidelines on the conduct required of directors and staff in their dealings with suppliers, contractors, customers, and other business partners as appropriate to specific trades.*]

Compliance with the Code

19. It is the responsibility of every director and staff member of the Company to understand and comply with this Code, whether performing his duties of the Company in or outside Hong Kong. Managers and supervisors should also ensure that the staff under their supervision understand well and comply with this Code.

20. Any director or staff member in breach of this Code will be subject to disciplinary action, including termination of appointment. Any enquiries about this Code or reports of possible breaches of this Code should be made to *(post of a designated senior staff member)*. In cases of suspected corruption or other criminal offences, a report should be made to the appropriate authority.

_____

(*Name of Company*)
Date :

Annex 1

Extracts of the Prevention of Bribery Ordinance (Cap. 201)

Section 9

(1) Any agent who, without lawful authority or reasonable excuse, solicits or accepts any advantage as an inducement to or reward for or otherwise on account of his –

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(2) Any person, who, without lawful authority or reasonable excuse, offers any advantage to any agent as an inducement to or reward for or otherwise on account of the agent's –

(a) doing or forbearing to do, or having done or forborne to do, any act in relation to his principal's affairs or business; or

(b) showing or forbearing to show, or having shown or forborne to show, favour or disfavour to any person in relation to his principal's affairs or business,

shall be guilty of an offence.

(3) Any agent who, with intent to deceive his principal, uses any receipt, account or other document –

(a) in respect of which the principal is interested; and

(b) which contains any statement which is false or erroneous or defective in any material particular; and

(c) which to his knowledge is intended to mislead the principal,

shall be guilty of an offence.

(4) If an agent solicits or accepts an advantage with the permission of his principal, being permission which complies with subsection (5), neither he nor the person who offered the advantage shall be guilty of an offence under subsection (1) or (2).

Section 4

(1) Any person who, whether in Hong Kong or elsewhere, without lawful authority or reasonable excuse, offers any advantage to a public servant as an inducement to or reward for or otherwise on account of that public servant's-

(a) performing or abstaining from performing, or having performed or abstained from performing, any act in his capacity as a public servant;

(b) expediting, delaying, hindering or preventing, or having expedited, delayed, hindered or prevented, the performance of an act, whether by that public servant or by any other public servant in his or that other public servant's capacity as a public servant; or

(c) assisting, favouring, hindering or delaying, or having assisted, favoured, hindered or delayed, any person in the transaction of any business with a public body,

shall be guilty of an offence.

(3) If a public servant other than a prescribed officer solicits or accepts an advantage with the permission of the public body of which he is an employee being permission which complies with subsection (4), neither he nor the person who offered the advantage shall be guilty of an offence under this section.

Section 8

(1) Any person who, without lawful authority or reasonable excuse, while having dealings of any kind with the Government through any department, office or establishment of the Government, offers any advantage to any prescribed officer employed in that department, office or establishment of the Government, shall be guilty of an offence.

(5) For the purposes of subsection (4) permission shall – (a) be given before the advantage is offered, solicited or accepted; or (b) in any case where an advantage has been offered or accepted without prior permission, be applied for and given as soon as reasonably possible after such offer or acceptance, and for such permission to be effective for the purposes of subsection (4), the principal shall, before giving such permission, have regard to the circumstances in which it is sought.	(2) Any person who, without lawful authority or reasonable excuse, while having dealings of any kind with any other public body, offers any advantage to any public servant employed by that public body, shall be guilty of an offence.

Extracts of the Prevention of Bribery Ordinance (Cap. 201)

Section 2

"Advantage" means :

(a) any gift, loan, fee, reward or commission consisting of money or of any valuable security or of other property or interest in property of any description;

(b) any office, employment or contract;

(c) any payment, release, discharge or liquidation of any loan, obligation or other liability, whether in whole or in part;

(d) any other service, or favour (other than entertainment), including protection from any penalty or disability incurred or apprehended or from any action or proceedings of a disciplinary, civil or criminal nature, whether or not already instituted;

(e) the exercise or forbearance from the exercise of any right or any power or duty; and

(f) any offer, undertaking or promise, whether conditional or unconditional, of any advantage within the meaning of any of the preceding paragraphs (a), (b), (c), (d) and (e),

but does not include an election donation within the meaning of the Elections (Corrupt and Illegal Conduct) Ordinance (Cap. 554), particulars of which are included in an election return in accordance with that Ordinance.

"Entertainment" means :

The provision of food or drink, for consumption on the occasion when it is provided, and of any other entertainment connected with, or provided at the same time as, such provisions.

Section 19

In any proceedings for an offence under this Ordinance, it shall not be a defence to show that any such advantage as is mentioned in this Ordinance is customary in any profession, trade, vocation or calling.

Annex 2
Form A

(Company Name)
REPORT ON GIFTS/ADVANTAGES RECEIVED

Part A – To be completed by Receiving Staff

To : (Approving Authority)

Description of Offeror *:*

Name & Title : _____

Company : _____

Relationship (Business / Personal) : _____

Occasion on which the Gift/Advantage was / is to be received : _____

Description & (assessed) value of the Gift/Advantage: _____

Suggested Method of Disposal :	**Remark**
( ) Retain by the Receiving Staff	_____
( ) Retain for Display / as a Souvenir in the Office	_____
( ) Share among the Office	_____
( ) Reserve as Lucky Draw Prize at Staff Function	_____
( ) Donate to a Charitable Organization	_____
( ) Return to Offeror	_____
( ) Others (please specify) : _____	

_____
(Name of Receiving Staff)
(Date) (Title / Department)

Part B – To be completed by Approving Authority

To : (Name of Receiving Staff)

The recommended method of disposal is ****approved / not approved***. *The gift/advantage concerned should be disposed of by way of : _____

_____
(Name of Approving Authority)
(Date) (Title / Department)

**Delete as appropriate*

Annex 3
Form B

(Company Name)
DECLARATION OF CONFLICT OF INTEREST

Part A – **Declaration** *(To be completed by Declaring Staff)*

To : (Approving Authority) via (supervisor of the Declaring Staff)

I would like to report the following actual/potential* conflict of interest situation arising during the discharge of my official duties:-

Persons/companies with whom/which I have official dealings
My relationship with the persons/companies (e.g. relative)
Relationship of the persons/companies with our Company (e.g. supplier)
Brief description of my duties which involved the persons/companies (e.g. handling of tender exercise)

_____
(Name of Declaring Staff)
(Date) (Title / Department)

Part B – **Acknowledgement** *(To be completed by Approving Authority)*

To : (Declaring Staff) via (supervisor of the Declaring Staff)

Acknowledgement of Declaration

The information contained in your declaration form of (Date) is noted. It has been decided that:-

- ❑ You should refrain from performing or getting involved in performing the work, as described in Part A, which may give rise to a conflict.
- ❑ You may continue to handle the work as described in Part A, provided that there is no change in the information declared above, and you must uphold the Company's interest without being influenced by your private interest.
- ❑ Others (please specify) : _____

_____
(Name of Approving Authority)
(Date) (Title / Department)

**Delete as appropriate*

C ADDITIONAL ETHICAL REQUIREMENTS

SECTION 100

Introduction

100.1 This Chapter of the Code sets out the additional ethical requirements on specific areas. Where the Council of the Institute deems it necessary, it has included, and may develop further, additional ethical requirements on matters of relevance not covered by the International Code. The existing additional ethical requirements are primarily derived from local legal or regulatory requirements.

100.2 The sections under Chapter C, Additional Ethical Requirements ("Chapter C") are to be read in the context of the fundamental principles of professional ethics for professional accountants and the conceptual framework for applying those principles which are set out in Chapter A, Requirements and Application Material for Professional Accountants ("Chapter A"). Consequently, it is not sufficient for a professional accountant merely to comply with the additional ethical requirements under this Part; rather, the entire Code should be applied to the particular circumstances faced.

100.3 The sections under Chapter C originate from Professional Ethics Statements that were in existence prior to the issuance of the Code. They have not yet been conformed to all the requirements under Chapter A which are adopted from the International Code. The Institute plans to review and update where necessary all the sections under this Part. The references to the previous Professional Ethics Statements are inserted in the relevant sections for easy reference.

100.4 Until the sections under Chapter C are updated, where members encounter situations where a requirement under this Part is:

(a) more stringent than a provision in Chapter A, the requirement under Chapter C should prevail; or

(b) in conflict with or less stringent than a provision in Chapter A, the relevant provision in Chapter A should be followed.

SECTION 200

Changes in a Professional Appointment

This section should be read in conjunction with Section 320 "Professional Appointments" under Chapter A of the Code.

The Statement

Preamble

200.1 Where a change of auditor is contemplated, the nominated auditor should write to the existing auditor to obtain "professional clearance". This is an important procedure to be followed to protect the interest of the nominated auditor, such that he may be made aware of any unusual circumstances surrounding the proposed change of auditor which may be relevant in determining his acceptance of nomination.

200.2 The existing auditor should act promptly upon receipt of such written request from the nominated auditor. Where it is the wish of a client to change auditor, the existing auditor should not cause undue hindrance to such a change, and should co-operate with the client and the nominated auditor to facilitate the flow of information and an effective change over.

Audit Appointments

200.3 A member who is asked to accept nomination as auditor should, save where the company or organisation has not previously had an auditor:

(a) find out whether the change of auditor has been properly dealt with in accordance with the Companies Ordinance or other legislation; and

(b) request the prospective client's permission to communicate with the auditor last appointed.

200.4 If a member is aware that the change of auditor has not been properly dealt with in accordance with the Companies Ordinance or other legislation by the company or organisation, he should advise his prospective client of any remedial action.

200.5 A member should decline nomination if the prospective client:

(a) fails to properly deal with the change of auditor in accordance with the Companies Ordinance or other legislation; or

(b) refuses permission for him to communicate with the auditor last appointed.

200.6 On receipt of permission to communicate with the auditor last appointed, a member should request in writing of the latter if there are any unusual circumstances surrounding the proposed change which he should be aware of, so that he may determine whether he should accept nomination. An example of such written request is given in the Appendix.

200.7 A member receiving such written request should act expeditiously and:

(a) if there is no professional or other reason why the proposed nominee should not accept nomination, reply accordingly without delay; or

(b) if he considers it appropriate to discuss the client's affairs with the proposed nominee, request permission of the client to do so freely.[1] If this request is not granted the member should report that fact to the proposed nominee who should not accept nomination.

200.8 On receipt of permission from the client, the member should advise the proposed nominee of his concern about the circumstances surrounding the proposed change and disclose fully all information needed by the proposed nominee to enable him to decide whether to accept nomination.

Other Appointments

200.9 The same principles apply in respect of changes of appointment for all other recurring professional work.

200.10 A member invited to undertake professional work additional to that already being carried out by the auditor and/or another accountant, who will still continue with his/their existing duties, should notify the auditor and/or the other accountant of the work he is undertaking. This notification need not be given if the client advances a valid reason against it. The member undertaking the additional work has the right to expect of the continuing auditor and/or accountant full co-operation in carrying out his assignment.

Guidelines

General

200.11 Although the guidance which follows takes as its basis the replacement of an auditor of a company, that basis is adopted as but one example of a change in a professional appointment. It follows that the considerations arising on a change of auditor generally also apply, in appropriate fashion, when a member is invited to undertake advisory work of a recurring nature (including the provision of services such as, e.g. accountancy and taxation) in place of another accountant, except for paragraph 200.23 in this Section which applies only to audit engagement. They apply whether the client is a company or any other corporate body, an individual, a partnership or any other kind of association, and a member invited to accept nomination or appointment as auditor of a body other than a company should be guided by the same considerations as those indicated in relation to a company. In the case of an audit client they apply in respect of non-audit work as they do to audit work. The reasons for communication as set out in this guidance are equally applicable in all cases.

[1] Section 414 of the Companies Ordinance (Cap.622) aims to facilitate transitional arrangements in the event of any changes in the auditor of a company. The section provides that an outgoing auditor does not contravene any duty just because he gives "work-related information" to an incoming auditor. "Work-related information" means information of which the person became aware in the capacity as such auditor. Please refer to the section for details.

200.12 A member may be invited to undertake professional work which is additional to that already being carried out by another accountant who will continue with his existing duties. In that event, the member should notify the other accountant that he is undertaking the special work unless the client gives a valid reason why such notice should not be given. The reason for this notification is not merely to adhere to a pattern of common professional courtesy, but to give the existing accountant notice of the scope of the new appointment which may have an important bearing on the way he discharges his own continuing responsibilities to the client and to enable him to meet the obligation placed on him under paragraph 200.2 to offer full co-operation to the member carrying out the new assignment.

Audit Appointments

200.13 In this guidance the term “existing auditor” means the individual or firm currently filling or who last filled the office. The term “member” is used to denote the individual member or firm invited to accept appointment, whilst the term “proposed new auditor” is used when referring to the obligations of an existing auditor to any prospective successor.

200.14 The client has an indisputable right to choose its auditors and other professional advisors and to change to others if it so decides.

200.15 Auditors of a company are usually appointed to hold office until the conclusion of the next general meeting at which accounts are submitted. Provided the relevant statutory procedure is followed, the shareholders are entitled in general meeting to appoint an auditor other than the existing auditor, just as, when the necessary notice of such an intention is received, the existing auditor is entitled under the Companies Ordinance to make written representations and to address the meeting.

200.16 A member who is invited to accept nomination in replacement of an existing auditor should endeavour to ascertain the reasons for the proposed change. This he cannot effectively do without direct communication with the existing auditor. The member, therefore, should not accept nomination without first communicating in writing with the existing auditor to enquire whether there is any reason for or circumstance behind the proposed change of which he should be aware when deciding whether or not to accept nomination.

200.17 When a member is first approached by a prospective client he should explain his duty to communicate with the existing auditor and request authority to do so. If authority is refused he should explain to the client that in that case he may not accept nomination and the matter can proceed no further. He should, in any event, make it clear that he must not be nominated until he has informed the client in writing that he is prepared to accept nomination. The member should ask that the client inform the existing auditor of the proposed change, making it clear that the member has not at that stage accepted nomination, before he himself communicates with the existing auditor. He should also ask that, at the same time, the client should give the existing auditor written authority to discuss the client’s affairs with the member. The member should decline to accept nomination if he is informed by the existing auditor that the client has refused to give the existing auditor authority to discuss its affairs with him.

200.18 The initiative in the matter of communication rests with the member. The existing auditor should not volunteer information in the absence of such communication and of authority from the client (See paragraph 200.23 for circumstance where client's consent is not needed).

200.19 The purpose of finding out the background to the proposed change is to enable the member to determine whether, in all the circumstances, it would be proper for him to accept nomination. In particular, members will wish to ensure that they do not unwittingly become the means by which any unsatisfactory practices of the company or any impropriety in the conduct of its affairs may be enabled to continue or may be concealed from shareholders or other legitimately interested persons. Communication is meant to ensure that all relevant

facts are known to the member who, having considered them, is then entitled to accept the nomination if he wishes so to do. The need to communicate exists whether or not the existing auditor intends to make representations to the proprietors, including his statutory right to make representations to the shareholders of a client company, and whether or not he still holds office as auditor. Communication of the facts to a prospective successor cannot relieve the existing auditor of his duty to continue to press on the client his views on any technical or ethical matters which may have led him into dispute with the client, nor does it affect the freedom of the client to exercise his right to a change of auditor.

200.20 The existing auditor should answer without delay the communication from a proposed new auditor. If there are no matters of which the new auditor should be made aware, the existing auditor should write to say that this is the case. Subject to what is said in paragraphs 200.13, 200.14 and 200.17, if there are such matters, he should inform the proposed new auditor of those factors of which in his opinion the latter should be aware. The proposed auditor may wish to confer with the existing auditor and the latter may explain why in his opinion it is not advisable for the proposed auditor to accept nomination. He may prefer to explain this orally.

200.21 The existing auditor should give information as to the professional considerations which arise. This information may indicate, for example, that the reasons for the change which are advanced by the client are not in accordance with the facts. It may disclose that the proposal made to displace the existing auditor is put forward because he has stood his ground and carried out his duties as auditor in the face of opposition or evasion on an occasion on which important differences of principle or practice have arisen between him and the client.

200.22 Should it be represented to the member, by the client or by the existing auditor, that the desire to replace the existing auditor is prompted by disagreement over such matters as the truth and fairness of the view shown by the client's accounts or the depth or methods of audit work performed, the member should, after ascertaining the existing auditor's views, discuss with the client the areas of disagreement and satisfy himself either that the client's view is one which he can accept as reasonable, or that, if he does not accept it, the client will accept his right to that contrary opinion, and, if appropriate, his duty to express it in his audit report. Only if he is so satisfied should the member be prepared to accept nomination.

200.23 If the existing auditor has withdrawn from the professional relationship pursuant to paragraphs R360.20 and 360.21 A1 under Chapter A of the Code, he should, on request by the proposed new auditor, provide all facts and other information concerning the identified or suspected non-compliance with laws and regulations to the proposed new auditor without the need to obtain client's consent, unless prohibited by law or regulation. See paragraph R360.22 under Chapter A of the Code for further guidance.

200.24 Where there has been failure or refusal by the client to supply him with information properly required by him for the performance of his duties, the existing auditor should so inform the proposed new auditor.

200.25 It may be essential for the performance of his professional obligations defined in this guidance or (if the member subsequently accepts appointment) for the proper discharge of his duties as auditor, that the member should disclose information given to him by his predecessor. For example, disclosure to officers or employees of the client may be unavoidable if the matters brought to his attention by his predecessor are to be properly investigated. However, such disclosure should be no wider than is necessary for the performance of these obligations and duties. Unless the foregoing considerations apply, the member should treat in the strictest confidence any information given to him by an outgoing auditor. He should give due weight to the reply of that auditor and to any representations which the latter may inform him he intends to make to the shareholders. Resentment on the part of the existing auditor of the actions taken by those who propose a change or at the possible loss of an audit is not a valid argument against the change.

200.26 If the member does not receive within a reasonable time a reply to his communication to the existing auditor and he has no reason to believe that there are any unusual circumstances surrounding the proposed change, he should endeavour to get into touch with the existing auditor by some other means. If he is unable to do so, or is unable to obtain a satisfactory outcome in this way he should send a further letter, preferably by recorded delivery service, stating that unless he receives a reply within a specified time, he will assume that there are no matters of which he should be aware before deciding whether to accept.

200.27 [Not used]

200.28 The foregoing paragraphs indicate the general principles by which a member should be guided when invited to act as auditor of a company. Additional considerations on matters of detail are indicated below.

Appointment of a Joint Auditor

200.29 When a member receives an invitation to accept nomination as a joint auditor either with a prospective new joint appointee or with an existing auditor he should be guided by similar principles to those set out above in relation to nomination as sole auditor.

Retirement of a Joint Auditor when the Fellow Joint Auditor Continues in Office

200.30 The appointment of joint auditors confers joint and several responsibility on all the joint auditors appointed by a company. The proposed withdrawal or displacement of a joint auditor creates a circumstance in which the nature of the appointment is substantially changed so that a surviving joint auditor should communicate formally with his fellow joint auditors as though he was being asked to undertake a completely new appointment.

Filling a Casual Vacancy

200.31 When a member is invited by the directors to accept appointment to fill a casual vacancy, he should be guided by principles similar to those set out above in relation to an ordinary nomination. He may, however, need to adapt his procedure in the light of the particular circumstances, obtaining such information as he may need from the previous auditor's partners, if any, or the administrators of his estate or such other source as seems appropriate.

Business Acquired by a New Company

200.32 When a member is asked to accept appointment as auditor of a new company formed to acquire an existing business and the ownership of the company is substantially the same as it was of the acquired business, the member should, in his own interest, communicate with the auditor or accountant who acted for that business.

Unpaid Fees of Previous Auditor

200.33 The fact that there may be fees owing to the existing auditor is not of itself a reason why the member should not accept nomination. If he does accept, it may be appropriate for him to assist in any way open to him towards achieving a settlement of the fees outstanding; whether or not he does so is entirely a matter for his own judgement in the light of all the circumstances. He should not seek to interfere with the exercise of any lien which the existing auditor may have (see Statement 1.301, paragraphs 29 et seq).

Transfer of Books and Papers

200.34 The existing auditor should transfer promptly to his successor after he has been duly appointed all books and papers of the company which are in his possession, unless he is

exercising a lien thereon for unpaid fees. As to the exercising of a lien, see Statement 1.301 and, in particular, in relation to corporate clients, paragraphs 33 - 40 thereof.

Providing Information to a Successor

200.35 The new auditor will often need to ask his predecessor for information as to the client's affairs, lack of which might prejudice the client's interests. Such information should be promptly given and, unless there is good reason to the contrary, such as an unusual amount of work involved, no charge should be made.

200.36 The existing auditor is under no legal obligation to make any of his working papers available for review by the new auditor but he has an ethical obligation to respond to the new auditor's specific enquiries and, inter alia, should make available, in respect of those specific areas, working papers relating to matters of continuing accounting significance, including information which may assist the new auditor in determining consistent application of accounting principles.

Statutory Provisions

200.37 By statute, an outgoing auditor or one whose replacement is proposed, is entitled and may be obliged to communicate to members or creditors matters connected with his ceasing to hold office and which he considers should be brought to their notice. Nothing in this section affects the exercise of those statutory rights or duties. Paragraphs 200.38 – 200.43 contain a non-exhaustive summary of the relevant provisions.

200.38 For an auditor whose appointment is terminated either when the term of office expires (unless the auditor is appointed as auditor of the company for a term immediately following the term of office that expires or is deemed to be reappointed as auditor of the company for the next financial year) or when the auditor is removed from office by an ordinary resolution of the company passed at a general meeting, under section 425 of the Companies Ordinance, the auditor must, on the termination, give the company:

(a) if he considers that there are circumstances connected with the termination that should be brought to the attention of the company's members or creditors, a statement of those circumstances (i.e. statement of circumstances); or

(b) if he considers that there are no such circumstances, a statement to that effect.

200.39 When special notice is given by the company for a resolution for appointing an incoming auditor in place of the outgoing auditor, under section 422(2) of the Companies Ordinance, the outgoing auditor:

(a) may give the company a statement that sets out in reasonable length the circumstances surrounding the termination of the appointment as auditor (i.e. cessation statement);

(b) may request the company to state in every notice of the meeting given to the members that the statement has been made and to send a copy of the statement to every member to whom a notice of the meeting is or has been given, if the company receives the statement on a date that is more than 2 days before the last day on which notice may be given to call the general meeting;

(c) may request the company to ensure that the statement is read out at the meeting, if the company has not sent a copy of the statement to every member to whom a notice of the meeting is or has been given;

(d) is entitled:

- to be given every notice of, and every other item of communication, relating to the general meeting, that a member of the company is entitled to be given;

- to attend the general meeting; and

- to be heard at the general meeting on any part of the business of the meeting that concerns the person as auditor or former auditor of the company.

200.40 When special notice is given by the company to the auditor on an ordinary resolution for removing him from the office of auditor, under section 422(3) of the Companies Ordinance the outgoing auditor:

- may give the company a statement that sets out in reasonable length the circumstances surrounding the proposed removal (i.e. cessation statement);

- may request the company to state in every notice of the meeting given to the members that the statement has been made and to send a copy of the statement to every member to whom a notice of the meeting is or has been given, if the company receives the statement on a date that is more than 2 days before the last day on which notice may be given to call the general meeting;

- may request the company to ensure that the statement is read out at the meeting, if the company has not sent a copy of the statement to every member to whom a notice of the meeting is or has been given.

200.41 When a proposed written resolution is given by the company for appointing an incoming auditor in place of the outgoing auditor, under section 423(2) of the Companies Ordinance, the outgoing auditor:

- may give the company a statement that sets out in reasonable length the circumstances surrounding the proposed termination of the appointment as auditor (i.e. cessation statement); and

- may require the company to send a copy of the statement to every member at the same time when the written resolution is circulated under section 550 or 552 of the Companies Ordinance.

200.42 For an auditor who resigns by giving the company a notice in writing under section 417(1): his term of office expires at the end of the day on which the notice is given to the company or at a later date as specified in the notice. By section 424 of the Companies Ordinance such auditor must, on the resignation, give the company:

- if he considers that there are circumstances connected with the resignation that should be brought to the attention of the company's members or creditors, a statement of those circumstances (i.e. statement of circumstances); or

- if he considers that there are no such circumstances, a statement to that effect.

By section 421 of the Companies Ordinance, if the notice of resignation is accompanied by a statement of circumstances, such auditor may require the directors to convene a general meeting for receiving and considering the explanation of the circumstances connected with the resignation that the auditor places before the meeting. If such general meeting is convened, under section 422(1) of the Companies Ordinance such auditor:

- may give the company a statement that sets out in reasonable length the circumstances surrounding the resignation (i.e. cessation statement);

- may request the company to state in every notice of the meeting given to the members that the cessation statement has been made and to send a copy of the cessation statement to every member to whom a notice of the meeting is or has been given, if the company receives the statement on a date that is more than 2 days before the last day on which notice may be given to call the general meeting;

- may request the company to ensure that the cessation statement is read out at the meeting, if the company has not sent a copy of the cessation statement to every member to whom a notice of the meeting is or has been given;

- is entitled to be given every notice of, and every other item of communication, relating to the general meeting, that a member of the company is entitled to be given;

- is entitled to attend the general meeting and to be heard at the general meeting on any part of the business of the meeting that concerns the person as auditor or former auditor of the company.

200.43 Section 410 of the Companies Ordinance gives an auditor qualified privilege for statements made in the course of performing duties as auditor of the company. In particular, in the absence of malice, an auditor is not liable for defamation in respect of any cessation statement or statement of circumstances connected with his or her cessation of office.

APPENDIX

AN EXAMPLE OF A "CLEARANCE LETTER"

Dear Sirs,

We have been nominated to act as auditors of ..... Limited.

In order to assist us in determining whether to accept such nomination, we should be grateful if you would advise if there are any circumstances surrounding the proposed change of which we should be aware.

Yours faithfully,

SECTION 300

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

This section should be read in conjunction with Section 320 "Professional Appointments" under Chapter A of the Code*.*

300.1 The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) have raised concerns with the Hong Kong Institute of Certified Public Accountants concerning announcements made by listed issuers of the SEHK of the reasons for changes in auditors. In many cases, fee disputes are stated to be the reason for the change. Concern has been expressed that certain auditors have been relying on purported fee disputes to disguise the real reasons for the change. As a result, potentially significant and fundamental matters about the listed issuer may not be disclosed to investors and creditors and the market is not therefore being kept fully informed. It is important that the situation concerning the change of auditors should be disclosed in full to avoid the possibility of the market being misled.

300.2 The purpose of this section, which has been prepared in consultation with the SEHK and the SFC, is to establish a framework to enhance communication by auditors with a listed issuer where there is a change of auditors. The framework requires the outgoing auditors to prepare a letter to the audit committee and the board of directors setting out the circumstances leading to their resignation or termination.

300.3 This section deals with changes of auditors of a listed issuer including auditors who resign before the expiration of their term of office, decide not to seek re-election at the Annual General Meeting, are notified by the directors that they will not be nominated for re-appointment, or are removed during their term of office.

300.4 This section should be read in conjunction with Section 320 "Professional Appointments" under Chapter A of the Code and Section 200 "Changes in a Professional Appointment" of this chapter.

300.5 Under Rule 13.88 of the Main Board Listing Rule and Rule 17.100 of the GEM Listing Rule, a listed issuer must at each annual general meeting appoint an auditor to hold office from the conclusion of that meeting until the next annual general meeting. The issuer must not remove its auditor before the end of the auditor's term of office without first obtaining shareholders' approval at a general meeting. An issuer must send a circular proposing the removal of the auditor to shareholders with any written representations from the auditor, not less than 10 business days before general meeting. An issuer must allow the auditor to attend the general meeting and make written and/or verbal representations to shareholders at the general meeting. Under code provision E.1.2 in Appendix 14 of Main Board Listing Rule and Appendix 15 of GEM Listing Rule, an issuer's management should ensure the external auditor attend the annual general meeting to answer questions about the conduct of the audit, the preparation and content of the auditor's report, the accounting policies and auditor independence.

300.6 Auditors of Hong Kong incorporated listed issuers are reminded that sections 417 and 424 of the Companies Ordinance require an auditor who resigns from office before the expiry of its term must, if the resignation is to be effective, include in his resignation a statement of any circumstances connected with his resignation which he considers ought to be brought to the notice of members or creditors of the company, or a statement that there are no such circumstances. Under section 425(1) such requirements are also extended to an auditor who has been removed and a retiring auditor who has not been reappointed. However, auditors are to note that this section is not intended to provide guidance regarding the above requirements of the Companies Ordinance.

300.7 The terms “listed issuer”, “incoming auditors” and “outgoing auditors” are used throughout this section and are defined as follows:

(a) "Listed issuer" means a company listed on the Main Board or Growth Enterprise Market (GEM) of the SEHK.

(b) “Incoming auditors” means the auditors or the auditors to be nominated for the current period who did not audit the preceding period’s financial statements.

(c) “Outgoing auditors” means the auditors who were previously the auditors and have been or are to be replaced by any incoming auditors.

Duty to the Shareholders to Report on the Financial Statements

300.8 Auditors are reminded that once they are appointed, they have a duty to the shareholders to report to them on the financial statements, and should make every reasonable effort to discharge this duty. Auditors should not attempt to avoid the responsibility of reporting on the financial statements by resigning.

300.9 The auditors’ proper course of action, once appointed, is to report on the financial statements. If they are considering resigning during their term of office they should discuss the contentious issues which may lead to their resignation with the audit committee and seek the audit committee’s assistance to resolve the issues with management and to complete the audit. Having completed the audit, if they do not wish to be re-appointed, they should decline to stand for re-appointment when their term of office expires.

Communication with the Audit Committee and the Board of Directors

300.10 This section requires the outgoing auditors to prepare a letter to the audit committee and the board of directors of the listed issuer, whenever:

(a) the outgoing auditors resign or decline to stand for re-appointment (Resignation); or

(b) the listed issuer decides to propose to its shareholders that the outgoing auditors be removed from office during the auditors’ term of office, or there is a proposal or intention not to re-appoint them on the expiry of their term of office (Termination).

300.11 The outgoing auditors’ letter to the audit committee and the board of directors should set out the circumstances leading to their Resignation or Termination, hereafter referred to as “Letter of Resignation or Termination”. The circumstances to be disclosed in the Letter of Resignation or Termination are all occurrences that, in the opinion of the outgoing auditors, affect the relationship between the listed issuer and the outgoing auditors.

300.12 Occurrences that affect the relationship between the listed issuer and the outgoing auditors include, but are not limited to, “disagreements” and/or “unresolved issues”, as discussed below. The disagreements and unresolved issues to be disclosed will generally be those that occurred in connection with:

(a) the audit of the listed issuer’s most recently completed financial year;

(b) any period subsequent to the most recently completed financial period for which an audit report has been issued up to the date of the Resignation or Termination.

300.13 Disagreements refer to any matter of audit scope, accounting principles or policies or financial statement disclosure that, if not resolved to the satisfaction of the outgoing auditors, would have resulted in a qualification in the audit report.

300.14 Disagreements include both those resolved to the outgoing auditors' satisfaction which affect the relationship between the listed issuer and the outgoing auditors, and those not resolved to the outgoing auditors' satisfaction. Disagreements should have occurred at the decision making level, i.e., between personnel of the listed issuer responsible for the finalization of its financial statements and personnel of the auditors responsible for authorizing the issuance of audit reports with respect to the listed issuer.

300.15 The term disagreement is to be interpreted broadly. It is not necessary for there to have been an argument for there to have been a disagreement, merely a difference of opinion. The term disagreement does not include initial differences of opinion, based on incomplete facts or preliminary information, that were later resolved to the outgoing auditors' satisfaction, provided that the listed issuer and the outgoing auditors do not continue to have a difference of opinion upon obtaining additional facts or information.

300.16 Unresolved issues refer to matters which come to the outgoing auditors' attention and which, in the outgoing auditors' opinion, materially impact on the financial statements or audit reports (or which could have a material impact on them), where the outgoing auditors have advised the listed issuer about the matter and:

(a) the outgoing auditors have been unable to fully explore the matter and reach a conclusion as to its implications prior to a Resignation or Termination;

(b) the matter was not resolved to the outgoing auditors' satisfaction prior to a Resignation or Termination; or

(c) the outgoing auditors are no longer willing to be associated with the financial statements prepared by management of the listed issuer in relation to circumstances described in HKSA 560 "Subsequent Events" when it becomes effective on "Facts which become known to the auditor after the financial statements have been issued" resulting in the withdrawal of an audit report.

300.17 The outgoing auditors should note that disclosing the circumstances leading to their Resignation or Termination in the Letter of Resignation or Termination is the appropriate method of discharging their responsibilities during a change in a professional appointment without having to be concerned with the professional duty of confidentiality owed to the listed issuer. In the event that the incoming auditors approach the outgoing auditors for professional clearance and ask whether the outgoing auditors are aware of any unusual circumstances surrounding the proposed change of auditors which may be relevant in determining their acceptance of nomination, as required by Section 200 "Changes in a Professional Appointment" of this chapter, the outgoing auditors can refer the incoming auditors to their Letter of Resignation or Termination.

The Incoming Auditors

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

300.19 If the listed issuer refuses to provide the incoming auditors with a copy of the Letter of Resignation or Termination and any correspondence referred to in the Letter of Resignation or Termination, the incoming auditors should decline to accept nomination.

Announcement Made by the Listed Issuer on the Change of Auditors

300.20 Auditors of a listed issuer should be cognizant of the provisions of the Main Board and GEM Listing Rules (Listing Rules) regarding changes in audit appointments.

300.21 The outgoing auditors should note that the listed issuer is required to make an announcement pursuant to the Listing Rules setting out the reason(s) for the change of auditors and any other matters that need to be brought to the attention of holders of securities of the issuer (including, but not limited to, circumstances set out in the outgoing auditors' Letter of Resignation or Termination in relation to the change of auditors). In the Letter of Resignation or Termination, the outgoing auditors should remind the listed issuer of this obligation and should give their express consent to the letter being supplied to the SEHK.

300.22 The outgoing auditors should read and assess whether the circumstances as reported in their Letter of Resignation or Termination, which, in their opinion, need to be brought to the attention of the shareholders, are reflected in the announcement made by the listed issuer. In the event that the outgoing auditors notice that the circumstances leading to their Resignation or Termination as announced by the listed issuer are materially different from the circumstances as reported by them in their Letter of Resignation or Termination in respect of matters that need to be brought to the attention of the shareholders, they should write to the audit committee and board of directors of the listed issuer regarding those matters.

300.23 In practice, it is recommended that the listed issuer should agree with the outgoing auditors the details relating to the circumstances in the announcement before its issuance. This is to help avoid the situation described in paragraph 300.22 above. However, it should be noted that such an approach should not unduly delay the listed issuer's announcement of the change of auditors.

300.24 If the outgoing auditors write in accordance with paragraph 300.22 above and the listed issuer takes no adequate action in response, they should consider whether the market has been adequately informed as to the circumstances leading to their Resignation or Termination. If not, the outgoing auditors should consider whether these should be brought to the attention of the relevant regulatory authority.

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

SECTION 400

Unlawful Acts or Defaults by Clients of Members

This section should be read in conjunction with Subsection 114 "Confidentiality" and Section 360 "Responding to Non-Compliance with Laws and Regulations" under Chapter A of the Code.

Occasions sometimes arise where a member, in carrying out his professional duties, acquires knowledge indicating that a client or an officer or employee of the client may have been guilty of some default or unlawful act. This may put him in a difficult situation of conflicting duties, aggravated sometimes by allegations that he himself is implicated in some way in those unlawful acts, or has some legal responsibility arising from those acts. Section 360 under Chapter A of the Code sets out the response framework for members in practice when members encounter or are made aware of suspected or actual non-compliance with laws and regulations in the course of providing professional services to clients. This section gives additional guidance to members concerning certain areas of difficulty, which involve both professional conduct and legal considerations. However, it is for general guidance only and in any particular case reference should also be made to any relevant legislation. Although various examples are given of the duties of members, they are examples only.

Every case depends upon its own circumstances and if a member is in the slightest doubt as to his correct course of action he should seek independent legal or other professional advice.

This section of guidance has been settled in consultation with counsel.

General Principles

Introduction

400.1 In recent years there has been a steady growth internationally in the number of criminal offences committed, or suspected by the authorities to have been committed, in the business environment. It is not practicable to set out all the offences which members may encounter in the course of their work but the principal statutory and common law offences concerned are:

(a) theft, obtaining by deception, false accounting;

(b) fraud, forgery and offences in relation to companies including frauds on creditors and shareholders;

(c) corruption offences;

(d) conspiracy, soliciting or inciting to commit crime;

(e) offences in relation to taxation;

(f) involvement in arrangements relating to the proceeds of drug trafficking.

400.2 Section 360 under Chapter A of the Code sets out the response framework for members in practice to respond to suspected or actual non-compliance with laws and regulations committed by clients that have a direct effect on the client's financial statements or the operation of the client's business. This section provides additional local guidance to assist members in responding to situations when, in one way or another, their clients or officers or employees of their clients come under suspicion by the authorities (whether justified or not) of having committed some criminal offences, or members themselves have information that their clients have in one way or another become so implicated. The guidance given in the Guidelines is not intended to be exhaustive. There will arise from time to time situations of conflicting duties not covered by these Guidelines. Members should therefore use their own

judgement in all cases and would be well advised to seek legal or other professional advice if in doubt.

400.3 A practising member, acting in any professional capacity, has access to much information of a private nature. It is essential that he should normally treat such information as available to him for the purpose only of carrying out the professional duties for which he has been engaged. To divulge information about a client's affairs would normally be a breach of professional confidence unless the response framework set out in section 360 under Chapter A of the Code prescribes otherwise. Accordingly, the duty of confidentiality is not absolute. Where, for example, members acquire information in the course of an audit showing that actual or suspected defaults and unlawful acts have taken place, members may be duty-bound to make such disclosures and statements in their reports as would ensure that their functions and duties as auditors are properly discharged. Likewise members may have duties to make reports as auditors under the Banking Ordinance 1986 or to make disclosures to the relevant authorities under the Drug Trafficking (Recovery of Proceeds) Ordinance both of which require the disclosure of confidential information. Even if there is no law or regulation that requires members to disclose the defaults and unlawful acts, members should follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Relations Between a Member and His Client

Disclosure of Information by His Client to a Member

400.4 Where a member is engaged to prepare or audit accounts of a client or to deal with taxation or any other work relating to that client he should always make it clear to the client that he can only do so on the basis of full disclosure of all information relevant to the work in question. If the client will not agree, the member should not act for him.

400.5 If the client fails to provide such information or explanation as the member may require, the member has a clear professional obligation to indicate this fact in any report and may consider that he can no longer act. Under section 408 of the Companies Ordinance the auditor commits an offence if he knowingly or recklessly cause certain statements required by section 407(2)(b) and (3) of the Companies Ordinance to be omitted from the auditor's report. Section 407(2)(b) and (3) contain requirements on auditor's report when the auditor cannot obtain adequate information or explanation that are necessary and material for the purpose of the audit or when the financial statements are not in agreement with the accounting records in any material respect.

400.6 Under section 413 of the Companies Ordinance a person commits an offence if:

(a) the person makes a statement to an auditor of a company that conveys or purports to convey any information or explanation that the auditor requires, or is entitled to require, under section 412(2) or (4) of the Companies Ordinance;

(b) the statement is misleading, false or deceptive in a material particular; and

(c) the person knows that, or is reckless as to whether or not, the statement is misleading, false or deceptive in a material particular.

400.7 A member may, in the course of acting for one client, acquire information which he is aware discredits the information supplied to the member by a second client. In such a case the member may not reveal to the second client any information obtained as a result of his dealings with the first client. To do so without permission would be a breach of the duty of confidentially owed to the first client. In practice it will probably not be possible to obtain the first client's permission to disclose information to the second client without a breach of confidentiality in respect of the second client's affairs. The member must first do his best to

make sure that the information that he has acquired is valid. Thereafter, the member should use every endeavour to obtain from within the records of the second client evidence to substantiate independently the information acquired from the first client. In the absence of any such evidence the member should, in appropriate cases, consider seeking the second client's consent to obtaining direct confirmation of the information concerned. If the member is seeking confirmation in connection with his work as auditor of the second client and consent is refused he should consider qualifying his report or resigning, and, where relevant, making an appropriate statement under sections 417 and 424 of the Companies Ordinance without revealing the name of the first client. In other cases where consent is refused the member should consider ceasing to act.

Disclosure of Defaults or Unlawful Acts

400.8 It is an implied term of a member's contract with his client that the member will not, as a general rule, disclose to other persons information about his client's affairs acquired during and as a result of their professional relationship, against his client's wishes.

400.9 The relationship between client and member is a highly confidential one, in which candour on the part of the client is of great importance, and it is in the public interest that, in general, that confidence should be maintained. The very fact that, relying on the confidential relationship which exists, clients are frank with members probably prevents a large number of offences being committed because a client, on discussing his intentions and proposed action with the member, will have the dangers pointed out to him; if he acts on the member's advice, he will refrain from putting his proposal into action.

400.10 However, the confidentiality is by no means absolute. There will be circumstances where a member is *required by law or statute* to disclose to others knowledge of defaults or criminal acts acquired in the course of such confidential relationship. Even if there is no law or regulation that requires the member to disclose suspected or actual non-compliance matters, members should follow the response framework set out in section 360 under Chapter A of the Code to respond to such non-compliance situations and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Obligation to Disclose

400.11 A member must disclose information if compelled by process of law, for example under a court order or under the compulsion of a statute, in particular sections 13 and 14(1)(d) of the Prevention of Bribery Ordinance, section 51(4)(a) of the Inland Revenue Ordinance and sections 20, 21 and 25 of the Drug Trafficking (Recovery of Proceeds) Ordinance.

400.12 The only exception to the above rule - paragraph 400.11 - might be where, in the course of giving the information, the member might incriminate himself in relation to crimes that he might himself have committed. In such circumstances he might be entitled to the benefit of the ordinary privilege against self-incrimination. If such a situation should arise, members are strongly advised to seek legal representation. However it should be noted that a person cannot refuse to reply to a section 14(1)(d) Notice on the grounds of self-incrimination because any reply to the Notice cannot be used as evidence against the maker.

400.13 Where a member is approached by the police, the Inland Revenue Department, the Independent Commission Against Corruption ('ICAC') or other authority in the course of making enquiries concerning the affairs of a client or former client, the member should act with caution. He should first ascertain whether or not the person requesting information has a statutory right to demand it. Generally speaking, a member will not be acting contrary to law if he refuses to impart information to persons who have no statutory right to demand it; on the other hand, he might well be acting in breach of his duty of confidence to his client if he volunteers the information. It is advisable for members to seek legal advice to clarify the legal aspects of their positions if in doubt. Nevertheless, if a member has encountered or is

aware of any suspected or actual non-compliance with laws and regulations in the course of providing professional services to his client that is related to the enquiry made by the authority, he should follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

400.14 If a notice is served on a client requiring production of documents which are in the possession of the member but are the property of the client the member should read the notice carefully to see if he is under compulsion of law to produce the documents. If he is, then the question of the client's permission is not relevant and the member must comply with the notice. If there is doubt in the matter - where, for example, the notice does not sufficiently identify the documents or class of documents to be produced - then the member should not produce the document unconditionally. One way of resolving a dispute of this nature is to have the documents put separately and sealed, pending the taking of legal advice.

400.15 Likewise, if the notice requires the giving of information (rather than the production of documents) the considerations set out in paragraph 400.14 will generally apply.

400.16 A member should not normally appear in court as a witness in a case against a client or former client, unless he is served with a subpoena or other lawful summons to do so. He cannot lawfully refuse to produce in court any documents in his ownership or possession which the court may direct him to produce. If the persons in charge of the prosecution have indicated that they will call upon him to produce certain documents in court, the member should have the documents with him, but the power to order the production in court rests with the court.

Disclosure for the Protection of the Member's Own Interest

400.17 [Not used]

400.18 A member may disclose to the appropriate authorities information concerning his client where the member's own interests require disclosure of that information. Under such circumstances there is no contractual bar to disclosure of information concerning a client. Examples of circumstances where a member is free to disclose include the following:

(a) where it might enable the member to defend himself against a criminal charge or to clear himself of suspicion; or

(b) to resist an action for negligence brought against him by his client or some third person; or

(c) to enable the member to defend himself against disciplinary proceedings or criticism of him which is the subject of enquiry under the disciplinary rules of the Hong Kong Institute of Certified Public Accountants (the "Institute"); or

(d) to enable the member to sue for his fees.

Members' Own Relations with Authorities

Criminal Offences

400.19 A member himself commits a criminal offence:

(a) if he incites a client or anyone else to commit a criminal offence; or

(b) if he helps or encourages a client or anyone else in the planning or execution of a criminal offence; or

(c) if he agrees with a client or anyone else to pervert or obstruct the course of justice by concealing, destroying or fabricating evidence or by misleading the police by statements which he knows to be untrue.

400.20 Further, section 90 of the Criminal Procedure Ordinance makes it a criminal offence for anyone to do any act with intent to impede the apprehension or prosecution of another person, knowing that the other person has committed a serious offence.

400.21 Section 91 of the Criminal Procedure Ordinance makes it a criminal offence for anyone, knowing that a serious offence has been committed by another person, and knowing (or believing) that he has information that might be of material assistance in securing the prosecution or conviction of that person, accepts any consideration for not disclosing such information.

400.22 With regard to paragraphs 400.20 and 400.21 above, offences under the Inland Revenue Ordinance involving the evasion (or attempted evasion) of tax assessable under the Ordinance may constitute a “serious offence” as referred to in those two paragraphs above.

Taxation Matters

Introduction

400.23 Fraudulent evasion and attempted evasion of taxes are criminal offences.

400.24 The making of false statements (whether written or not) relating to tax with intent to defraud the Revenue or delivery of false documents with that intent are likewise criminal offences.

400.25 Tax avoidance is not an offence and should be distinguished from evasion. Avoidance consists of the arrangement of a taxpayer’s affairs within the law so as to minimise the incidence of tax. In advising on methods of minimizing tax, members must obviously have regard to the dominant objectives of the client’s transactions, particularly having regard to the provisions of sections 61 and 61A of the Inland Revenue Ordinance.

Penalty Proceedings and Mitigation

400.26 The statutes imposing taxes and duties usually define a number of offences for which money penalties recoverable in penalty proceedings are prescribed. Penalty proceedings are not criminal proceedings, and the recovery of a penalty against a taxpayer does not normally prejudice the institution of criminal proceedings against him; although in the case of proceedings instituted under section 82A of the Inland Revenue Ordinance to recover additional tax, the taxpayer is protected from criminal proceedings under section 80(2) or 82(1) in respect of the same facts.

Property Tax, Salaries Tax, Profits Tax and Interest Tax

400.27 At the date of publication of this section the taxes with which members are most likely to be concerned are property tax, salaries tax, profits tax and interest tax. The position as regards these taxes is considered in more detail in paragraphs 400.28 to 400.47 below.

Taxation Frauds and Negligence Involving Accounts

Presumption as to returns statements and forms submitted by one person on behalf of another

400.28 The attention of members is drawn to subsection (5) of section 51 of the Inland Revenue Ordinance which provides that any returns or statements submitted by or on behalf of any person shall be deemed to have been submitted by him or by his authority unless he proves the contrary. In view of this provision, and in order to minimise the risk of misunderstanding between the client and the accountant, members are recommended to ensure that they are acting under an appropriate authority when submitting accounts to the Inland Revenue Department in connection with the ascertainment of a client's liability to property tax, profits tax or interest tax and to take steps to ensure that the client has signed or otherwise approved the accounts.

Past accounts later found to be defective

400.29 A member's duty of confidence to his client can be qualified by the client's own conduct. If a client has withheld information from or otherwise deceived a member, with the result that accounts prepared or reported upon by him or returns or computations based thereon were defective, and the member has submitted or is aware that the client has submitted those accounts or documents to the Inland Revenue Department, it would be improper for the member to allow the Inland Revenue Department to continue to rely upon them. He should advise his client to make a complete disclosure to the Inland Revenue Department. (For the circumstances in which disclosure may be justified see paragraphs 400.8 to 400.18 above).

400.30 Having advised his client to make such disclosure without delay, the member should, for his own protection, ensure that a record of his advice to his client is kept, so as to rebut any possible charge of conspiracy with or of aiding and abetting his client under section 80(4) or of assisting his client to evade tax under section 82(1) of the Inland Revenue Ordinance.

400.31 If the client refuses to act in accordance with the member's advice to make an immediate disclosure, the member should inform his client that he can no longer act for him in tax matters and that it will be necessary for the member to inform the Inland Revenue Department that, since he prepared or reported upon the accounts concerned or the returns or computations based thereon, he has acquired information which indicates that those accounts or documents cannot be relied upon and that he has ceased to act for the client in tax matters. The member should then so inform the Inland Revenue Department. Under sections 51(4) and 51B of the Inland Revenue Ordinance, the Inland Revenue Department may require members to furnish relevant information as may be required, and may obtain search warrants for the purpose of obtaining such information. Should such action be taken by the Inland Revenue Department, the member would be under no obligation to obtain the client's consent before releasing such information. Even if the Inland Revenue Department does not invoke section 51(4) and 51B of the Inland Revenue Ordinance, members should follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Accounts currently being prepared or audited

400.32 A member may acquire knowledge of matters which do not affect past accounts but would result in the Inland Revenue Department being defrauded if not properly dealt with in accounts which the member is currently engaged in preparing or auditing. If the client fails to provide such information as the member may require or refuses to agree to the accounts being drawn up in the manner which the member considers necessary, then the member clearly has a professional obligation to include such qualifications in his report on the accounts as will indicate the respects in which they are defective. A member must always bear in mind that "Any person who wilfully with intent to evade or to assist any other person

to evade tax ..... makes any false statement; ..... signs any statement or return without reasonable grounds for believing the same to be true; or falsifies or authorises the falsification of any books of account or records shall be guilty of a misdemeanour." (section 82 of the Inland Revenue Ordinance).

400.33 If the client dispenses with the member's services or if the member resigns before he has completed his work and reported on the accounts, there is no further legal duty rests on the member towards the Inland Revenue Department unless the Inland Revenue Department invokes section 51(4) or 51B of the Inland Revenue Ordinance. However, members are reminded that as set out in paragraph 360.21 A2 under Chapter A of the Code, withdrawing from an engagement or a professional relationship in response to non-compliance with laws and regulations would not discharge the members' professional duty under the Code as withdrawing from an engagement or a professional relationship is not a substitute for taking other appropriate actions, e.g. disclosing the matter to an appropriate authority.

400.34 Where, however, the member's services are not dispensed with, his position in relation to the Inland Revenue Department after he has completed his professional duties as accountant or auditor is as follows:

(a) the member should not without the client's authority send the accounts to the Inland Revenue Department (see paragraph 400.28).

(b) if the member is not requested to undertake the taxation work (that is to say, to act on the client's behalf in dealing with the Inland Revenue Department) he has no responsibility towards the Inland Revenue Department. In the event of his receiving any enquiry from the Inland Revenue Department he should normally do no more than state that he is not dealing with taxation matters and that all enquiries should be addressed to the client. If the enquiry indicates that accounts bearing the member's name have been submitted he should normally state that he cannot add to his report thereon. The position is the same whether or not the member has acted for the client in taxation matters in previous years.

(c) on the other hand, if the client requests the member to undertake the taxation work he should always make it clear to the client that he can do so only on the basis of full disclosure of all relevant information. If the client will not agree, the member should state that he cannot act for him in taxation matters and in that case the position regarding any enquiries the member may receive from the Inland Revenue Department is the same as in b above.

In any cases, the Inland Revenue Department may invoke section 51(4) or 51B of the Inland Revenue Ordinance to obtain relevant information from members. Members also have a professional duty to follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

400.35 Where the member has not been requested, or has declined, to act in taxation matters (items (b) and (c) of the preceding paragraph), he could lawfully continue in the future to act as accountant or auditor, including appropriate qualifications when necessary in his reports on the accounts, but not taking any part in taxation matters. In the circumstances envisaged, however, it seems likely that either the member or the client would not wish to continue the professional association between them.

Past accounts of a new client

400.36 A member who is engaged in preparing or auditing accounts for a new client may acquire knowledge indicating that accounts submitted to the Inland Revenue Department for previous years were defective. In these circumstances:

(a) the member should advise his client to make a complete disclosure to the Inland Revenue Department;

(b) the member has no responsibility for the past accounts but if the nature of the defects in them is such as to affect the correctness of the accounts which the member is engaged in preparing or auditing he should inform his client that an appropriate adjustment will need to be made and shown separately in those accounts; and if the client refuses to agree to such an adjustment the member should include appropriate qualifications in his report on the accounts. Paragraphs 400.33 to 400.35 would then apply.

Taxation Frauds and Negligence not Involving Accounts

400.37 Paragraphs 400.28 to 400.36 above relate to taxation frauds and negligence through the medium of defective accounts. A member may, however, acquire knowledge indicating that a client has been guilty of taxation frauds or negligence by means which do not affect the client's accounts, for example, the submission of incorrect returns of private income. The member should advise his client to make a complete disclosure to the Inland Revenue Department. If the client refuses to do so, the member's position will depend upon whether or not the matter is within the scope of the duties he has undertaken for the client:

(a) if it relates to taxation matters on which the member has not acted for the client (for example, omission of private income where the member has dealt only with the tax computations of business profits and not with the client's tax returns), the member has no legal duty to make any disclosure to the Inland Revenue Department. He could lawfully continue to act for the client as hitherto. He may prefer to terminate the association.

(b) if it relates to taxation matters on which the member has acted for the client, then the member should inform the client that he can no longer act for him and that it will be necessary for the member to inform the Inland Revenue Department that he must dissociate himself from the returns (or other information involved) for the years in question and that he has ceased to act for the client on taxation matters. The member should then so inform the Inland Revenue Department.

In the case of either a or b above, the Inland Revenue Department may invoke section 51(4) or 51B of the Inland Revenue Ordinance to obtain such further details as may be relevant. Members also have the professional duty to follow the response framework in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing such taxation frauds and negligence to an appropriate authority.

General Professional Duty to Give Guidance

400.38 A member should regard himself as having a professional obligation to urge upon a client, in the client's own interests, the importance of making a full disclosure and authorising the member to proceed, where necessary, with "back duty" negotiations.

400.39 Circumstances vary and it is not always that a client fully appreciates the seriousness of his offence or the consequences that may ensue: in particular he may not realise that if there is no disclosure and the Inland Revenue Department later discovers a fraud there is considerably greater likelihood of a criminal prosecution (with the possibility of imprisonment on conviction) than where a suitable monetary settlement is offered on the client's own disclosure.

400.40 The client may also not realise that if a member is obliged to cease to act for him and notifies the Inland Revenue Department to that effect in the manner advised in preceding paragraphs (after which the member would have no further dealings with the Inland

Revenue Department in relation to the client) this may well result in the Inland Revenue Department commencing enquiries which lead to discovery of fraud.

400.41 All these are matters which the member should regard as his professional duty to impress upon the client. If nevertheless his advice is not accepted, it is important that the member's subsequent conduct should, from both the legal and professional standpoints, be correct.

Statutory Provisions Relating to Disclosure of Information

400.42 Under section 51(4) of the Inland Revenue Ordinance an assessor of the Inland Revenue Department has power to serve a notice requiring any person on whom the notice is served to make available for inspection any documents which may be relevant for the purposes of obtaining full information on any matter which may affect any liability, responsibility, or obligation of any person under the Inland Revenue Ordinance. A member on whom such a notice is served has a statutory duty to comply with the notice. No question of confidentiality to the client could arise if the notice sufficiently identifies the documents or class of documents for which production for inspection is required.

400.43 It is, however, not unusual for assessors as a matter of practical convenience to ask a client, or the member acting for him, for information which the assessor may have no statutory right to demand but which could be called for by the Assistant Commissioners or by the Commissioner of Inland Revenue under the statutory provisions referred to above. A client need not comply with an assessor's request where it exceeds the rights which could be exercised by the assessor. The client may, however, prefer to comply (and it may be in his best interests to do so) rather than wait for the formal exercise of powers under section 51B.

400.44 As indicated in paragraphs 400.31 and 400.37(b) above, a member should inform the Inland Revenue Department when he subsequently learns that accounts prepared by him, or returns or computations based thereon, are defective and cannot be relied upon, and where such is the fact, that he has ceased to act for the client in taxation matters. Where a member has taken over the practice of another accountant, he may receive a request from the Inland Revenue Department for his co-operation by way of providing information relating to his clients, the object being to enable the Department to make a general review to decide whether there are any clients whose affairs appear to need further investigation. The member should not normally disclose information without client's consent unless he is compelled by law or he determines that such disclosure is needed in the public interest according to section 360 under Chapter A of the Code.

Members' Working Papers

400.45 As indicated in the Institute's Statement 1.301 "Books and Papers - Ownership, Disclosure and Lien", a member's working papers are his own property and not that of his client. However, working papers do fall within the powers given to the various commissioners under the sections referred to in paragraphs 400.42 and 400.43 above and they may have to be produced as relevant evidence in connection with sections 51(4)(a) and 51B(1)(i) and in terms of section 51B(1) subsections (i) and (iii) the powers relating to search warrants were specifically extended to allow the Commissioner or authorised officer to make copies of accounts etc. relating to a client but not belonging to the person being investigated (see subsection (iii)). In contrast to the above, correspondence with the Inland Revenue Department and tax computations are the property of the client as the member is acting as agent for his client in his dealing with the Inland Revenue Department. Accordingly, he would seldom be justified in acceding to a request for the surrender of such papers without the client's consent (For the circumstances in which he could accede to the request see paragraphs 400.8 to 400.18 above).

400.46 The Institute's Council understands from discussion with the Inland Revenue Department that in back duty cases "working papers" are regarded by the Inland Revenue Department as including:

(a) analyses of banking accounts;

(b) schedules supporting the statements submitted with the report;

(c) correspondence such as with bankers and stockbrokers;

(d) correspondence with the client and with solicitors; and

(e) notes of questions and answers between the client and the accountant.

400.47 The Council wishes to emphasise that it is entirely for the member to decide whether to make his working papers available to the Inland Revenue Department. He should not normally do so without the consent of his client unless such disclosure is required by law or regulation or when the member determines that it is needed in the public interest in accordance with section 360 under Chapter A of the Code. The following paragraphs provide guidance about disclosure of the working papers listed in paragraph 400.46:

(a) with regard to the analyses, schedules and correspondence referred to in paragraph 400.46 (a), (b) and (c), the Council would see no objection to the production of relevant working papers to the Inland Revenue Department in appropriate cases if they are likely to be significant as factual evidence supporting the accountant's report and the statements submitted therewith;

(b) the correspondence and notes referred to in paragraph 400.46 (d) and (e) may well be of a highly confidential nature. Members should normally not produce such working papers to the Inland Revenue Department without client's consent unless it is required by law or regulation or when members determines that it is needed in the public interest in accordance with section 360 under Chapter A of the Code. Members are advised to seek legal advice if in doubt as to his rights and duty to disclose.

Other Taxes and Duties

400.48 Taxes and duties other than property, salaries, profits and interest taxes with which members or their clients may be concerned include at the date of publication of this section:

(a) Stamp, Estate, Betting, Entertainment and Hotel Accommodation Duties.

(b) Business Registration Fees.

The general considerations regarding taxation frauds and negligence mentioned in paragraphs 400.23 to 400.26 above broadly apply to the above mentioned fees and duties; and where a practising member is acting as an agent for a client for the purpose of any of them similar considerations to those set out in paragraphs 400.29 to 400.41 above arise. With regard to requirements to disclose information or to produce documents, reference should be made in each case to the relevant statutory provisions, which vary in their terms as between one tax or duty and another, and whether such disclosure is needed in the public interest in accordance with section 360 under Chapter A of the Code.

Special Areas

Special Points in Connection with Companies

400.49 In considering the advice given in this section it is important to bear in mind that in the case of a company governed by the Companies Ordinance the auditor's client is the company and not the directors. Where, however, the directors have so acted as to result in the company defrauding the Inland Revenue Department or committing other offences, references in this section to the "client" should be regarded in the first instance as referring to the directors of the company: for example, where it is necessary for the member to advise a client to make a full disclosure to the Inland Revenue Department the advice should be given to the directors.

Qualifications in the Auditor's Report

400.50 If it becomes necessary for the member to include qualifications in his report on the accounts, the qualifications should be in such terms as will indicate clearly the respects in which he has been unable to satisfy himself on the matters on which he is required to satisfy himself or to express an opinion, even though the result will be to disclose, to the shareholders and others who may see the accounts, the fact that offences have been committed.

400.51 Members are advised not to attempt to avoid the awkward responsibility of qualifying the report on the accounts by refusing to report and by resigning. A member has a contractual duty to the shareholders to report to them on the accounts, and should make every effort to discharge this duty. The member's proper course of action is to report upon the accounts. He should then consider whether to accept reappointment at the next General Meeting when his term of office expires. In any case, the member will not be able to avoid bringing to the attention of shareholders circumstances which may indicate that offences have been committed by resigning his office. Section 424 of the Companies Ordinance requires him to include in his notice of resignation a statement of any circumstances connected with his resignation which he considers should be brought to the notice of members or creditors of the company, or else a statement to the effect that there are no such circumstances. His resignation will be treated as ineffective unless he complies with this obligation. Members should refer to Section 200 "Changes in a Professional Appointment" in this chapter for further guidance.

400.52 In deciding whether to accept an audit appointment or reappointment as auditor, a member should consider whether limitations on the scope of his work are likely to be imposed by the client such that the member may be frustrated in performing his functions as an auditor. Such limitations may result from a client's conduct, such as the directors' refusal to provide access to books and records, or to give the required information and explanations, or where the directors prevent a particular procedure considered necessary by the auditor from being carried out. When the envisaged limitation is so significant that the member believes that the need to issue a qualification of opinion exists, or when the limitation infringes on his statutory duties as the auditor, the member would normally not accept appointment or reappointment as auditor.

Transmission of Report to Shareholders

400.53 An auditor's duty is normally performed when he sends his report to the secretary or directors of the company for onward transmission to the shareholders of the company. But if he knows that his report has not been sent to the shareholders or if he has good reason to believe that his report, when sent to the secretary or directors, will not be sent to the shareholders, it may be necessary for him to take such steps as are practicable to communicate the contents of his report direct to the shareholders. As soon as the possibility of making such a communication arises, therefore, he should seek legal advice about his duty to the shareholders in the particular circumstances of the case, as to the method of

any communication his duty requires and as to the terms in which the communication should be made.

Past Accounts

400.54 In relation to past accounts on which the auditor has reported and now finds to be defective he should consider the positions of the Inland Revenue Department, the shareholders and third parties other than the Inland Revenue Department.

(a) The Inland Revenue Department. The auditor should follow the procedure set out in paragraphs 400.29 to 400.31 above whether it is the directors or the directors and the shareholders who refuse to comply with the auditor's advice and whether or not the auditor is removed from office by means of a general meeting specially called for that purpose.

(b) Shareholders. The auditor should consider whether it is necessary that the shareholders be informed of the falsity of the past accounts. If it is necessary, he should do so either by exercising his right to speak at a general meeting on any part of the business which concerns him or by adjusting the next accounts or, if he feels that matters cannot properly be left for so long, by requesting the directors to issue a suitable statement to the shareholders. If they refuse to do so, or do not do so to his satisfaction, the auditor may have to take such steps as are practicable to notify the shareholders himself. As soon as the possibility of making such a communication arises, therefore, he should seek legal advice about his duty to the shareholders in the particular circumstances of the case, as to the method of any communications his duty requires and as to the terms in which the communication should be made.

(c) Third parties. The auditor ought not to allow anyone to continue to rely upon accounts on which he has reported, but now finds to be false, if there is any possibility of the third party acting to his detriment through reliance on the false accounts. An auditor might be held to be guilty of fraud (though the point is not covered by any authority) or held to be civilly liable in negligence (see the ICAEW statement "Accountants' Liability to Third Parties - The Hedley Byrne Decision") if he knew that the accounts had been submitted to a third party as an inducement to the third party to act thereon and he failed to inform the third party on discovering the falsity of the accounts before the third party had acted to his detriment. And in the case of a listed company an auditor should follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include informing the relevant Stock Exchanges of what he had discovered. It is advised that, before making any such communication, he should seek legal advice about his duty and rights in the particular circumstances of the case, as to the method of any communication he decides to make and as to the terms in which the communication should be made.

Removal of the Auditor

400.55 The distinction between the directors and the shareholders will sometimes have little or no relevance, either because the directors hold a controlling interest or because all the shareholders are directors. When in these circumstances the directors fail to comply with the auditor's advice they are likely to wish to prevent the auditor from completing his audit and making a report containing qualifications. They could achieve this by calling a general meeting at which the sole business would be the removal of the auditor, no accounts being placed before the meeting. If this procedure is followed, the auditor may wish to exercise his right under section 411 of the Companies Ordinance to attend the meeting and be heard. The auditor may also consider exercising the rights under section 422(3) of the Companies Ordinance by giving the company a statement that sets out in reasonable length the circumstances surrounding the proposed removal and may request the company to comply with the requirements specified in section 422(5) of the Companies Ordinance in relation to

the statement. If he has been acting for the company in relation to taxation matters, and he receives any enquiries from the Inland Revenue Department he should follow the guidance in paragraphs 400.23 to 400.48 when responding to the Inland Revenue Department.

Companies in Liquidation

400.56 Although the appointment of an auditor of a company is made by the shareholders in general meeting his appointment is by the company as a legal entity and his duty of confidence is to the company as distinct from the individual shareholders. If the company goes into liquidation the company's rights remain vested in the company as an entity and it is therefore still the company to which the auditor has a duty of confidence. The liquidator is the person through whom the company's rights are exercised, enforced, or defended and it follows therefore that there can be no breach of confidence on the part of an auditor in giving to the liquidator information to which the company itself is entitled.

400.57 The auditor of a company which is in liquidation may be approached by the police for assistance in enquiries which may lead to a director or other individual being prosecuted. Under this circumstance, the auditor's appropriate course is to make available to the liquidator all relevant information, leaving with the liquidator the responsibility of deciding whether under section 277 of Companies (Winding Up and Miscellaneous Provisions) Ordinance the liquidator has a duty to make a report to the Secretary for Justice. If such a report is made by the liquidator then the auditor is, by subsection (4), one of the persons having a statutory duty to give assistance to the Secretary for Justice, so that in these circumstances his duty of confidence is overridden by the statutory provisions. However, if the auditor has encountered or is aware of any suspected or actual non-compliance with laws and regulations of the clients which is related to the enquiry made by the police, the auditor should follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to the police, without referring to the liquidator.

400.58 The appointment of a member to the office of liquidator or receiver of a company does not give rise to a professional, client relationship vis-a-vis the company and a member would not therefore in such circumstances normally be under any duty of confidence towards the company. If, however, the member is already the auditor of the company at the time of his appointment as liquidator *in a members voluntary winding up,* he is clearly under a duty of confidence in respect of matters which came to his knowledge while as auditor and the normal considerations would apply except to the extent that as liquidator he is under a statutory duty to disclose or report certain matters. Though a receiver appointed under the powers contained in an instrument is normally appointed as agent of the company, a receiver of the property of a company, whether appointed by the Court or under hand, is not a representative of the company in the way in which a liquidator is. Therefore an auditor of the company should continue to regard the company or its liquidator as his client, the appointment of a receiver notwithstanding.

Companies under Investigation

400.59 In respect of the inspector appointed to investigate a company's affairs, under section 846 of the Companies Ordinance, the auditor is one of the persons who has a statutory duty to:

(a) produce any record or document that is or may be relevant to the investigation and is in the person's custody or power;

(b) take all reasonable steps to preserve the record or document before it is produced to the inspector;

(c) attend before the inspector at the time and place specified in the notice, and answer any question, whether on oath or otherwise, relating to any matter under investigation that the inspector may raise with the person;

(d) answer any question relating to any matter under investigation;

(e) give the inspector all other assistance in connection with the investigation that the person is reasonably able to give.

Where these provisions apply the auditor's duty of confidence is overridden by his statutory duty.

400.59A Under section 848 of the Companies Ordinance the inspector may make copies, or otherwise record the details, of the record or document; and by notice in writing, require the person to provide any information or explanation in respect of the record or document. The inspector may also, by notice in writing, further require the person to verify, within the time specified in that further requirement, the answer, information or explanation by a statutory declaration. If a person does not give any answer or provide any information or explanation for the answer, information or explanation is not within the person's knowledge or in the person's possession, the inspector may, by notice in writing, further require the person to verify, within the time specified in that further requirement, that reason and fact by a statutory declaration.

400.59B In case the inspector considers it necessary for the purpose of the investigation, under section 849 of the Companies Ordinance the inspector may also exercise any or all of the powers under section 846 and 848 of the Companies Ordinance as described in the paragraphs 400.59 and 400.59A in relation to an associated body corporate of the company.

Special Points In Connection with Sole Traders and Partnerships

400.60 For sole traders and partnerships a practising member may have to work from incomplete records and within limits laid down by his client. Such clients are not subject to statutory requirements similar to those relating to the accounts and audit of companies incorporated under the Companies Ordinance. Such a company has statutory obligations in regard to its accounting records and the auditor has a statutory duty to report when in his opinion those obligations have not been complied with: moreover such a company is required to have its accounts audited and it cannot limit the duties and powers of the auditor or the responsibility he undertakes for satisfying himself that the accounts show a true and fair view except as provided for the private companies and companies limited by guarantee falling within the reporting exemption under section 359 of the Companies Ordinance. As such statutory requirements are not present in the case of sole traders and partnerships, it is important that anyone who sees the accounts should be made aware, by the member's report, of the significance of the association of his name with the accounts.

400.61 Where a member is acting for a client in taxation matters he may receive from the Inland Revenue Department questions designed to ascertain whether all receipts have been properly accounted for, or whether disallowable expenditure is included in amounts charged in the accounts, or whether stock has been valued on proper and consistent principles. A member should not undertake responsibility for replies to such questions unless he is satisfied from his examination of the books and records that all relevant information is available to him. Where he is not so satisfied his proper course is to obtain answers from his client and pass them on as such to the Inland Revenue Department.

400.62 In the event of a member discovering that past accounts which he has prepared or audited were false or misleading through his having been deceived by his client, the procedure he should follow in relation to the Inland Revenue Department has been indicated in paragraphs 400.29 to 400.31. With regard to third parties other than the Inland Revenue Department the member should act, where necessary, on the basis of the advice given in paragraph 400.54(c).

Special Points in Connection with Independent Commission Against Corruption Investigation Procedures

400.63 Members may find that they are requested in their professional capacity by the Independent Commission Against Corruption ("ICAC") to "assist" in investigation of certain corruption allegations, mainly against their own clients. Such assistance usually is requested in the form of furnishing information to ICAC officers either orally or in writing.

Since the relevant Ordinances do not cover all the procedural aspects arising from different practical situations, where members have duties under the Prevention of Bribery Ordinance and ICAC Ordinance, the following procedures have been the subject of agreement with the Commission.

Principles Underlying an Approach Made by ICAC

400.64 No investigation will be commenced by the ICAC without reasonable suspicion that an offence has been committed. In other words, "fishing expeditions" will not be conducted.

When an approach is made by ICAC to firm of Certified Public Accountants (Practising), such approach will in all cases be made firstly to the senior partner or someone designated by him. If the matter is extremely urgent and the most senior partner is not available, the most senior member of the firm available will be approached. In the event of an urgent or confused situation arising, liaison can be maintained by the Registrar on the part of the Institute.

ICAC will do its best to ensure that investigating officers who approach members for information and assistance are sufficiently qualified to be able to understand what they are being given. In return, members of the Institute will be expected to do their utmost to explain matters in clear and simple terms to ICAC officers.

Access to Documents

400.65 Where copies of documents are taken by ICAC officers from members a receipt will be given by the officer concerned. If required, the accountant can make out his own form of receipt which will be signed by the officer.

Where files are being used currently for the purpose of an interim or final audit which will suffer if the files are removed during an investigation by ICAC, ICAC officers will either take copies of the files they require or take the originals and give copies back. In such an instance the member concerned shall contact the officer in charge of the investigation to come to a suitable arrangement. ICAC will pay for copies of documents prepared by members provided that such charges are reasonably computed. No remuneration will be paid for man-hours expended in locating information required by investigating officers.

Member under Investigation

400.66 It is not possible for ICAC to advise the Institute when a member is under investigation. This would be an infringement of section 30 of the Prevention of Bribery Ordinance. In the event of an investigation uncovering improper activities which ICAC do not prosecute it will be possible, with the approval of the Operations Review Committee, for information to be lodged with the Registrar, in confidence, to enable disciplinary proceedings to be commenced by the Institute itself.

Client under Investigation

400.67 If ICAC shall require information on a client under investigation from a member which for some reason will result in that member disclosing to the client that he is under investigation,

the member should immediately contact the investigating officer in charge and ask for advice.

Responsibilities of a Member who Discovers During his Work that His Client is Committing or Has Committed an Offence under the Prevention of Bribery Ordinance

400.68 Although in the absence of compulsion by due process of law, a member is not at liberty and is generally under no legal obligation to disclose to the ICAC information acquired during the performance of his duties, he should, in the event of his discovering a corruption offence, follow the response framework set out in section 360 under Chapter A of the Code.

400.69 Under the Prevention of Bribery Ordinance certain powers of investigation are conferred on the Commissioner or a duly authorised investigating officer. Where such powers are properly invoked a member will be compelled under sections 13 and 14 of the Ordinance to disclose any relevant information or produce any relevant documents. In such circumstances a member has no privilege to withhold the information.

Special Points in Connection with Investigation Procedures under the Drug Trafficking (Recovery of Proceeds) Ordinance

400.70 The law enforcement agencies primarily responsible for narcotics enforcement are the Royal Hong Kong Police Force and the Customs and Excise Department and as such they have each set up a Financial Investigation Group (FIG) to deal with all investigations under the Ordinance.

Members may be requested, in their professional capacity, to assist in an investigation of certain drug trafficking allegations against their clients by FIG officers. Such assistance is usually in the form of providing information to requesting officers either orally or in writing.

As the Ordinance does not cover all the procedural aspects arising from different practical situations where members have duties under the Ordinance, the following procedures have been accepted by the relevant law enforcement authorities.

400.71 When an approach is made by the law enforcement authorities to a firm of Certified Public Accountants (Practising), such approach will in all cases be made to the firm's Compliance Officer, if one has been appointed, or someone designated by him. Information should only be divulged to the authorities in response to a valid production order or search warrant. If the matter is extremely urgent and the Compliance Officer, if one has been appointed, is not available the senior partner of the firm or someone designated by him will be approached. In the event of an urgent or confused situation arising, liaison can be maintained by the Registrar on the part of the Institute. In no circumstances should the member disclose the identity of the party under investigation.

The FIG has advised the Institute that it will do its best to ensure that investigating officers who approach members for information and assistance are sufficiently qualified to be able to understand what they are being given. In return, members of the Institute will be expected to do their utmost to explain matters in clear and simple terms to FIG officers.

Access to Documents

400.72 Documents requested will be specified in a production order or search warrant. The accountant should ensure that the existence of all documents so specified is disclosed to the officers. The contents of those documents which are the subject of legal privilege in accordance with section 20(4)(b)(ii) do not need to be disclosed, but this may be contested in the courts by the authorities. All other documents specified in the production order or search warrant should be made available to the authorised officers.

400.73 Where copies of documents are taken by investigating officers from members a receipt will be given by the officer concerned. If required, the accountant can make out his own form of receipt which will be signed by the officer.

Where files are removed by FIG for an investigation, FIG officers will normally take the originals and give copies back if requested. In such an instance the member concerned should contact the officer in charge of the investigation to come to a suitable arrangement. The investigating authorities will pay for copies of documents prepared by members provided that such charges are reasonably computed. No remuneration will be paid for man-hours expended in locating information required by investigating officers.

Member under Investigation

400.74 It is not possible for FIG to advise the Institute when a member is under investigation. This would be an infringement of section 24 of the Drug Trafficking (Recovery of Proceeds) Ordinance. In the event of an investigation uncovering improper activities which FIG do not prosecute, it may be lawful for FIG to pass the information on to the Registrar, in confidence, to enable disciplinary proceedings to be commenced by the Institute itself.

Client under Investigation

400.75 If FIG shall require information on a client under investigation from a member which for some reason will result in that member disclosing to the client that he is under investigation, the member should immediately contact the investigating officer in charge and ask for advice. Any disclosure to the client which may indicate that he is under investigation could prejudice the investigation and is an offence under section 24.

Responsibilities of a member who discovers during his work that his client is committing or has committed an offence under the Drug Trafficking (Recovery of Proceeds) Ordinance

400.76 Members should familiarise themselves with the provisions of section 25 of the Drug Trafficking (Recovery of Proceeds) Ordinance and in particular with subsection (1).

400.77 Subsection (1) is aimed at persons (including professional accountants) who become concerned in arrangements whereby the retention or control of proceeds of drug trafficking is facilitated. If a person becomes knowingly involved in this way, or has reasons to believe that he has become so involved, he commits a criminal offence. Subsection (3) makes provisions for disclosure of suspicion or belief by persons who have become thus involved, and relieves them of criminal and civil liability in certain circumstances. The disclosure should be made to the firm's Compliance Officer (if one has been appointed) or to the FIG. Subsection (3) expressly states that such disclosure shall not be treated as a breach of any restriction upon disclosure of information imposed by contract or by rules of professional conduct.

400.78 Under the Ordinance certain powers of investigation are conferred on the courts of a duly authorised investigating officer. Where such powers are properly invoked a member will be compelled under sections 20 and 21 of the Ordinance to disclose any relevant information or produce any relevant documents. In such circumstances a member has no privilege to withhold the information, except that subject to legal privilege. Items subject to legal privilege may include communications between a legal advisor and an accountant representing his client, or legal advice on behalf of his client and in the possession of the accountant.

Other Matters

Member's Relationship with a successor

400.79 It is the duty of any member of the Institute, before accepting nomination for appointment as auditor for a company, partnership or individual, to communicate with the previous auditor. In this connection attention is drawn to section 200 "Changes in a Professional Appointment" of this chapter wherein the Council makes it clear that it is essential for a member who is proposed for appointment as auditor to have an opportunity of knowing all the reasons for the change, that this requirement can only be fulfilled by direct communication with the holder of the existing appointment and that a member should not accept the appointment if he is refused permission to make this communication.

400.80 Where a member resigns his appointment or indicates to his client that he will not accept reappointment, or where the client terminates the appointment, the question arises whether the member should inform his prospective successor of the reasons for the change where they relate to fraud on the Inland Revenue Department or other unlawful acts or defaults. Members are advised as follows:

(a) the initiative in the matter of communication rests with the prospective successor; the retiring member should not volunteer information in the absence of any communication;

(b) the prospective successor should seek the permission of the client to make this communication and should not accept the appointment if permission to make the communication is refused;

(c) subject to what is said in the next sub-paragraph, when a member receives a communication from a prospective successor he should inform the prospective successor of at least the general nature of the reason for the change; and to the extent that it seems necessary in order to put the prospective successor adequately on his guard he should be informed of the facts constituting that reason;

(d) the legal position of the retiring member depends not upon whether the prospective successor has received the client's permission to communicate with the retiring members but upon whether the retiring member has been authorised by the client to discuss the client's affairs with the prospective successor. The retiring member could obtain this authorisation either by having made it a term of his contract with his client that he should be entitled to comply with the Code of Ethics issued by the Institute regarding these communications or by informing his client when the prospective successor communicates with him and getting express permission to tell the prospective successor the reasons for his retirement. If he has this authorisation then provided he says what he honestly believes to be true he can state the reasons for his retirement without any fear of an action for either breach of contract or defamation. If he does not have this authorisation the Council is advised that he would nevertheless have a strong measure of protection against an action for defamation in that his communication would be the subject of qualified privilege, which means that he would not be liable to pay damages for defamatory statements, even though untrue, if they were made without malice: and provided he stated only what he sincerely believed to be true the chances of his being held malicious are remote. Moreover although in making a communication without authorisation a retiring member might technically be in breach of contract and although there could be circumstances in which the resulting damages were substantial, the likelihood of an action being brought against him is small and in most cases the damages awarded in such an action would be nominal;

(e) where a member, in the course of an audit of financial statements, has unconfirmed suspicion or actual knowledge that the audit client has defrauded the Inland Revenue Department or been guilty of some other unlawful act or default and as a result, has withdrawn from the professional relationship with the client, he should provide all such facts and other information to a prospective successor who communicates with him without the need to obtain client's consent. (See paragraph R360.22 under Chapter A of the Code);

(f) the prospective successor should treat in the strictest confidence any information given to him by the retiring member. After due consideration of the information it is for the prospective successor to decide whether as a matter of professional conduct or as one of personal inclination he can properly accept the appointment. If he does so, the advice given in this section would then be applicable to him.

400.81 The consideration arising on a change of auditor apply to a large extent also where a member is invited to undertake other recurring professional work in place of another accountant, except that section 400.80(e) above does not apply to non-audit engagement.

Prosecution of a Client or Former Client

400.82 It follows from paragraphs 400.8 to 400.18 above that it would depend upon the nature of the offence and other circumstances connected with it whether or not a member would be acting in breach of his contractual duty of confidence or contrary to proper professional standards if he were, except under legal compulsion or with his client's consent, to assist the police, Inland Revenue Department, ICAC or other authority by giving information about his client's affairs for the purposes of enquiries leading towards a prosecution of the client for an offence other than treason. If he is requested to give information he should comply if the person requesting the information has a statutory right to demand it. In any other cases, the member should follow the response framework set out in section 360 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the information to an appropriate authority.

400.83 A member should not normally appear in Court as a witness for the government in a case against a client or former client, unless he is served with a subpoena or other lawful summons to do so, in which case he must of course answer truthfully any questions that the Court allows to be put to him even though this involves disclosure of facts of which he obtained knowledge in his confidential professional capacity. Moreover he cannot lawfully refuse to produce in Court any documents in his ownership or possession which the Court may direct him to produce. If the persons in charge of the prosecution have indicated that they will call upon the member to produce certain documents in Court, the member would be wise to have the documents with him but the power to order their production in Court rests with the Court.

400.84 A member would be wise to keep in close touch with his solicitor on the legal aspects of his position in relation to a prosecution or possible prosecution of a client or former client.

SECTION 500

Unlawful Acts or Defaults by or on Behalf of a Member's Employer

This section should be read in conjunction with Subsection 114 "Confidentiality" and Section 260 "Responding to Non-Compliance with Laws and Regulations" under Chapter A of the Code

A statement by the Council for the guidance of members in business.

Occasions sometimes arise where a member, in the course of his work, acquires knowledge indicating that his employer, or someone acting on behalf of his employer, may have been guilty of some default or unlawful act. A member may consequently find himself the subject of allegations that he ought to have communicated what he had discovered to others, either within or outside the company. This section gives guidance to members concerning some of the questions of professional conduct and legal obligation which arise in these circumstances. It does not cover obligations of company directors.

The section is intended for general guidance only and does not deal with the special circumstances of regulated sectors such as banks and investment businesses. Although examples are given to illustrate the duties of members it should be borne in mind that they are examples only. Every case depends upon its own circumstances and if a member is in doubt as to his correct course of action he should seek independent legal or other professional advice or contact the Hong Kong Institute of Certified Public Accountants' (the "Institute") Registrar.

Part 1 - Introduction

500.1 It is not practicable to set out all the offences which members may encounter in the course of their work but the principal statutory and common law offences concerned are:

(a) theft, obtaining by deception, false accounting, and suppression of documents;

(b) fraud, forgery and offences in relation to companies;

(c) corruption offences;

(d) bankruptcy or insolvency offences, frauds on creditors or customers, false trade descriptions, and offences arising out of relations between employers and employees;

(e) conspiracy, soliciting or inciting to commit crime and attempting to commit crime;

(f) offences in relation to taxation;

(g) insider dealing.

500.2 If a member acquires knowledge indicating that his employer or someone acting on behalf of his employer may have been guilty of some default or unlawful act he should normally raise the matter with management internally at an appropriate level. If his concerns are not satisfactorily resolved, he should report the matter to non-executive directors and those charged with governance where these exist. Where this is not possible or fails to resolve the matter a member may wish to consider making a report to a third party. Members in business should refer to section 260 under Chapter A of the Code, which sets out the response framework when members encounter non-compliance with laws and regulations during the course of their work. Local guidance is provided below on reporting suspected defaults or unlawful acts to third parties outside the organisation for which the member works.

Part 2 - Relations between a Member and His Employer

Disclosure of Information by His Employer to a Member

500.3 Where a member is employed to prepare accounts or to deal with taxation or any other work he can only do so on the basis of full disclosure of all information relevant to the work in question. A member in employment is responsible for his work and, if he is aware that there has not been full disclosure to him of all relevant information, he should raise the matter internally at an appropriate level. The member should make clear to his employer the effect of this professional obligation of integrity, which requires that if there is still not full disclosure, he should indicate this in any accounts or reports that he prepares. If this is not possible, he would be well-advised to consider his position in the company in the light of his responsibility for the accounts or reports in question.

Disclosure to Third Parties of Defaults or Unlawful Acts

500.4 An employed member has a general duty to his employer to act with good faith and fidelity, including a duty to keep confidential information obtained as a result of this employment. If no such express term appears in his contract of employment it will be implied by law.

500.5 Provided that the information is not public knowledge it can be confidential irrespective of whether or not it appears trivial to the employee. The employer will be entitled to restrain the use of such information during the period of employment and disclosure of confidential information without good cause may entitle the employer to dismiss the member from his employment. Therefore an employed member should not generally disclose any confidential information without his employer’s prior authority, or without first exhausting internal reporting channels.

500.6 There are, however, circumstances in which, in spite of any duty of confidentiality, a member may be obliged to disclose. Even if not obliged to disclose, he may determine that such disclosure is justified in the public interest (see section 260 under Chapter A of the Code) or required for the protection of the member's own interest. Guidance on whether a member should disclose the matter to a third party is set out in the paragraphs below.

Obligation to Disclose

500.7 A member will be obliged to disclose information if compelled to do so by the process of law, for example under a court order. He may also be obliged to disclose information by statute, for example:

(a) a member may be obliged to disclose specified information to the liquidator, administrative receiver or administrator of his employer;

(b) he may be obliged to give information on oath to an inspector appointed by the Financial Secretary to investigate an alleged insider dealing offence;

(c) he may be obliged to disclose information to the ICAC under a statutory notice.

In each case the member need not disclose any information which would incriminate himself.

500.8 Under section 412 of the Companies Ordinance, the auditors of a company have a right of access to the company's accounting records and may require a person that is a related entity of the company (as defined in section 412(9) of the Companies Ordinance), or was a related entity of the company (as defined in section 412(9) of the Companies Ordinance) at the time to which the information or explanation relates, to provide the auditor with any information or explanation that the auditor reasonably requires for the performance of the duties as auditor of the company. Under section 413 of the Ordinance, a person commits an offence if:

(a) the person makes a statement to an auditor of a company that conveys or purports to convey any information or explanation that the auditor requires, or is entitled to require, under section 412(2) or (4) of the Ordinance;

(b) the statement is misleading, false or deceptive in a material particular; and

(c) the person knows that, or is reckless as to whether or not, the statement is misleading, false or deceptive in a material particular.

A person guilty of an offence under this section is liable to imprisonment or a fine, or both.

500.9 [Not used]

500.10 [Not used]

Disclosure for the Protection of the Member's Own Interest

500.11 A member may disclose to the proper authorities information concerning his employer where the protection of the member's own interest requires disclosure of that information:

(a) to enable the member to defend himself against a criminal charge or to clear himself of suspicion; or

(b) to resist proceedings for a penalty in respect of a taxation offence, for example in a case where it is suggested that he assisted or induced his employer to make or deliver incorrect returns or accounts; or

(c) to resist a legal action brought against him by his employer or some third person; or

(d) to enable the member to defend himself against disciplinary proceedings, or against criticism of him which is the subject of enquiry under the Institute's disciplinary rules; or

(e) to enable the member to take legal action in relation, for example, to an unfair dismissal claim or redundancy payment claim.

Disclosure Authorised by Statute

500.12 In some cases the public interest in disclosure of information to a proper authority is such that the authorities have made express statutory provision for the duty of confidentiality to be set aside. An example of this is to be found in the Drug Trafficking (Recovery of Proceeds) Ordinance. (Guidance on the implications of this Ordinance was included in Section 400 of this chapter and Statement 1.301.)

500.13 Each example of a statutory freedom to disclose must be considered separately since the scope of the freedom and the protection offered to the person making the disclosure varies from statute to statute.

Disclosure to Non-governmental Bodies

500.14 Members are sometimes approached by recognised but non-governmental bodies seeking information concerning suspected acts of misconduct not amounting to a crime or civil wrong. Some non-governmental bodies enjoy statutory powers to require persons to supply information for that purpose, in which case the member should comply. In other cases, however, the member should follow the response framework in section 260 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Prosecution of an Employer or Former Employer

500.15 Where a member is approached by the police, the Inland Revenue Department, or other public authority making enquiries which may lead to the prosecution of an employer or former employer for an offence, the member should comply if the person requesting for information has such a legal right. In other cases, however, the member should follow the response framework in section 260 under Chapter A of the Code and determine whether further action is needed, which may include disclosing the matter to an appropriate authority.

Part 3 - Members' Own Relations with Authorities and Third Parties

Criminal Offences

500.16 A member himself commits a criminal offence:

(a) if he incites anyone to commit a criminal offence, whether or not his advice is accepted; or

(b) if he helps or encourages anyone in the planning or execution of a criminal offence which is committed; or

(c) if he agrees with anyone to pervert or obstruct the course of justice by concealing, destroying or fabricating evidence or by misleading the police by statements which he knows to be untrue; or

(d) if with a view to obtaining property or to obtaining for himself or another a pecuniary advantage he deceives any person, either by making a statement which he knows to be false or (in certain circumstances) by stating a "half-truth", i.e. making a statement but suppressing matters relevant to a proper appreciation of its significance.

500.17 Where a member knows or believes that an arrestable offence has been committed the member would himself commit a criminal offence if he were to do any act with the intention of impeding the arrest or prosecution of the person in question unless the member has lawful authority or reasonable excuse (section 90 of the Criminal Procedure Ordinance). The mere fact that he was the suspect's employee or fellow-employee would not be a reasonable excuse. An arrestable offence is one for which the sentence is fixed by law or "serious" offences for which a person not previously convicted can be sentenced to imprisonment.

500.18 A member would have to do some positive act to assist the suspect to escape arrest or prosecution for an arrestable offence in order to be convicted of the offence of impeding the arrest or prosecution of the suspect. If a member refuses to answer questions by the police about the suspect's affairs or refuses to produce documents relating to the suspect's affairs without the suspect's consent, the refusal would not be an act to impede the arrest or prosecution of the suspect.

500.19 Where a member knows or believes an arrestable offence has been committed and the member has information which might be of material assistance in the prosecution of the suspect for the offence, the member would be committing a criminal offence if he were to accept or agree to accept any consideration in return for not disclosing that information (section 91 of the Criminal Procedure Ordinance).

500.20 In these circumstances, the acceptance of reasonable remuneration for employment would not be an offence. However, if the remuneration were wholly or partly paid in consideration for the member not disclosing the information, the member would be committing an offence. The acceptance of unusually high remuneration might be used as evidence against a member.

500.21 A member must give full disclosure in his dealings with the Inland Revenue Department. Fraudulent evasion and attempted evasion of taxes are criminal offences. The making of false statements with intent to defraud the Revenue is also an offence. Some tax legislations (for example section 82 of the Inland Revenue Ordinance) create specific criminal offences, whilst breach of other provisions leads to the imposition of penalties.

Civil Liability

500.22 A member may himself incur civil liability to third parties if, knowing of a course of unlawful conduct by his employer or any co-employee, he allows himself to become implicated in it by assisting in its planning or execution. In some cases the nature of a member's work may make it impossible to avoid implication in the execution of another person's wrong unless disclosure is made.

SECTION 600

Ethics in Tax Practice

This section should be read in conjunction with Part 3 - Professional Accountants in Public Practice under Chapter A of the Code*.*

Fundamental Principles

600.1 The fundamental principles to be observed when developing ethical requirements relating to tax practice include all five Fundamental Principles by which a member is governed in the conduct of his professional relations with others. These principles are enumerated in Section 110 “The Fundamental Principles" under Chapter A and expanded upon in the rest of the Code.

Development of the Fundamental Principles

600.2 A member rendering professional tax services is entitled to put forward the best position in favour of his client, provided he can render the service with professional competence, it does not in any way impair his standard of integrity and objectivity, and is in his opinion consistent with the law. He may resolve doubt in favour of his client if in his judgment there is reasonable support for his position.

600.3 A member should not hold out to clients the assurance that the tax return he prepares and the tax advice he offers are beyond challenge. Instead, he should ensure that his clients are aware of the limitations attaching to tax advice and services so that they do not misinterpret an expression of opinion as an assertion of fact.

600.4 A member who undertakes or assists in the preparation of a tax return should advise his client that the responsibility for the content of the return rests primarily with the client. The member should take the necessary steps to ensure that the tax return is properly prepared based on the information received from the client.

600.5 Tax advice or opinions of material consequence given to a client should be recorded either in the form of a letter to the client or in a memorandum for the files.

600.6 A member must not associate himself with any return or communication which he has reason to believe:

(a) contains a false or misleading statement;

(b) contains statements or information furnished by the client recklessly or without any real knowledge of whether they are true or false; or

(c) omits or obscures information required to be submitted and such omission or obscurity would mislead the Inland Revenue Department.

If any of the above situations prevails, the member’s responsibility is to resign from acting as the client’s tax representative. Having resigned the member should:

(a) inform the Inland Revenue Department that he has withdrawn his services.

(b) act according to paragraphs R360.38 – 360.40 A1 under Chapter A of the Code, including consider whether disclosing the matter to the external auditor and / or the Inland Revenue Department.

600.7 A member may prepare tax returns involving the use of estimates if such use is generally acceptable or if it is impractical under the circumstances to obtain exact data. When estimates are used, they should be presented as such in a manner so as to avoid the implication of greater accuracy than exists. The member should be satisfied the estimated amounts are reasonable under the circumstances.

600.8 In preparing a tax return, a member ordinarily may rely on information furnished by his client provided that the information appears reasonable. Although the examination or review of documents or other evidence in support of the client's information is not required, the member should encourage his client to provide such supporting data, where appropriate.

In addition, the member:

(a) should make use of his client's returns for prior years whenever feasible.

(b) is required to make reasonable inquiries where the information presented appears to be incorrect or incomplete.

600.9 The member's responsibility when he learns of a material error or omission in a client's tax return of a prior year (with which he may or may not have been associated), or of the failure of a client to file a required tax return, is as follows:

(a) He should promptly advise his client of the error or omission and recommend that the client make disclosure to the Inland Revenue Department.

(b) If the client does not correct the error:

(i) the member should inform the client that he cannot act for him in connection with that return or other related information submitted to the authorities;

(ii) the member should consider whether continued association with the client in any capacity is consistent with his professional responsibilities;

(iii) and if the member concludes that he can continue with his professional relationships with the client, he should take all reasonable steps to assure himself that the error is not repeated in subsequent tax returns.

(c) If because of the error or omission, the member ceases to act for the client, in these circumstances, the member should advise the client of the position before informing the authorities of his having ceased to act.

(d) He should consider, as set out in paragraphs R360.38 – 360.40 A1 under Chapter A of the Code, whether disclosing the matter to the external auditor and / or the Inland Revenue Department is appropriate.

SECTION 700

Corporate Finance Advice

This section should be read in conjunction with Part 3 Professional Accountants in Public Practice under Chapter A of the Code*.*

Introduction

700.1 This section applies to all members, and is issued by the Council not as a directive but to assist members to conduct themselves in a manner which the Council considers appropriate to the members of the Hong Kong Institute of Certified Public Accountants (the "Institute").

700.2 Its objective is to provide ethical guidance that will safeguard corporate finance clients by ensuring that they can rely on the objectivity and integrity of the advice given to them by members.

700.3 Failure to follow such guidance may constitute misconduct, and a member concerned may be at risk of having to justify his actions in answer to a complaint to the Institute. In addition, matters discussed in this section may have legal implications and a member who is in doubt as to his position should consider obtaining legal advice.

700.4 Corporate finance activities are wide-ranging in their nature and members are frequently involved in giving corporate finance advice, to both audit and non-audit clients. The role and nature of advice expected of a member may change in character when the client becomes involved in or anticipates a particular transaction, such as a takeover bid, issue of securities or acquisition or disposal of securities, in respect of which advice or an opinion is required from a member. It is at that point that problems of independence and conflict of interest can arise. The guidance which follows is designed to assist members who find themselves advising in these and related circumstances.

700.5 A definition of corporate finance activities is set out in Annex I of this section.

Objectivity and Integrity

700.6 Subsection 111 "Integrity", Subsection 112 "Objectivity" and Part 4A "Independence for Audit and Review Engagements" under Chapter A of the Code include the guidance on integrity, objectivity and independence for members which is applicable to corporate finance activities.

700.7 Subject to paragraph 700.6 above, and provided that a member maintains objectivity and integrity throughout, both in regard to the client and to other interested third parties, there can be no objection to a firm accepting an engagement which is designed primarily with a view to advancing the client's case.

Conflicts of Interest

700.8 It may be in the best interests of a client company for corporate finance advice to be provided by its auditor and there is nothing improper in the auditor supporting a client in this way. There are however a variety of situations in which conflict can arise.

700.9 It would not on the face of it be improper for the firm to continue to act as auditor to both parties in a takeover situation, even if the takeover were contested.

Avoiding Conflicts of Interest

700.10 All reasonable steps should be taken to ascertain whether a conflict of interest exists or is likely to arise in the future between a firm and its clients, both in regard to new engagements and to the changing circumstances of existing clients, and including any implications arising from the possession of confidential information. (See section below headed "Documents for client and public use/confidentiality".)

700.11 A firm should not accept or continue an engagement in which there is or is likely to be a significant conflict of interest between the firm and its clients.

700.12 Whether a significant conflict of interest exists will depend on all the circumstances of the case. The test is whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect the objectivity of the firm. However, any material financial gain which accrues or is likely to accrue to the firm as a result of the engagement, otherwise than in the form of fees or other reward from the client for its services, or commission, etc. properly earned and declared will always amount to a significant conflict of interests.

700.13 Relationships with clients and former clients need to be reviewed before accepting a new appointment and annually thereafter. A relationship which ended over two years before is unlikely to constitute a conflict. Where it is clear that a material conflict of interest exists a firm should decline to act as corporate finance adviser.

Conflict between Interests of Different Clients

700.14 There is, on the face of it, nothing improper in a firm having two or more clients whose interests may be in conflict. In such a case however, the work of the firm should be so managed as to avoid the interests of one client adversely affecting those of another. Where the acceptance or continuance of an engagement would, even with safeguards, materially prejudice the interests of any client, the appointment should not be accepted or continued, or one of the appointments discontinued.

700.15 It would be neither reasonable nor necessary to discontinue acting in any capacity in anticipation of every potential conflict. It could in some instances give rise to harmful rumour or speculation for a firm to disengage from a situation before a transaction had become public knowledge.

700.16 Where there appears to be a conflict of interests between clients but after careful consideration the firm considers that the conflict is not material and unlikely seriously to prejudice the interests of any of those clients, the firm may accept or continue the engagement, but not without first informing the clients concerned and obtaining the consent of both in writing.

700.17 A firm should not act or continue as lead adviser for two or more clients if the disclosure called for in paragraph 700.16 would materially prejudice the interests of a client.

700.18 For the purposes of the preceding paragraph the “lead adviser” is the firm or person primarily responsible for advising on, organising and presenting an offer or the response to an offer acting in its or his capacity as a sponsor or independent financial adviser. This definition would include the “independent financial adviser” required by a defending company under Rule 2.1 of the Hong Kong Takeovers and Share Repurchase Codes (see below).

700.19 Where a conflict of interests is likely to materially prejudice the interests of a client an engagement should not be accepted or continued even at the informed request of the clients concerned.

700.20 Where a firm is required for any reason to disengage from an existing client it should do so as speedily as practicable having regard to the interests of the client.

700.21 Wherever there is identified a significant conflict between the interests of different clients or potential clients, sufficient disclosure in writing should be made to the clients or potential clients concerned together with details of the safeguards proposed below so that they may make an informed decision as to whether to engage the firm or continue their relationship with the firm.

Safeguards

700.22 Where a firm acts or continues to act for two or more clients following disclosure in accordance with paragraph 700.16, all reasonable steps should be taken to manage the conflict which arises and thereby avoid any adverse consequences. These steps should include the following safeguards except to the extent that they are inappropriate:

(a) the use of different partners and teams for different engagements;

(b) standing instructions and all other necessary steps to prevent the leakage of confidential information between different teams and sections within the firm;

(c) regular review of the situation by a senior partner or compliance officer not personally involved with either client; and

(d) advising at least one or all the clients to seek additional independent advice.

700.23 Any decision on the part of a sole practitioner should take account of the fact that the safeguards at (a) to (c) of paragraph 700.22 will not be available to him. Similar considerations apply to a small practice.

Documents for Client and Public Use/Confidentiality

700.24 Information acquired in the course of professional work should not be disclosed except where consent has been obtained from the client, employer or other proper source, or where there is a public duty to disclose or where there is a legal or professional right or duty to disclose (see Subsection 114 “Confidentiality” and Section 360 "Responding to Non-Compliance with Laws and Regulations" under Chapter A of the Code).

700.25 Where in the course of corporate finance advice a firm prepares information for a client (for example a critique of the accounts of another company) it may be called upon to do so:

(a) in a document which is for the consumption of the client only;

(b) in order to assist the client to produce a document which will go out solely under the client’s name and authority, whether including quotations from the original document or not; or

(c) as part of a document which is to be published over the name of the firm.

700.26 Any statements or observations in a document prepared for a client must be such as, taken individually and as a whole, are justifiable on an objective examination of the available facts.

700.27 In the case of a document prepared solely for the client and its professional advisers, it should be a condition of the engagement that the document should not be disclosed to any third party without the firm’s express permission.

700.28 Any document whether for private or public use should be prepared in accordance with normal professional standards of integrity and objectivity and with a proper degree of care.

700.29 A firm is, in the absence of any indication to the contrary, entitled to assume that the published accounts of the company on which it is commenting have been prepared properly and in accordance with all relevant Accounting Standards. Where scope for alternative accounting treatment exists, and the accuracy of the comment or observation is dependent on an assumption as to the actual accounting treatment chosen, that assumption must be stated, together with any other assumptions material to the commentary. Where the firm is not in possession of sufficient information to warrant a clear opinion this should be declared in the document.

700.30 A firm must take responsibility for anything published under its name, and the published document should make clear the identity of the client for whom the firm is acting. To prevent misleading or out-of-context quotations, it should be a condition for the engagement that, if anything less than the full document is to be published, the text and its context should be expressly agreed with the firm.

700.31 A firm should ensure that public documents and circulars include prominently the name of the brokers, investment bank or other advisers responsible for promoting or underwriting the share or securities described in the document or circular, where different from that firm which has accepted the roles of sponsor, in order to make abundantly clear the roles undertaken by the various advisers.

The Hong Kong Takeovers and Share Repurchase Codes (the Codes)

700.32 A member who provides takeover services for clients is required to comply with the Codes which are expressly applied to professional advisers as well as to those engaged in the securities market. Members' attention is particularly drawn to Annex II - Guidance note: Compliance with the Hong Kong Takeovers and Share Repurchase Codes.

700.33 The Codes apply to what are described as "public companies in Hong Kong" and the persons to whom the Codes apply are stated to be as follows:

(a) directors of public companies;

(b) persons or groups of persons who seek to gain or consolidate control of public companies;

(c) their professional advisers; and

(d) those who are actively engaged in the securities market in all its aspects.

700.34 There is a definition of a "private company" under section 11 of the Companies Ordinance. It is a company which is not a company limited by guarantee and has three restrictions imposed by its articles:

(a) the right to transfer shares must be restricted;

(b) the maximum number of members, exclusive of employees and persons who were members while being employees of the company and who continue to be members after ceasing to be such employees, is 50; and

(c) the company is prohibited to invite the public to subscribe for any shares or debentures of the company.

700.35 Section 12 of the Companies Ordinance defines a "public company" as a company that is not a private company and not a company limited by guarantee. Section 94 of the Companies Ordinance stipulates that if a private company alters its articles so that they no longer include the three restrictions required to constitute it as a private company; on the date on which the alteration takes effect the company ceases to be a private company.

Requirement for Independent Advice

700.36 Rule 2.1 of the Codes states the general principle that the financial adviser must be independent. Rule 2.6 of the Codes provides that:

> *A person who has, or had, a connection, financial or otherwise, with the offeror or offeree company of a kind likely to create a conflict of interest will not be regarded as a suitable person to give independent advice.*

Independence is particularly important in Hong Kong, where many companies are dominated by a single shareholder. Rule 2.7 of the Codes, which gives guidance on relationships which are inconsistent with the independence of the financial adviser, takes exception not only to a relationship between the financial adviser and the offeror or offeree company, but also to a relationship between the financial advisers with the controlling shareholder of either the offeror or offeree company.

700.37 The onus is on the financial adviser to ensure that no conflict of interest exists which might affect, or be perceived to affect, the impartiality of the advice he gives. When there is any doubt, the financial adviser should disclose the conflict to the Takovers and Mergers Executive (the Executive). The adviser should not assume that the Executive is aware of the conflict or that the independence of the adviser is accepted by the Executive merely because an announcement of the offer and appointment of the adviser is published. Consulting the Executive is always advisable to minimise the risk of any objection to the appointment after it has been publicly announced. When consulting the Executive, the financial adviser must disclose all relevant information which the Executive will require in order to render a fully informed decision.

It should be noted that the Codes do not provide a strict definition of independence and the Executive will decide if the independent financial adviser is qualified to so act on a case by case basis.

Takeovers Subject to the Codes

700.38 A firm may find itself acting as auditor or corporate finance adviser for two or more parties involved in a takeover subject to the Codes. For the firm to cease to act for a client within the limited period of the takeover, on the basis that conflict might arise, could damage the client's interests.

Accordingly in such circumstances a firm may continue to act for more than one party as auditor, as reporting accountants on any profit forecast, and in the provision of incidental advice consistent with these roles. However the firm should not act as lead adviser for any party involved or issue a critique of a client's accounts, and should implement proper safeguards (see paragraph 700.22 above).

700.39 The attention of firms is also directed to those sections of the Codes dealing with conflict of interest in particular Note 1 "Conflicts of interest" to paragraph 2.9 in the Chapter headed "Rules" including the possession of "material confidential information". Members in doubt as to their position under the Codes should consult the Takeovers and Mergers Panel.

Takeovers Not Subject to the Codes

700.40 Where a takeover is not subject to the Codes, and there is no substantial public interest involved, a firm may, subject to the implementation of appropriate safeguards (see paragraph 700.22 above), continue to advise both sides. However the firm should ensure that the interests of minority shareholders are protected, and in such cases should consider the desirability of one company having a wholly independent adviser.

The Stock Exchange of Hong Kong Limited's (Stock Exchange) Rules Governing the Listing of Securities (Listing Rules)

700.41 Members' attention is also drawn to the Listing Rules in particular when acting as a sponsor or as an independent financial adviser.

When a firm accepts the responsibilities of a sponsor set out in Chapter 3 of the Listing Rules in respect of a client where it acts as auditor or reporting accountant, it should adopt steps described in paragraph 700.22 above and additionally set up procedures to review and to identity any potential conflicts of interest which could compromise the firm's objectivity.

Connected Transactions

700.42 Whilst the Listing Rules do not provide a strict definition of independence, when a firm accepts the responsibility to act as an independent financial adviser in relation to a connected transaction under Chapter 14 of the Listing Rules, it should take care to ensure that it has not previously advised the client on a previous transaction such as advising the shareholders of a listed issuer, which, because it is in possession of material confidential information of a kind likely to create a conflict of interest, could result in the firm being regarded as not suitable to give independent advice.

It will ultimately be the Stock Exchange who will decide if the independent financial adviser is qualified to so act, but the onus is on the financial adviser to ensure that no conflict of interests exists which might affect, or be perceived to affect, the impartiality of the advice he gives.

Promoting an Issue or Sale to the Public of Shares or Securities

700.43 A firm should not promote an issue or sale to the public of shares or securities of a company on which it has reported or is to report. Neither should the firm undertake to accept nomination as auditor or reporting accountant of the company whose shares it is promoting to the public. Involvement of this kind would endanger the independence of the firm in the audit and/or reporting function.

700.44 It is not inappropriate however:

(a) for an auditor or reporting accountant to assist a client in raising capital;

(b) for a firm to conduct an acquisition search, which could identify another client as a target, provided the search is based solely on information which is not confidential to that client;

(c) for an auditor or reporting accountant to provide independent advice to a client or its professional advisers in connection with the issue or sale of shares or securities to the public; or

(d) for an auditor or reporting accountant to fulfil the responsibilities of a sponsor

Fees

700.45 Where a member undertakes an engagement for a fee which is contingent upon the successful outcome of a transaction such as a bid, offer, purchase, sale or raising finance, the member should take particular care to ensure that the arrangements do not prejudice his independence and objectivity with regard to any other role which the member may have, notably as auditor or reporting accountant of either the bidder or the target.

700.46 In some circumstances, such as advising on a management buy-out, the raising of venture capital, acquisitions search or sales mandates, fees cannot realistically be charged save on a contingency basis; to require otherwise would, in certain cases, deprive potential clients of professional assistance, for example where the capacity of the client to pay is dependent upon the success or failure of the venture.

700.47 Where work is subject to a fee on a contingency, percentage or similar basis the capacity in which a member has worked and the basis of the remuneration should be made clear in any document prepared by the member in contemplation that a third party may rely on it.

Overseas Transactions

700.48 This section has been drafted with regard to the situation in Hong Kong. Members should apply the spirit of the guidance, subject to local legislation and regulation, to overseas transactions of a similar nature.

ANNEX I TO SECTION 700

Definition of Corporate Finance Activities

In this section, corporate finance activities shall include any of the following matters:

1. general corporate or general financial advice or assistance, in relation to the affairs of a company or any of its associates, to the company or officers thereof, including in particular advice or assistance as to borrowing profile, capital requirements and fund raising, investment and foreign exchange policies, dividend policies, share incentive schemes, investor relations, general meetings and proxy solicitation, board composition and management structure;

2. a takeover, acquisition, management buy-out, management buy-in or disposal of a business or a merger, de-merger, division, reconstruction or reorganisation:

   (a) by or on behalf of the client; or

   (b) concerning any securities issued by any business carried on by or for the client;

3. the valuation or appraisal of any investment, asset, business or security;

4. (a) giving advice to any country or its central bank or other monetary authority or an international banking or financial institution whose members are countries (or their central banks or monetary authorities) with respect to financial matters including in particular the management, restructuring and securitisation of external debt and the promotion of inward investments; or

   (b) any scheme for providing finance in connection with (a) above;

5. any kind of financing, refinancing or rescheduling or reorganisation of debt or any interest rate or currency swap or comparable operation related to any financing, refinancing or rescheduling or reorganisation of debt which has previously been effected or which is in contemplation;

6. the financing of a construction or other commercial or industrial project or the establishment of a new business or the expansion of a business;

7. the raising of borrowed moneys, whether by the issue of securitised debt instruments or otherwise, and including the formation and management of a syndicate to provide such finance;

8. (a) an offering or placement or other distribution of investments whether by the issuer or any other person or group of persons to the public or privately for subscription or purchase; or

   (b) a listing of, or the admission of any securities to dealings on an investment exchange or a suspension or discontinuance of, or other matters arising from, any such listing or admission to dealings;

9. (a) an exchange, conversion, redemption, sale, purchase, re-issue or cancellation of any securities; or

   (b) an alteration in the terms of any securities; or

   (c) a reduction of capital or share premium account or a scheme of arrangement or similar operation involving or affecting any securities;

10. the underwriting of securities whether by the client himself or by a third party on behalf of the client or making arrangements with a view to or in connection with any such underwriting; and

11. provision of advice in relation to any transaction governed by the Listing Rules.

ANNEX II TO SECTION 700

Guidance Note

Compliance with the Hong Kong Takeovers and Share Repurchase Codes

(see paragraph 700.32 of Section 700)

1. A member who provides takeover services for clients is required to comply with the Hong Kong Takeovers and Share Repurchase Codes (the Codes), and with all rulings made and guidance issued under them by the Takeovers and Mergers Panel (the Panel).

2. Accordingly a member proposing to provide takeover services to a client should at the outset:

   (a) explain that these responsibilities will apply; and

   (b) include in the terms of the engagement recognition of the member's obligation to comply with the Codes including any steps which the member may be obliged to take in performing those responsibilities. A specimen clause for the engagement letter is set out in paragraph 10 below.

   Note: For breaches of the Codes, members are referred to Chapter 1 "Introduction to the Codes" and in particular paragraph 12 "Disciplinary proceedings".

3. As regards contractual relationships existing at the date of publication of this Guidance Note, members should seek to amend the relevant engagement letter to include such wording. Where this does not prove possible, members should inform clients of their intention to comply with the Codes. If the client objects to this, the member should carefully consider the reasons given for such objection and then consider whether it is appropriate to continue to act for the client. In such a situation it may be necessary for the member to take separate legal advice.

4. In this Guidance, "takeover services" means any professional services provided by a member to a client in connection with a transaction to which the Codes apply.

5. In the case of accountants, the kinds of activities most commonly relevant for this purpose include:

   (a) acting as financial adviser to one of the parties;

   (b) reporting on profit forecasts and/or valuations for the purposes of takeover documents;

   (c) conducting acquisition searches for clients, and introducing clients to other parties with a view to potential acquisitions; and

   (d) advising in relation to acquisitions and disposals of securities to which the Codes may apply.

6. Whilst the Codes do not define precisely the range of activities and transactions within its scope, paragraph 4 “Companies to which the Codes apply” of Chapter 1 “Introduction to the Codes” describes the companies which are subject to the Codes. In practice, those engaging in providing takeover services rarely experience difficulty in determining whether the Codes are or may be relevant to the activities proposed to be undertaken for any particular client.

7. A member who has provided or is providing takeover services to a client should:

   (a) supply to the Panel any information, books, documents or other records concerning the relevant transaction or arrangement which the Panel may properly require and which are in the possession or under the control of the member; and

   (b) otherwise render all such assistance as the member is reasonably able to give to the Panel,

   provided that in each case the relevant information, books, documents or other records were acquired by the member in the course of the member providing the relevant takeover services.

8. Except with the consent of the Panel, a member should not provide or continue to provide takeover services for any person if the Panel has stated that it considers that the facilities of the securities markets in the Hong Kong should be withheld from that person and has not subsequently indicated a change in this view.

9. If members have included in the engagement letter agreed with their client a provision to the effect of that recommended in paragraph 2(b) above, they will be able to discharge their responsibilities under paragraphs 7 and/or 8 above, without any breach of confidentiality or duty to the client. While members should include such a provision, it is recognised that, on occasion, compliance with such responsibilities may still involve a breach of confidentiality to a third party or a breach of some other duty owed to the client. In such circumstances members should consider obtaining legal advice.

10. The client agrees and acknowledges that where the services provided by the firm relate to a transaction within the scope of the Codes, the client and the firm will comply with the provisions of the Codes and the firm will observe Section 700 issued by the Institute relevant to such services or transactions. In particular, the client acknowledges that:

    (a) if the client or its advisers or agents fail to comply with the Codes then the firm may withdraw from acting for the client; and

    (b) the firm is obliged to supply to the Panel any information, books, documents or other records concerning the services or transaction which the Panel may properly require.

SECTION 800

Use of Designations and Institute's Logo

This section should be read in conjunction with Subsection 115 "Professional Behavior" under Chapter A of the Code*.*

Use of Designations

Designations of Certified Public Accountant

Certified Public Accountant

800.1 Use of the designation "Certified Public Accountant (會計師)" or the initials "CPA" is governed by By-law 22 of the Professional Accountants By-laws (Cap. 50A) (By-laws).

800.2 With effect from the commencement of the Professional Accountants (Amendment) Ordinance 2004 on 8 September 2004, all current members on the Hong Kong Institute of Certified Public Accountants (the "Institute") membership register are deemed to be registered as certified public accountants under section 22(4) of the Professional Accountants Ordinance (Cap. 50) (PAO). They therefore acquire the designation "Certified Public Accountant (會計師)" and are entitled to use the initials "CPA" under By-law 22.

800.3 The designation "Certified Public Accountant (會計師)" or the initials "CPA" is used to describe a member's professional qualification. Under sections 42(1)(h), (ha), (i) and (ia) of the PAO the right to the use of the description "certified public accountant", the initials "CPA" or the characters "會計師" to carry on a business, trade or profession is reserved only for practice units as defined in section 2 of the PAO. Practice unit means a firm of Certified Public Accountants (Practising) practising accountancy, a Certified Public Accountant (Practising) practising on his own account or a Corporate Practice. Accordingly,

(a) a CPA not holding a practising certificate, who carries on a business, trade or profession whether by himself or through an entity, should not include the description "Certified Public Accountant" or the initials "CPA" or the characters "會計師" in his trade or business name or the trade or business name of the entity; and

(b) A CPA not holding a practising certificate, who registers his own name or the name of his entity as a trade or business name under the Business Registration Ordinance, should not include the description "Certified Public Accountant" or the initials "CPA" or the characters "會計師" in the trade or business name.

Fellow

800.4 Use of the designation "Fellow of the Hong Kong Institute of Certified Public Accountants (資深會計師)" or the initials "FCPA" is governed by By-law 22.

800.5 Under a Council Ruling, a Fellow of the Hong Kong Institute of Certified Public Accountants who holds a practising certificate may describe himself as a "Fellow of the Hong Kong Institute of Certified Public Accountants (Practising) (執業資深會計師)" and use the initials "FCPA (practising)".

Practice of Public Accountancy

800.6 Under the PAO, the use of the description "Certified Public Accountant (Practising)" is restricted to a certified public accountant holding a practising certificate.

800.7 Under By-law 25 however:

(a) a certified public accountant holding a practising certificate has the option of describing himself as "Certified Public Accountant (會計師)" or "Certified Public Accountant (Practising) (執業會計師)" and using the initials "CPA" or "CPA (practising)"; and

(b) a firm of Certified Public Accountants (Practising) or a Corporate Practice has the option of describing itself as "Certified Public Accountants" or "Certified Public Accountants (Practising)", or in Chinese "會計師事務所" or "會計師行".

Designation of Affiliate

800.8 Use of the designation "International Affiliate of the Hong Kong Institute of Certified Public Accountants" is governed by By-law 22A.

Members in Overseas Countries

800.9 Outside Hong Kong, the rights of members to use the designations to which they are entitled as members of the Institute depend upon the law of the country concerned.

Use of Institute's Logo

800.10 In the light of the provisions laid down in sections 42(1)(h), (ha), (i) and (ia) of the PAO, which restrict the use of the description "certified public accountant", the initials "CPA" or the characters "會計師" for business purposes by practice units, only practice units are permitted to use the logo of the Institute on their stationery and only those CPAs working for practice units and holding practising certificates are allowed to use the logo of the Institute on their business name cards.

800.11 Guidelines on the use of the logo of the Institute are available on the Institute's website.

SECTION 900

Practice Promotion

This section should be read in conjunction with Subsection 115 "Professional Behavior" under Chapter A of the Code*.*

Introduction

This section sets out the requirements for practice promotion activities, including all forms of publicity and advertising. This section comprises four parts:

Part 1 deals with scope and responsibilities;

Part 2 sets out the general principles which must be observed in respect of all practice promotion activities;

Part 3 sets out additional principles which apply to advertising; and

Part 4 sets out prohibited media.

Part 1 - Scope and Responsibilities

Scope

900.1 This section applies to:

(a) Certified Public Accountants (Practising), including member practices, their affiliates and, members who are employees of member practices; and

(b) members advertising themselves as professional accountants providing professional and other services, whether as individuals, partnerships or through other entities over which they exercise control.

900.2 For the purposes of this section, an affiliate of a Certified Public Accountants (Practising) is deemed to be any individual or entity over which the Certified Public Accountants (Practising) exercises control or significant influence, regardless of whether such control or significant influence results from direct or indirect ownership, common ownership or other arrangement.

900.3 The provisions of this section are applicable to all forms of practice promotion, including publicity sought by members for their services, achievements and products and any advertising thereof.

900.4 The principles set out in this section apply equally to all forms of communication by members, e.g. letterheads, invoices, name cards and via electronic media.

Responsibilities

900.5 Members to whom this section applies will be held responsible for the form and content of any advertisement, publicity, or solicitation, whether undertaken personally or by another person or organisation on behalf of the member or his practice. Any practice promotion activity or material relating to a member or member practice shall be presumed, subject to proof by the member to the contrary, to have been issued (in the form in which it was issued) with his authority.

900.6 Where members receive the benefits of promotional activities by third parties they are reminded that they are not permitted to do through others what they are prohibited from doing themselves by the Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants (the "Institute").

900.7 Members are required to use their best endeavours to ensure that promotional activities in Hong Kong by connected or associated individuals or entities outside Hong Kong, comply with this section.

900.8 In the event of a complaint being received by the Institute relating to the promotion of professional services, members will be required to justify their position or actions.

Part 2 - General Principles Applicable to All Forms of Practice Promotion

900.9 The general principles set out in this Part must be observed in respect of any practice promotion activities.

900.10 Where publicity, advertising or other forms of practice promotion are carried out, such activities should:

(a) be aimed at informing the recipients or the public in an objective manner;

(b) conform to the basic principles of legality, decency, clarity, honesty and truthfulness; and

(c) not project an image which is inconsistent with that of a professional person bound to high ethical and technical standards.

900.11 In no circumstances should any promotional activities be conducted in such a way or to such an extent as to amount to harassment or coercion of prospective clients.

900.12 Activities which are expressly prohibited include those which:

(a) create false, deceptive or unjustified expectations of favourable results;

(b) imply the ability to influence any court, tribunal, regulatory agency or similar body or official;

(c) make unjustified claims to be an expert or specialist in a particular field;

(d) contain purported statements of fact which cannot be verified or which are misleading by reason of the context in which they appear;

(e) make disparaging references to or disparaging comparisons with the services of others;

(f) contain testimonials or endorsements other than where:

(i) the prior consent has been obtained from the giver of the testimonial or endorsement;

(ii) the giver of the testimonial or endorsement is clearly identified; and

(iii) the testimonial or endorsement has not been obtained for reward;

(g) contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

900.13 Practising members should not give any commission, fee or reward to a third party, unless he/she is either their employee or another professional accountant, in return for the introduction of a client.

Part 3 - Principles Applicable to Advertising

900.14 This Part sets out additional principles which must be observed with regard to advertising or other forms of promotional material which are widely circulated or on public display (subject to the restrictions set out in Part 4).

900.15 An advertisement should be clearly identified as such.

900.16 Advertising and promotional material should not contain references to scale charges or amounts of fees for professional and other services, nor should members make comparisons between their fees and the fees of others. It is, however, permissible to make reference to a free initial consultation at which levels of fees will be discussed. This Part of the section refers to advertising and therefore does not preclude members from quoting fees or a range of fees in proposals where they have been requested to do so by a prospective client.

900.17 As the “Homepage” of a website of a member or member practice is considered analogous to a newspaper advertisement, it is not allowed to contain any references to scale charges or amounts of fees. However information on scale charges or amounts of fees contained in a separate file on the website which is linked to the “Homepage” is allowed as the user is required to act to gain access to such information by clicking the relevant “icon” on the “Homepage”.

900.18 Members should not make generalised claims as regards size or quality. A claim to be, for example, the “largest” or “fastest growing” member practice in any area or field of practice is likely to be misleading, as it is impossible to know whether such a claim refers to the number of partners or staff, the number of offices or the amount of fee income. A claim to be the “best” or the “leading” member practice is subjective and cannot be substantiated.

900.19 Signboards and other notices on public display should be maintained at all times to a high standard and consistent with the dignity of the profession. Notices in the nature of handbills, stickers, etc. are unacceptable.

Part 4 - Prohibited Media

900.20 This Part sets out prohibitions and restrictions on the use of certain media for practice promotion activities including publicity and advertising.

900.21 The restrictions set out below do not apply to members standing as candidates for public office. Such members are, however, required to ensure that they are not using their election campaigns to advertise their professional services.

Direct Mailing

900.22 Except as permitted by paragraph 900.23 below, members should not mail, deliver or send directly or indirectly (whether by mail, fax, electronic mail or other means) material promoting their services.

900.23 The general exceptions to the above prohibition on direct mailing are:

(a) direct mailing of material to clients, close associates and other practising members or upon receipt of an unsolicited request from the recipient;

(b) direct mailing of material in relation to seminars, provided that it is strictly relevant to the seminar in question and should not be capable of being construed as an advertisement for the general professional services of the member;

(c) a member may send a letter introducing his practice and its range of services to another professional adviser, such as a solicitor or banker, provided that it is made clear that this is not done with the aim of procuring the professional adviser itself as a client.

Cold Calling

900.24 A member should not make or instigate an unsolicited approach to a non client for the purpose of obtaining professional work, for example by making an uninvited visit or by telephone either to solicit business or to make an appointment to visit.

Distribution of Leaflets, Promotional Gifts and Other Items

900.25 Leaflets, flyers, handbills, promotional gifts or other items advertising or promoting the name of a member or member practice or its services may not be distributed in public places. It is, however, acceptable for such items to be distributed at the location of events sponsored by the member or member practice during that event.

SECTION 1000

Clients' Monies

This section should be read in conjunction with Section 350 "Custody of Client Assets" under Chapter A of the Code.

The Statement

1000.1 A member in practice is strictly accountable for all clients' monies received by him. Such monies should be kept separate from all other monies in his hands and be applied only for the purposes of the client.

Guidelines

1000.2 In this section, the term "clients' monies" includes all monies received by a practice to be held or disbursed by it on the instructions of the person from whom or on whose behalf they are received.

1000.3 Clients' monies should under normal circumstances be paid within five working days into a separate bank account, which may be either a general account or an account in the name of a specific client but which shall in all cases include in its title the word "client". Any such bank account is referred to herein as "a client account". It is desirable for a member to open a general client account at the commencement of his practice.

1000.4 Whenever a practice opens a client account appropriate notice of the nature of the account should be given in clear terms to the bank at which the account is to be opened. Legal advice has been received to the effect that if this is done no question will arise of set-off by the bank against the member's other accounts or of sequestration by a trustee in bankruptcy of a member of the amounts held in the client account for the benefit of the general creditors of the bankrupt member.

1000.5 Where a practice receives a cheque or draft which includes both clients' monies and other monies he should cause the same to be credited to a client account. Once the monies have been received into such client account a practice may withdraw from that account such part of the sum received as can properly be transferred to the office account in accordance with the principles set out in paragraph 1000.7 below.

1000.6 Save as referred to in paragraph 1000.5 above, no monies other than clients' monies should be paid into a client account.

1000.7 Drawings on a client account may be made only:

(a) to meet payments due from a client to the practice for professional work done by the practice for that client provided that:

(i) a bill has been rendered; and

(ii) the client has been informed in writing, and has not disagreed within a reasonable period of time, that money held or received for him will be so applied;

(b) to cover disbursements made on a client's behalf;

(c) to, or on the instructions of, a client.

1000.8 A practice must be careful to differentiate, both in its records and, where appropriate, in its use of client accounts, between monies held on behalf of a client in his personal capacity and those, within the knowledge of the practice, held on behalf of the same client as trustee for others. Save where the size of the fund does not, on grounds of expense, warrant it, a separate client account should be opened to receive the trust monies of each separate trust.

1000.9 In no circumstances should a practice permit any payment to be made to or on behalf of a client from a client account, whether by transfer to office account of the practice or otherwise, which will result in a drawing on the relevant client account exceeding the balance held in that account on such client's behalf.

1000.10 Interest on client account monies:

(a) In the absence of express agreement to the contrary any interest received on a client's monies may be retained by the practice.

(b) Variations to sub-paragraph (a) above should be agreed between members and their clients. Any such agreement might conveniently be recorded in the engagement letter, or in any subsequent correspondence.

(c) Where a practice receives monies of a client for retention and it is under instructions from the client that the monies be deposited at interest, the practice shall so deposit them in a designated client deposit account in respect of which notice shall have been given as provided in paragraph 1000.4. It may be appropriate for a practice to charge a fee for this service. If monies belonging to more than one client are held in the same client bank account, any interest arising thereon should be apportioned as appropriate among the clients concerned.

1000.11 Money held by a member as stakeholder should be regarded as clients' money and should be paid into a separate bank account maintained for the purpose or into a client bank account. The disposition of interest arising from such monies should be the subject of an agreement between the parties.

1000.12 Every member in practice should at all times maintain records so as to show clearly the money he has received, held or paid on account of his clients, and the details of any other money dealt with by him through a client account, clearly distinguishing the money of each client from the money of any other client and from his own money.

D COMPARISON WITH THE IESBA CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

Since 2005, the Institute has adopted the IESBA *Code of Ethics for Professional Accountants* (International Code) as the ethical requirements for its members. Additional guidance which is highlighted with shading in Chapter A has been incorporated to reflect local or legal requirements in Hong Kong. In this version of the Code of Ethics for Professional Accountants, Chapter A, Requirements and Application Material, is based on the International Code.

This comparison appendix deals only with significant differences in Chapter A with the International Code, is produced for information only and does not form part of the Code of Ethics for Professional Accountants.

The following sets out the major textual differences between Chapter A and the International Code and the reasons for the differences.

	Differences	**Reasons for the Differences**
1.	**Paragraphs 250.5 A1, 250.5 A2, 250.5 A3, 330.5 A3, Footnote 1a, 1b and Appendix 1**	The paragraphs reflect the legal requirement in Hong Kong and additional guidance on the application of the Prevention of Bribery Ordinance.
2.	**Glossary, Footnote 1c**	Additional guidance on the definition of "public interest entity" under the legislation of Hong Kong.
3.	**Footnote 1d**	Additional guidance on "cooling-off" period for professional accountants in public practice in respect of long association of personnel (including partner rotation) under the legislation of Hong Kong.

E SPECIALIZED AREAS OF PRACTICE

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SECTION 500
PROFESSIONAL ETHICS IN LIQUIDATION AND INSOLVENCY
(EFFECTIVE ON 1 APRIL 2012)
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SECTION 500

Professional Ethics in Liquidation and Insolvency

This section should be read in the context of the fundamental principles of professional ethics for professional accountants and the conceptual framework for applying those principles which are set out in Chapter A, Requirements and Application Material for Professional Accountants of the Code ("Chapter A")*.*

Part 1 – General Application

Introduction

500.1 This section of the Code is intended to assist an insolvency practitioner meets the standards of conduct and ethics expected of him when undertaking or preparing to undertake liquidation and insolvency appointments. It should be noted that this section does not purport to cover the requirements that are imposed by authorities in other jurisdictions. It is also not intended to detract from any responsibilities which may be imposed by law or regulations. The headings in this section are intended to facilitate its presentation only and do not in any way affect the interpretation or meaning of its contents.

500.2 For avoidance of doubt, the use of the word “shall” in this section imposes a requirement on the insolvency practitioner or practice to comply with the specific provision in which “shall” has been used. Compliance is required unless an exception is permitted by this section.

Scope

500.3 This section of the Code is applicable to and governs the standards of conduct of all insolvency practitioners. An insolvency practitioner shall take steps to ensure that this section is applied in all professional work relating to liquidation and insolvency appointments, and to any professional work that may lead to such appointments. Although such an appointment will normally be of the insolvency practitioner personally rather than his practice, he shall ensure that the standards set out in this section are applied to all members of the insolvency team and his practice, where appropriate.

500.4 The appointments, to which this section of the Code refers, include but are not limited to the following appointments, whether in insolvent or solvent estates:

(a) liquidator, provisional liquidator, special manager, receiver (or receiver and manager), trustee in bankruptcy, provisional trustee in bankruptcy, nominee of an individual voluntary arrangement;

(b) administrator, manager, adjudicator or any other similar role, however described in respect of a scheme of arrangement between a company and its creditors;

(c) administrator under the Securities and Futures Ordinance (Cap. 571); and

(d) examiner in bankruptcy cases under the Official Receiver's Office tender scheme.

Fundamental Principles

500.5 An insolvency practitioner shall comply with the fundamental principles set out in paragraph 110.1 A1 under Chapter A of the Code. The five fundamental principles are:

(a) *Integrity* – to be straightforward and honest in all professional and business relationships.

(b) *Objectivity* – not to compromise professional or business judgments because of bias,

conflict of interest or undue influence of others

(c) *Professional Competence and Due Care* – to:

(i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and
(ii) Act diligently and in accordance with applicable technical and professional standards.

(d) *Confidentiality* – to respect the confidentiality of information acquired as a result of professional and business relationships.

(e) *Professional Behaviour* – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

500.6 It is important for an insolvency practitioner to be aware of the intention of this section of the Code. An insolvency practitioner shall look to and comply with the fundamental principles and not merely focus on the specific situations analysed in this section. All of the fundamental principles are important. They direct the attention of an insolvency practitioner to the overriding importance of professional ethics in his professional life. They are as important in the acceptance and conduct of liquidation and insolvency work as in any other area of professional life.

500.7 As it is the fundamental principle of objectivity that more frequently gives rise to ethical dilemmas, this section of the Code provides more specific guidance primarily in respect of objectivity. The preservation of objectivity needs to be demonstrated by the maintenance of an insolvency practitioner's independence from influences, which could affect his objectivity. An insolvency practitioner shall not only be satisfied as to the actual objectivity which he can bring to his judgement, decisions and conduct, but shall also be mindful of how his objectivity may be perceived by others. An insolvency practitioner shall also be aware of the possible threat to objectivity if he engages in regular or reciprocal arrangements in relation to appointments with another practice or organisation.

Framework Approach

500.8 Paragraphs R120.6 to R120.11 under Chapter A of the Code set out the conceptual framework approach that requires a professional accountant to:

(a) identify threats to compliance with the fundamental principles;

(b) evaluate such threats; and

(c) address such threats in an appropriate manner.

500.9 This section of the Code provides a framework which insolvency practitioners can use to identify actual or potential threats to compliance with the fundamental principles, and determine whether there are any safeguards that may be available to mitigate them. As well as including illustrative guidance, it includes examples of specific threats and possible safeguards. These examples are illustrative only and are not intended to be, nor should they be interpreted as an exhaustive list of all relevant threats or safeguards. It is impossible to define all circumstances that may create threats to compliance with the fundamental principles or to specify safeguards that may be available.

Identification of threats to the fundamental principles

500.10 An insolvency practitioner shall take reasonable steps to identify the existence of any threats to compliance with the fundamental principles which arise during the course of his professional work.

500.11 An insolvency practitioner shall take particular care to identify the existence of threats which exist prior to or at the time of taking an appointment or which, at that stage, may reasonably be expected to arise during the course of such an appointment. Paragraphs on accepting or not accepting appointments and professional and personal relationships below contain particular factors an insolvency practitioner shall take into account when deciding whether to accept an appointment.

500.12 In identifying the existence of any threats, an insolvency practitioner shall have regard to relationships whereby the practice is held out as being part of a network, which is aimed at (a) co-operation and (b) profit or cost sharing or which 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.

500.13 Many threats fall into one or more of five categories:

(a) *Self-interest threat* – The threat that a financial or other interest will inappropriately influence the insolvency practitioner's judgement or behaviour;

(b) *Self-review threat* – The threat that an insolvency practitioner will not appropriately evaluate the results of a previous judgement made or service performed by him, or by another individual within his practice or employing practice, on which the insolvency practitioner will rely when forming a judgement as part of providing a current service;

(c) *Advocacy threat* – The threat that an insolvency practitioner or an individual within the practice will promote a position to the point that the insolvency practitioner's objectivity is compromised;

(d) *Familiarity threat* – The threat that due to a long or close relationship with others**,** an insolvency practitioner or an individual within the practice will be too sympathetic to the interests of others or too accepting of the work of others; and

(e) *Intimidation threat* – The threat that an insolvency practitioner will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the insolvency practitioner.

500.14 The following paragraphs give examples of the possible threats that an insolvency practitioner may face. These examples are illustrative only and they are not intended to be, nor should they be interpreted as an exhaustive list of all relevant threats.

500.15 Examples of circumstances that may create self-interest threats for an insolvency practitioner include:

(a) An individual within the practice having an interest in a creditor or potential creditor with a claim which requires adjudication.

(b) Concern about the possibility of damaging a business relationship.

(c) Concern about potential future employment.

500.16 Examples of circumstances that may create self-review threats include:

(a) The acceptance of an appointment in respect of an entity where an individual within the practice has recently been employed by or seconded to that entity.

(b) An insolvency practitioner or the practice has carried out professional work of any description, including sequential appointments, for that entity.

Such self-review threats may diminish over the passage of time.

500.17 Examples of circumstances that may create advocacy threats include:

(a) Acting or having acted in an advisory capacity for a creditor of an entity which subsequently becomes insolvent.

(b) Acting or having acted as an advocate for a client in litigation or dispute with an entity which subsequently becomes insolvent.

500.18 Examples of circumstances that may create familiarity threats include:

(a) An individual within the practice having a close relationship with any individual having a financial interest in the entity.

(b) An individual within the practice having a close relationship with a potential purchaser of an insolvent entity's assets and/or business.

In this regard a close relationship includes both a close professional relationship and a close personal relationship.

500.19 Examples of circumstances that may create intimidation threats include:

(a) The threat of dismissal or replacement being used to:

(i) apply pressure not to follow regulations, this section of the Code, any other applicable code, technical or professional standards.

(ii) exert influence over an appointment where the insolvency practitioner is an employee rather than a principal of the practice.

(b) Being threatened with litigation.

(c) The threat of a complaint being made to the insolvency practitioner's professional body and/or his employer.

Evaluation of threats

500.20 An insolvency practitioner shall take reasonable steps to evaluate any threats to compliance with the fundamental principles when he knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles.

500.21 An insolvency practitioner shall exercise judgment to determine how best to deal with threats that are not at an acceptable level, whether by applying safeguards to eliminate the threat or reduce it to an acceptable level or, particularly where this is not possible, by terminating or declining the relevant appointment. In exercising this judgment, an insolvency practitioner shall consider whether a reasonable and informed third party, weighing all the specific facts and circumstances available to him at that time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of safeguards, such that compliance with the fundamental principles is not compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the appointment and the structure of the practice.

Possible safeguards

500.22 Having identified and evaluated threats to compliance with the fundamental principles, an insolvency practitioner shall determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level. The relevant safeguards will vary depending on the circumstances. Generally, safeguards fall into two broad categories. Firstly, safeguards created by the profession, legislation or regulation. Secondly, safeguards in the work environment. In the insolvency or liquidation context, safeguards in the work environment can include safeguards specific to an appointment. These are considered in the paragraphs on accepting or not accepting appointments below. In addition, safeguards can be introduced across the practice. These safeguards seek to create a work environment in which threats are identified and the introduction of appropriate safeguards is encouraged. Some examples include:

(a) Leadership of the practice that stresses the importance of compliance with the fundamental principles.

(b) Policies and procedures to implement and monitor quality control of appointments.

(c) Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant appointment.

(d) Documented internal policies and procedures requiring compliance with the fundamental principles.

(e) Policies and procedures to consider the fundamental principles of this section of the Code before the acceptance of an appointment.

(f) Policies and procedures that will enable the identification of interests or relationships between the insolvency practitioner or the practice or individuals within the practice and third parties.

(g) Policies and procedures to prohibit individuals (including those who are not members of the insolvency team) from inappropriately influencing the outcome of an appointment.

(h) Timely communication of a practice's policies and procedures, including any changes to them, to all individuals within the practice, and appropriate training and education on such policies and procedures.

(i) Designating a member of senior management to be responsible for overseeing the adequate functioning of the practice's quality control system.

(j) A disciplinary mechanism to promote compliance with policies and procedures.

(k) Published policies and procedures to encourage and empower individuals within the practice to communicate to senior levels within the practice and/or the insolvency practitioner any issue relating to compliance with the fundamental principles that concerns them.

Part 2 – Specific Application

Accepting or Not Accepting Appointments

500.23 The practice of liquidation and insolvency is principally governed by statute and secondary legislation and in many cases is subject ultimately to the control of the court. Where circumstances are dealt with by statute or secondary legislation, an insolvency practitioner shall comply with such provisions. An insolvency practitioner shall also comply with any relevant judicial authority relating to his conduct and any directions given by the court.

500.24 An insolvency practitioner shall act in a manner appropriate to his position as an officer of the court (where applicable) and in accordance with any fiduciary or other duties that he may be under.

500.25 Before accepting an appointment (including a joint appointment), an insolvency practitioner shall determine whether acceptance would create any threats to compliance with the fundamental principles. Of particular importance will be any threats to the fundamental principles of objectivity and integrity created by conflicts of interest or by any significant professional or personal relationships. These are considered in more detail below.

500.26 In considering whether objectivity or integrity may be threatened, an insolvency practitioner shall identify and evaluate any professional or personal relationship (see paragraphs 500.54 to 500.57 below dealing with the assets of an entity) which may affect compliance with the fundamental principles. The appropriate response to the threats arising from any such relationships shall then be considered, together with the introduction of any possible safeguards.

500.27 Generally, it will be inappropriate for an insolvency practitioner to accept an appointment where a threat to the fundamental principles exists or may reasonably be expected to arise during the course of the appointment unless:

(a) prior to the appointment, disclosure of the existence of such a threat is made to the court or to the creditors on whose behalf the insolvency practitioner would be appointed to act and no objection is made to the insolvency practitioner being appointed; and

(b) if the threat is other than trivial, safeguards are or will be available to eliminate or reduce that threat to an acceptable level.

500.28 The following are among the safeguards that may be considered:

(a) Involving and/or consulting another insolvency practitioner from within the practice to review the work done.

(b) Consulting an independent third party, such as a creditors' committee, a professional body or another insolvency practitioner.

(c) Involving another insolvency practitioner to perform part of the work, which may include another insolvency practitioner taking a joint appointment where the conflict arises during the course of the appointment.

(d) Obtaining legal advice from a solicitor or barrister with appropriate experience and expertise.

(e) Changing the members of the insolvency team.

(f) The use of separate insolvency practitioners and/or staff.

(g) Procedures to prevent access to information (e.g. strict physical separation of such insolvency teams, confidential and secure data filing).

(h) Clear guidelines for individuals within the practice on issues of security and confidentiality.

(i) The use of confidentiality agreements signed by individuals within the practice.

(j) Regular review of the application of safeguards by a senior individual within the practice not involved with the appointment.

(k) Terminating the financial or business relationship that gives rise to the threat.

(l) Seeking directions from the court.

500.29 As regards joint appointments, where an insolvency practitioner is specifically precluded by this section of the Code from accepting an appointment as an individual, a joint appointment will not be an appropriate safeguard and will not make accepting the appointment appropriate.

500.30 In deciding whether to take an appointment in circumstances where a threat to the fundamental principles has been identified, an insolvency practitioner shall consider whether the interests of those on whose behalf he would be appointed to act would best be served by the appointment of another insolvency practitioner who does not face the same threat and, if so, whether any such appropriately qualified and experienced other insolvency practitioner is likely to be available to be appointed.

500.31 An insolvency practitioner may encounter situations where no safeguards can reduce a threat to an acceptable level. Where this is the case, an insolvency practitioner shall conclude that it is not appropriate to accept the appointment.

500.32 Following acceptance of an appointment, any threats shall continue to be kept under appropriate review and an insolvency practitioner shall be mindful that other threats may come to light or arise. There may be occasions when the insolvency practitioner is no longer in compliance with this section of the Code because of changed circumstances or something that has been inadvertently overlooked. This would generally not be an issue, provided the insolvency practitioner has appropriate quality control policies and procedures in place to deal with such matters and, once discovered, the matter is corrected promptly and any necessary safeguards are applied**.** In deciding whether to continue an appointment, the insolvency practitioner may take into account the wishes of the creditors, who after full disclosure has been made have the right to retain or replace the insolvency practitioner.

500.33 In all cases an insolvency practitioner shall exercise his judgment to determine how best to deal with an identified threat. In exercising his judgment, an insolvency practitioner shall take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the insolvency practitioner at the time, including the significance of the threat and the efficacy of the safeguards applied, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles would not be compromised. This consideration will be affected by matters such as the significance of the threat, the nature of the work and the structure of the practice.

Conflicts of interest

500.34 An insolvency practitioner shall take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may create threats to compliance with the fundamental principles. Examples of where a conflict of interest may arise are where:

(a) An insolvency practitioner has deal with claims between the separate and conflicting interests of entities over which he is appointed. He should be particularly aware of the difficulties likely to arise from the existence of inter-company transactions or guarantees in group, associated or “family-connected” company situations. Acceptance of an appointment in relation to more than one company in the group or association may

raise issues of conflict of interest. Nevertheless it may be impracticable for a series of different insolvency practitioners to act. An insolvency practitioner therefore should not accept multiple appointments in such situations unless he is satisfied that he is able to take steps to minimise potential conflicts and that his overall integrity and objectivity are, and are seen to be maintained.

(b) There are a succession of or sequential appointments (see examples in category B of Part 3 on the application of the framework to specific situations).

(c) A significant relationship has existed with the entity or someone connected with the entity (see also paragraphs 500.49 to 500.53 below on professional and personal relationships). An insolvency practitioner, or a member of his practice, who is acting as insolvency practitioner in relation to an individual debtor may be asked to accept an appointment in relation to an entity of which the debtor is a major shareholder or creditor or where the entity is a creditor of the debtor. It is essential that, if the insolvency practitioner is to accept the new appointment, he should be able to show that the steps indicated in paragraph 500.34(a) above have been taken. Similar considerations apply if it is the entity appointment which precedes the individual appointment.

500.35 It is important to note that conflicts may arise not only at the time an appointment is offered but also after it has been accepted. It is always a matter for an insolvency practitioner to assess whether he may accept and/or continue an engagement in the particular context that applies at the time. It will always be up to an insolvency practitioner to justify his actions in cases of doubt. Whether an insolvency practitioner takes or continues an appointment will depend on what threats there are and whether, in the event that there are threats, the introduction of safeguards will overcome those threats. Sometimes, though, the mere perception of risk or conflict will make acceptance or continuation unwise so that the insolvency practitioner shall not only be satisfied as to the actual objectivity which he can bring to his judgment, decisions and conduct but also shall be mindful of how his objectivity could be perceived by others.

500.36 Some of the safeguards listed at paragraph 500.28 may be applied to reduce the threats created by a conflict of interest to an acceptable level. Where a conflict of interest arises, the preservation of confidentiality will be of paramount importance; therefore, the safeguards used should generally include the use of effective information barriers.

Practice mergers

500.37 Where practices merge, they shall subsequently be treated as one for the purposes of assessing threats to the fundamental principles. At the time of the merger, existing appointments shall be reviewed and any threats identified. Principals and employees of the merged practice become subject to common ethical constraints in relation to accepting new appointments to clients of either of the former practices. However, existing appointments which are rendered in apparent breach of this section of the Code by such a merger need not be determined automatically, provided that a considered review of the situation by the practice discloses no obvious and immediate ethical conflict.

500.38 Where an individual within the practice has, in any former practice, undertaken work upon the affairs of an entity in a capacity that is incompatible with an appointment of the new practice, the individual shall not personally work or be employed on that assignment.

Transparency

500.39 Both before and during an appointment an insolvency practitioner may acquire personal information that is not directly relevant to the insolvency or confidential commercial information relating to the affairs of third parties. The information may be such that others might expect that confidentiality would be maintained.

500.40 An insolvency practitioner in the role as office holder has a professional duty to report openly to those with an interest in the outcome of the insolvency or liquidation. An insolvency practitioner shall report on his acts and dealings as fully as possible having regard to the circumstances of the case, in a way that is transparent and understandable. An insolvency practitioner shall bear in mind the expectations of others and what a reasonable and informed third party would consider appropriate.

Professional competence and due care

500.41 Prior to accepting an appointment an insolvency practitioner, to the extent reasonably possible, shall ensure that he is satisfied that the following matters have been taken into consideration:

(a) Obtaining knowledge and understanding of the entity, its owners, managers and those responsible for its governance and business activities.

(b) Acquiring an appropriate understanding of the nature of the entity's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.

(c) Acquiring knowledge of relevant industries or subject matters.

(d) Possessing or obtaining experience with relevant regulatory or reporting requirements.

(e) Assigning sufficient staff with the necessary competencies.

(f) Using experts where necessary.

(g) Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

500.42 The fundamental principle of professional competence and due care imposes an obligation on an insolvency practitioner to only accept an appointment that the insolvency practitioner is competent to perform. For example, a self-interest threat to professional competence and due care is created if the insolvency team does not possess or cannot acquire the competencies necessary to properly carry out the appointment. Expertise will include appropriate training, technical knowledge, knowledge of the entity and the business with which the entity is concerned.

500.43 If any appointment necessitates the employment of agents, an insolvency practitioner shall exercise care to retain overall control of the conduct of the engagement. An insolvency practitioner shall not accept any insolvency or liquidation work as agent of another insolvency practitioner unless satisfied that he has been employed on this basis and the other insolvency practitioner has retained overall control of the conduct of the engagement.

500.44 Maintaining and acquiring professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments, including:

(a) Developments in insolvency and related legislation.

(b) The regulations of the Institute, including the continuing professional development requirements.

(c) Guidance issued by the Institute, e.g. Insolvency Guidance Notes, and relevant circulars issued by regulatory bodies.

(d) Technical issues being discussed within the profession.

Professional and Personal Relationships

500.45 The environment in which an insolvency practitioner works and the relationships formed in his professional and personal life can lead to threats to compliance with the fundamental principle of objectivity.

Identifying relationships

500.46 In particular, the principle of objectivity may be threatened if any individual within the practice, the close relative of an individual within the practice, or the practice itself, has or has had a professional or personal relationship which relates to the appointment being considered.

500.47 Professional or personal relationships may include, but are not restricted to, relationships with:

(a) the entity;

(b) any director or shadow director or former director or shadow director of the entity;

(c) shareholders of the entity;

(d) any principal or employee of the entity;

(e) business partners of the entity;

(f) companies or entities controlled by the entity;

(g) companies which are under common control;

(h) creditors (including debenture holders or floating charge holders) of the entity;

(i) debtors of the entity;

(j) close relative of the entity (if an individual) or its officers (if a corporate body);

(k) others with commercial relationships with the practice.

500.48 A practice shall have policies and procedures to identify relationships between individuals within the practice and third parties in a way that is proportionate and reasonable in relation to the appointment being considered.

Is the relationship significant to the conduct of the appointment?

500.49 Where a professional or personal relationship of the type described in paragraph 500.46 has been identified, an insolvency practitioner shall evaluate the impact of the relationship in the context of the appointment being sought or considered. Issues to consider in evaluating whether a relationship creates a threat to compliance with the fundamental principles may include the following:

(a) The nature of the previous duties undertaken by a practice during an earlier relationship with the entity.

(b) The impact of the work conducted by the practice on the financial state and/or the financial stability of the entity in respect of which the appointment is being considered.

(c) Whether the fee received for the work by the practice is or was significant to the practice itself or is or was substantial.

(d) How recently any professional work was carried out. It is likely that greater threats will arise (or may be seen to arise) where work has been carried out within the previous two years. However, there may still be instances where, in respect of non-audit work, any threat is at an acceptable level. Conversely, there may be situations whereby the nature of the work carried out was such that a considerably longer period should elapse before any threat can be reduced to an acceptable level.

(e) Whether the appointment being considered involves consideration of any work previously undertaken by the practice for that entity.

(f) The nature of any personal relationship and the proximity of the insolvency practitioner to the individual with whom the relationship exists and, where appropriate, the proximity of that individual to the entity in relation to which the appointment relates.

(g) Whether any reporting obligations will arise in respect of the relevant individual with whom the relationship exists (e.g. an obligation to report on the conduct of directors and shadow directors of a company to which the appointment relates).

(h) The nature of any previous duties undertaken by an individual within the practice during any earlier relationship with the entity.

(i) The extent of the insolvency team's familiarity with the individuals connected with the entity.

500.50 Having identified and evaluated a relationship that may create a threat to compliance with the fundamental principles, an insolvency practitioner shall consider his response including the introduction of any possible safeguards to reduce the threat to an acceptable level.

500.51 Some of the safeguards which may be considered to reduce the threat created by a professional or personal relationship to an acceptable level are considered in paragraph 500.28. Other safeguards may include:

(a) Withdrawing from the insolvency team.

(b) Terminating (where possible) the financial or business relationship giving rise to the threat.

(c) Disclosure of the relationship and any financial benefit received by the practice (whether directly or indirectly) to the entity or to those on whose behalf the insolvency practitioner would be appointed to act.

500.52 An insolvency practitioner may encounter situations in which no or no reasonable safeguards can be introduced to eliminate a threat arising from a professional or personal relationship, or to reduce it to an acceptable level. In such situations, the relationship in question will constitute a significant professional relationship or a significant personal relationship. Where this is the case, the insolvency practitioner shall conclude that it is not appropriate for him or any member of his practice to take the appointment.

500.53 Consideration should always be given to the perception of others when deciding whether to accept an appointment. Whilst an insolvency practitioner may regard a relationship as not being significant to the appointment, the perception of others may differ and this may in some circumstances be sufficient to make the relationship significant.

Dealing with the Assets of an Entity

500.54 Actual or perceived threats (for example self-interest threats) to compliance with the fundamental principles may arise when during an appointment, an insolvency practitioner realises assets.

500.55 An insolvency practitioner appointed to, or who is providing services which may lead to an appointment in relation to an entity shall not acquire, directly or indirectly, any of the assets of the entity. An insolvency practitioner shall not knowingly permit any individual within the practice, or any close relative of the insolvency practitioner or of an individual within the practice, directly or indirectly, to do so, save in circumstances which clearly do not impair the insolvency practitioner's objectivity.

500.56 Where the assets and business of an insolvent company are sold by an insolvency practitioner shortly after appointment on pre-agreed terms, this could lead to an actual or perceived threat to objectivity. The sale may also be seen as a threat to objectivity by creditors or others not involved in the prior agreement. The threat to objectivity may be eliminated or reduced to an acceptable level by safeguards such as obtaining an independent valuation of the assets or business being sold, or the consideration of other potential purchasers.

500.57 It is also particularly important for an insolvency practitioner to take care to ensure (where to do so does not conflict with any legal or professional obligation) that his decision making processes are transparent, understandable and readily identifiable to all third parties who may be affected by the sale or proposed sale.

Obtaining Specialist Advice and Services

500.58 When an insolvency practitioner intends to rely on the advice or work of another, the insolvency practitioner shall evaluate whether such reliance is warranted. The insolvency practitioner shall consider factors such as reputation, expertise, resources available and applicable professional and ethical standards. Any payment to the third party shall reflect the value of the work undertaken.

500.59 Threats to compliance with the fundamental principles (for example familiarity threats and self-interest threats) can arise if services are provided by a regular source even if it is independent of the practice.

500.60 Safeguards should be introduced to eliminate such threats or reduce them to an acceptable level. These safeguards should ensure that a proper business relationship is maintained between the parties and that such relationships are reviewed periodically to ensure that best value and service are being obtained in relation to each appointment. Additional safeguards may include clear guidelines and policies within the practice on such relationships. An insolvency practitioner shall also consider disclosure of the existence of such business relationships to the general body of creditors or the creditor’s committee if one exists.

500.61 Threats to compliance with the fundamental principles can also arise where services are provided from within the practice or by a party with whom the practice, or an individual within the practice, has a business or personal relationship. An insolvency practitioner shall take particular care in such circumstances to ensure that the best value and service are being provided.

Fees and Other Types of Remuneration

500.62 Where an engagement may lead to an appointment, an insolvency practitioner shall make any party to the work aware of the terms of the work and, in particular, the basis on which any fees are charged and which services are covered by those fees.

500.63 An insolvency practitioner shall not accept referral fees or commissions in relation to an appointment, as accepting referral fees or commissions could represent a significant threat to objectivity. For the avoidance of doubt, any amounts paid on account of liquidation costs (including the insolvency practitioner's fees and expenses) should not be regarded as referral fees or commissions and are not prohibited by this paragraph.

500.64 Insolvency practitioners should note that under the Prevention of Bribery Ordinance (Cap. 201), there are provisions governing acceptance of any payment by someone who is in an agent-principal relationship with another person. For example, if an agent receives payment from another for doing something or showing favour to another in relation to the affairs or business of the agent's principal (who may be the agent's employer or in some other relationships with the agent which involve trust and confidence), the permission of the principal should be obtained first before receiving the payment in order to avoid the risk of contravening the Prevention of Bribery Ordinance. The same principle applies to someone who is paying another person who is in an agent-principal relationship with some other person: the payer should ensure that the agent has obtained permission from his principal for receiving the payment. Whether an agent-principal relationship exists in any given situation depends on the facts of each case. Insolvency practitioners should consult their own legal advisers as and when necessary.

Obtaining Appointments

500.65 The special nature of appointments makes the payment or offer of any commission for, or the furnishing of any valuable consideration towards, the introduction of such appointments inappropriate. For the avoidance of doubt, this does not, however, preclude:

(a) An arrangement between an insolvency practitioner and his practice's employee whereby the employee's remuneration is based in whole or in part on introductions obtained for the insolvency practitioner through the efforts of the employee.

(b) Change of appointment resulting from transfer/sale of an existing practice due to, e.g., the sale or merger of an insolvency practice or retirement of the outgoing insolvency practitioner (owner of the practice).

500.66 When an insolvency practitioner solicits an appointment or work that may lead to an appointment through advertising or other forms of marketing, there may be threats to compliance with the fundamental principles.

500.67 An insolvency practitioner shall satisfy himself that any advertising or other form of marketing in relation to soliciting appointments:

(a) Is fair and not misleading.

(b) Avoids unsubstantiated or disparaging statements.

(c) Complies with other codes of practice and guidance in relation to advertising, where applicable. For example, members of the Institute shall take note of subsection 115 under Chapter A of the Code "Professional Behavior" and section 900 under Chapter C of the Code "Practice Promotion".

500.68 Advertisements and other forms of marketing should be clearly identified as such and conform to the basic principles of legality, decency, clarity, honesty and truthfulness.

500.69 If reference is made in advertisements or other forms of marketing to fees or to the cost of the services to be provided, the basis of calculation and the range of services that the reference is intended to cover should be provided. Care should be taken to ensure that such references do not mislead as to the precise range of services and the time commitment that the reference is intended to cover.

500.70 An insolvency practitioner shall never promote or seek to promote his services, or the services of another insolvency practitioner, in such a way, or to such an extent as to amount to harassment.

500.71 Where an insolvency practitioner or the practice advertises for work via a third party, the insolvency practitioner is responsible for ensuring that the third party follows the above guidance.

Gifts and Hospitality

500.72 An insolvency practitioner, or a close relative, may be offered gifts and hospitality. In relation to an appointment, such an offer may create threats to compliance with the fundamental principles. For example, self-interest or familiarity threats to objectivity may be created if a gift is accepted; and intimidation threats to objectivity may result from the possibility of such offers being made public.

500.73 The existence and significance of any threat will depend on the nature, value and intent of the offer. Where gifts or hospitality are offered that a reasonable and informed third party, weighing all the specific facts and circumstances, would consider trivial and inconsequential, an insolvency practitioner may conclude that the offer is made in the normal course of business without the specific intent to influence decision making or obtain information. In such cases, the insolvency practitioner may generally conclude that any threat to compliance with the fundamental principles is at an acceptable level.

500.74 An insolvency practitioner shall evaluate the significance of any threats and apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, an insolvency practitioner shall not accept such an offer.

500.75 In the light of the above, an insolvency practitioner shall also not offer or provide gifts or hospitality where this would give rise to an unacceptable threat to compliance with the fundamental principles.

500.76 An insolvency practitioner should also note the implications of the Prevention of Bribery Ordinance (Cap. 201) when accepting and/or offering advantages (including gifts). If in doubt legal advice should be sought.

Record Keeping

500.77 It will always be for an insolvency practitioner to justify his actions. An insolvency practitioner will be expected to be able to demonstrate the steps that he took and the conclusions that he reached in identifying, evaluating and responding to any threats, both leading up to and during an appointment, by reference to written contemporaneous records.

500.78 The records an insolvency practitioner maintains, in relation to the steps that he took and the conclusions that he reached, should be sufficient to enable a reasonable and informed third party to reach a view on the appropriateness of his actions.

Part 3 – The Application of the Framework to Specific Situations

Introduction to specific situations

500.79 The general principle is that it is inappropriate for an insolvency practitioner or any member of his practice to accept an appointment where a threat to the fundamental principles exists or may reasonably be expected to arise during the course of the appointment where safeguards are not or will not become available to eliminate such a threat, or to reduce it to an acceptable level (see paragraph 500.27). The following examples outline some specific circumstances and professional or personal relationships that will create threats to compliance with the fundamental principles. The examples may also assist members of the insolvency team to assess the implications of similar, but different, circumstances and relationships.

500.80 The examples are divided into two categories. Category A are examples which do not relate to a previous or existing appointment while Category B are examples that do relate to a previous or existing appointment. The examples are not intended to be exhaustive and should not be treated as such.

Category A Examples that do not relate to a previous or existing appointment

500.81 The following situations involve a professional relationship which does not consist of a previous appointment.

500.82 **Appointment following audit related work**

Relationship:

The practice or an individual within the practice has previously carried out audit related work within the previous two years.

Response:

Except in the case of a members' voluntary liquidation, as provided for below, and in some limited circumstances in relation to an insolvent scheme of arrangement, as provided for in paragraph 500.85, a significant professional relationship[1] will arise. An insolvency practitioner should conclude that it is not appropriate to take the appointment, whether that appointment be as liquidator, provisional liquidator, special manager, receiver (and manager), trustee in bankruptcy, provisional trustee in bankruptcy, nominee of an individual voluntary arrangement, or any other appointment referred to in paragraph 500.4 .

Where audit related work was carried out more than two years before the proposed date of the appointment of the insolvency practitioner, a threat to compliance with the fundamental principles may still arise. The insolvency practitioner should evaluate any such threat and consider whether the threat can be eliminated or reduced to an acceptable level by the existence or introduction of safeguards, including disclosure to creditors of the previous professional relationship.

This restriction does not apply where the appointment is in relation to a members' voluntary liquidation. An insolvency practitioner is not generally prevented from taking an appointment as liquidator in a members' voluntary liquidation in this situation. However, the insolvency practitioner should consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles. Further, the insolvency practitioner should satisfy himself that the directors' certificate of solvency in a members' voluntary liquidation is likely to be substantiated by events.

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1 See paragraphs 500.49 to 500.53.

500.83 **Appointment – relationship with the holder of a debenture or floating charge**

Relationship:

An insolvency practitioner, or an individual within his practice, has a personal or close and distinct business connection with the debenture holder or the floating charge holder.

Response:

An insolvency practitioner should, in general, decline to accept an appointment in relation to an entity if he, or a member of his practice, has a personal or close and distinct business connection with the debenture holder or the floating charge holder of the entity as might impair or appear to impair the insolvency practitioner's objectivity. Under normal circumstance, it is not considered likely that a close and distinct business connection would normally exist between an insolvency practitioner and, for example, a major financial institution simply because he is a retail customer of that institution. However, such a close and distinct business connection would exist where the insolvency practitioner, or a member of his practice, holds an appointment over such a financial institution.

500.84 **Appointment following appointment as investigating accountant**

Relationship:

The practice or a member of the practice was instructed by, or at the instigation of, a creditor or other party having an actual or potential financial interest in an entity to investigate, monitor or advise on its affairs.

Response:

A significant professional relationship would not normally arise in these circumstances provided that there has not been a direct involvement by an individual within the practice in the management of the entity or business. If the circumstances of the initial appointment were such as to prevent open discussion of the financial affairs of the entity with the directors, the investigating member or other individuals within the practice may be called upon to justify the propriety of their acceptance of the subsequent appointment.

500.85 **Appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client**

Relationship:

A significant professional relationship.
Where there has been a significant professional relationship with a client, no individual within the practice unit should accept appointment as administrator, manager, adjudicator or any other similar role in respect of a scheme of arrangement of that insolvent client. However, for the purposes of this paragraph a significant professional relationship shall not be deemed to have arisen by virtue of the appointment of an individual within the practice unit as liquidator or provisional liquidator of the client.

Response:

As indicated in paragraph 500.82, where there has been a significant professional relationship with a client, no individual within the practice should accept appointment as administrator, manager, adjudicator or any other similar role in respect of a scheme of arrangement made by that insolvent client. However, this restriction may not apply in circumstances which clearly do not impair, and would not be perceived as impairing, his objectivity. This may be the situation where the scheme assets and scheme liabilities are substantially different from the assets and liabilities of the company that were previously audited. Nevertheless, in such cases, an insolvency practitioner should satisfy himself that there is no self-review threat or any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

Category B Examples relating to previous or existing appointments

500.86 The following situations involve a prior professional relationship that involves a previous or existing appointment.

500.87 **Appointment following appointment as receiver**

Previous/existing appointment:

An individual within the practice is, or in the previous two years has been, a receiver (or receiver and manager) of an entity or any of its assets.

Proposed appointment:

Appointment in an insolvent liquidation.

Response:

No individual within the practice should accept an appointment in relation to the entity in an insolvent liquidation. This restriction does not apply where the previous appointment was made by the court. However, before a court-appointed receiver accepts a subsequent appointment, he should disclose the position to the relevant parties. Even if the creditors do not object to the appointment, he should give careful consideration as to whether there are any circumstances that give rise to an unacceptable threat to compliance with the fundamental principles, such as whether his objectivity might be, or appear to be, impaired, and, if so, the appointment should be refused.

500.88 **Conversion of members' voluntary winding-up into creditors' voluntary winding-up**

Previous/existing appointment:

An individual within the practice has been the liquidator of a company in a members' voluntary winding-up.

Proposed appointment:

Liquidator in a members' voluntary winding-up, where it has been necessary to convene a creditors' meeting under section 237A of the Companies (Winding Up and Miscellaneous Provisions) Ordinance because it appears that the entity will be unable to pay its debts in full within the period stated in the certificate of solvency. The insolvency practitioner's continuance as liquidator will depend on whether or not he believes on reasonable grounds that the entity will eventually be able to pay its debts in full.

Response:

If the entity will not be able to pay its debts in full:

(a) Where there has been a significant professional relationship, an insolvency practitioner should not accept nomination under the creditors' winding-up.
(b) In situations where an insolvency practitioner has had no significant professional relationship, he may continue or accept an appointment as liquidator, subject to creditors' approval. However, the insolvency practitioner should consider whether there are any other circumstances that give rise to an unacceptable threat to compliance with the fundamental principles.

If the insolvency practitioner concludes that the entity will eventually be able to pay its debts in full, he may accept nomination by the creditors and continue as liquidator. However, if it should subsequently appear that this belief was mistaken, and where he has previously had a significant professional relationship, the insolvency practitioner must then resign and should not seek re-appointment.

500.89 **Trustee in bankruptcy following appointment as nominee of an individual voluntary arrangement**

Previous/existing appointment:

An individual within the practice has been the nominee of an individual voluntary arrangement in relation to a debtor.

Proposed appointment:

Trustee in bankruptcy.

Response:

An insolvency practitioner may normally accept an appointment as trustee in bankruptcy of that debtor provided that it is effected by a general meeting of creditors under the provisions of section 17 of the Bankruptcy Ordinance (Cap. 6). However, the insolvency practitioner should consider whether there are any circumstances that give rise to an unacceptable threat, in particular self-review threats, to compliance with the fundamental principles.

500.90 **Appointment as independent trustee of provident fund schemes of companies in liquidation or receivership**

Previous/existing appointment:

An insolvency practitioner who is the liquidator, provisional liquidator or receiver of a company.

Proposed appointment:

Independent Trustee of the provident fund scheme of such company.

Response:

An insolvency practitioner should not act and should not appoint an individual within his practice, or any close relative of any of the above or of himself, as “Independent Trustee” of the provident fund scheme of a company of which he is the liquidator, provisional liquidator or receiver.

500.91 **Appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client**

Previous/existing appointment:

An individual within the practice has been the liquidator or provisional liquidator of an insolvent company.

Proposed appointment:

Administrator, manager or adjudicator of a scheme of arrangement of such company.

Response:

An insolvency practitioner may normally accept an appointment as administrator, manager or adjudicator of a scheme of arrangement of an insolvent client. However, when considering whether to accept such appointments, an insolvency practitioner should satisfy himself that there are no circumstances that give rise to an unacceptable threat, in particular self-review threat, to compliance with the fundamental principles.

Definitions

500.92 In section 500 of the Code, the following expressions have the following meanings:

Close relative	Includes a spouse (or equivalent), dependant, parent, grandparent, child or sibling, parents' sibling and his child.
Code	Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants.
Entity	*Any natural or legal person or any group of such persons, including a partnership.*
He/she	In this section, "he" is to be read as including "she".
Individual within the practice	The insolvency practitioner, any principals in the practice and any employees within the practice.
Institute	Hong Kong Institute of Certified Public Accountants.
Insolvency practitioner	An individual who has been appointed in respect of an appointment referred to in paragraph 500.4, or who provides professional services which may lead to such an appointment.
Insolvency team	An insolvency practitioner and any person under the control or direction of the insolvency practitioner.
Practice	The organisation in which the insolvency practitioner practises.
Principal	In respect of a practice: (a) which is a company: a director; (b) which is a partnership: a partner; (c) which is comprised of a sole practitioner: that person; Alternatively any person within the practice who is held out as being director or partner.

Effective Date

500.93 This section of the Code is effective on 1 April 2012.

F GUIDELINES ON ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING FOR PROFESSIONAL ACCOUNTANTS

Preamble

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018, effective on 1 March 2018, extends the scope of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615)("AMLO") to cover "designated non-financial businesses and professions" ("DNFBPs"), including accountants. It implements the FATFRs as these relate to customer due diligence ("CDD") and record keeping ("RK") for DNFBPs. These Guidelines are based on AMLO as amended, now entitled the Anti-Money Laundering and Counter-Terrorist Financing Ordinance, and subsequent references to "AMLO" relate to the amended ordinance. These Guidelines are effective as from 1 March 2018.

SECTION 600

Overview and Application

600.1 Introduction and purpose of Guidelines

600.1.1 These Guidelines are published under section 7 of AMLO. They apply primarily to practices and members working in practices. Reference to "practices" in the Guidelines includes practice units under the Professional Accountants Ordinance (Cap. 50) and also trust or company service providers, where the proprietors, partners or directors are all members. Reference to "practices" should also be taken to include references to members working in practices, where the context may be so construed. The Guidelines should also provide useful information for members generally[1].

600.1.2 In addition to AMLO, and in particular Schedule 2 of AMLO, these Guidelines also make reference to other existing legislation containing requirements relating to AML/ CFT, principally, the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405) ("DTROP"), the Organised and Serious Crimes Ordinance (Cap. 455) ("OSCO") and the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575) ("UNATMO"). AMLO and relevant sections of the other ordinances together seek to give effect to the FATFRs. As a member of FATF, Hong Kong is required to implement a credible AML/CFT regime having regard to the FATFRs, substantial parts of which apply to DNFBPs as well as to financial institutions ("FIs").

600.1.3 It is recognised that, in contrast to certain FIs, practices are not licensed to hold client monies or process cash transactions, so generally money laundering/ terrorist financing ("ML/TF") risks may be lower for practices than for FIs.

600.1.4 At the same time, members are bound by the Code of Ethics for Professional Accountants to conduct themselves with integrity and professionalism and to act in the public interest, not only the interests of their clients. Practices will therefore be expected by the community to have in place adequate CDD or "know your client" procedures and arrangements for maintaining documentation, to minimise any risk of involvement in ML/TF.

1 Members working in the financial services or other sectors specified in AMLO are advised to familiarise themselves with any guidelines issued by the appropriate relevant authority or regulatory body under AMLO to facilitate compliance with the requirements of the ordinance.

600.1.5 Against the above background, these Guidelines are intended to:

- Provide general guidance on AML/CFT requirements under AMLO and other relevant legislation.
- Indicate good practice on applying other relevant FATFRs.
- Summarise relevant legislative provisions on AML/CFT.
- Ensure compliance by members with prescribed requirements to prevent ML/TF activities.

600.1.6 It should be noted that, while these Guidelines require compliance by practices with certain provisions, they do not constitute legal advice and, in case of doubt, members should consider seeking their own legal advice.

600.1.7 A failure by a practice to comply with a provision in these Guidelines does not by itself render the practice liable to any judicial or other proceedings but, in any court proceedings under AMLO, the Guidelines are admissible in evidence; and if any provision set out in the Guidelines appears to the court to be relevant to any question arising in the proceedings, AMLO states that the provision will be taken into account in determining that question. In considering whether a practice has contravened an applicable requirement under AMLO, or other AML/CFT-related legislation, the Institute will have regard to any provision in the Guidelines that is relevant to the requirement.

600.1.8 More generally, practices that pay insufficient attention to the AML/ CFT issues covered in these Guidelines could be at greater risk of becoming unwittingly associated with ML/ TF activities, with potentially serious consequences, such as criminal prosecution and loss of reputation. In order to mitigate and address the risks, whether legal, regulatory and reputational, of being found to be involved in facilitating, or turning a blind eye to, ML/TF, it is in the interests of practices to familiarise themselves with these Guidelines and to take on board the relevant FATFRs within their risk management programmes, including those FATFRs already implemented in legislation other than AMLO, such as the requirement to report suspicious transactions under DTROP and OSCO.

600.1.9 Use of the word "must" in these Guidelines indicates a mandatory requirement, which may be a statutory obligation, or requirement that directly flows from this, or is seen by the Institute as being necessary to implement the statutory obligation effectively. In contrast, use of the words “should”, "would" and "may" in these Guidelines is not intended to indicate a mandatory requirement, but to provide guidance on possible means of compliance with statutory and regulatory requirements, and/or suggest good practice regarding compliance with the FAFTRs. Practices should consider their own particular circumstances when determining how to apply the detailed provisions of these Guidelines, and take into account the relevant legislation and mandatory requirements.

600.1.10 For terms, abbreviations and definitions used in these Guidelines members may also refer to Appendix E.

600.2 Application of the Guidelines

The Guidelines apply to practices (see paragraph 600.1.1) as follows:	AML/CTF policies, procedures and controls (section 610)	CDD, RK and ongoing monitoring (sections 620,630,660)	Suspicious transaction reporting and financial sanctions (sections 640,650)	Staff hiring and training (section 670)
When providing any service specified in paragraphs 600.2.1 or 600.2.2	**Mandatory**	**Mandatory**	**Mandatory**	**Mandatory**
When providing services other than those specified in paragraphs 600.2.1 or 600.2.2	**Good practice**	**Good practice**	**Mandatory**	**Good practice**

600.2.1 When practices, by way of business, prepare for or carry out for a client a transaction concerning one or more of the following services, there are specific CDD, ongoing monitoring and RK measures that they must adopt, as set out in Sections 620, 630 and 660:

(a) buying and selling of real estate;
(b) managing of client money, securities or other assets;
(c) management of bank, savings or securities accounts;
(d) organisation of contributions for the creation, operation or management of companies;
(e) creation, operation or management of legal persons or arrangements;
(f) buying and selling of business entities.

600.2.2 In addition, practices that provide trust or company services must adopt CDD, ongoing monitoring and RK procedures, when, by way of business, they prepare for or carry out for a client a transaction concerning any of the following services:

(a) forming corporations or other legal persons;
(b) acting as, or arranging for another person to act as, a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;
(c) providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement;
(d) acting as, or arranging for another person to act as, a trustee of an express trust or similar legal arrangement; or
(e) acting, or arranging for another person to act, as a nominee shareholder for a person other than a corporation whose securities are listed on a recognised stock market.

600.2.3 The provisions of these Guidelines should be read in the context of this subsection, together with the relevant provisions of Hong Kong laws, and applied accordingly.

600.3 The nature of money laundering and terrorist financing

600.3.1 "Money laundering" ("ML") is defined in AMLO[2] to mean an act intended to have the effect of making any property:

(a) that is the proceeds obtained from the commission of an indictable offence under the laws of Hong Kong, or of any conduct which if it had occurred in Hong Kong would constitute an indictable offence under the laws of Hong Kong; or

(b) that in whole or in part, directly or indirectly, represents such proceeds, not to appear to be or so represent such proceeds.

600.3.2 "Terrorist financing" ("TF") is defined in AMLO[3] to mean:

(a) the provision or collection, by any means, directly or indirectly, of any property –
(i) with the intention that the property will be used; or
(ii) knowing that the property will be used,

in whole or in part, to commit one or more terrorist acts (whether or not the property is actually so used); or

(b) the making available of any property or financial (or related) services, by any means, directly or indirectly, to or for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate; or

(c) the collection of property or solicitation of financial (or related) services, by any means, directly or indirectly, for the benefit of a person knowing that, or being reckless as to whether, the person is a terrorist or terrorist associate.

600.3.3 Terrorists or terrorist organisations require financial support in order to achieve their aims. There is often a need for them to obscure or disguise links between them and their funding sources. It follows that terrorist groups are also inclined to find ways to obscure fund movements, whether or not such funds are the proceeds of crime, in order to be able to use them without attracting the attention of the authorities.

600.4 Financial Action Task Force and legislation concerned with money laundering and terrorist financing

600.4.1 The FATF has issued the FATFRs as a framework to detect and prevent ML/TF activities. They have become a widely-accepted international benchmark and are used as the basis of, or as a reference for, legislation and regulation in many jurisdictions around the world.

600.4.2 Among the key FATFRs are those covering CDD and RK and the making of suspicious transaction reports ("STRs"), as well as AML/CFT controls and monitoring. FATF members are expected to implement statutory AML/CFT regimes to reflect the basic requirements of CDD, RK and making STRs. They apply to DNFPBs, including accountants, in relation to specified service offerings (see paragraphs 600.2.1 and 600.2.2).

600.4.3 Legislation prescribing criminal offences for involvement in ML/TF, and including requirements on making STRs, has been in place for a number of years in Hong Kong. The legislation applies to everyone in Hong Kong. It should be noted that, under the law, the requirement to make STRs is not limited to the FATF-specified services and includes a general obligation to report where there is knowledge or suspicion of ML/TF.

600.4.4 Apart from AMLO, the three main pieces of legislation in Hong Kong that are relevant to

2 AMLO, Schedule 1, Part 1.

3 Ibid.

ML/TF are DTROP, OSCO and UNATMO. It is important that practices and their staff fully understand their obligations under the respective pieces of legislation.

600.4.5 DTROP and OSCO create an offence of ML in relation to dealing with property known or believed to represent proceeds of drug trafficking specifically (under DTROP) or of an indictable offence generally (under OSCO)[4]. This is a serious offence carrying a maximum penalty of 14 years imprisonment and a fine of five million dollars.

600.4.6 DTROP, OSCO and UNATMO also contain provisions on making STRs and specify an offence of not reporting where a person has the requisite suspicion or knowledge[5]. They also specify an offence of "tipping off" in relation to making STRs (see Section 640 of these Guidelines). Additional information on the above legislation is provided in Appendix A.

4 Section 25 of DTROP and OSCO

5 Section 25A of DTROP and OSCO, and sections 12(1) and 14 of UNATMO

SECTION 610

AML/CFT Policies, Procedures and Controls

General requirements

610.1 Practices must have in place internal policies, procedures and other controls to address ML/TF concerns, and compliance with the existing legal requirements on AML/CFT, when they carry out any of the services specified in paragraphs 600.1.2 and 600.2.2 of these Guidelines, and should consider the need to do so in relation to other services that they provide. Practices should communicate these policies and procedures, etc., clearly to employees.

610.1.1 **Controls cover primarily the following areas:**

(a) risk assessment and management
(b) customer due diligence (Section 620)
(c) ongoing monitoring (Section 630)
(d) suspicious transactions reporting (Section 640)
(e) record keeping (Section 660)
(f) compliance management, including designating a Money Laundering Reporting Officer ("MLRO") at the management level
(g) staff hiring, ongoing training and communication (Section 670)
(h) group policy, where appropriate.

610.2 Adopting a risk-based approach

610.2.1 While no system can be expected to detect and prevent all ML/TF activities, practices must establish and implement adequate and appropriate AML/CFT controls (including client acceptance policies and procedures), taking into account factors such as:

- types of client involved and their geographical locations
- services/ products offered
- mode of delivery of the service/ product; and
- size of the practice.

Appendix B provides some examples of steps practices should consider taking. See also the **FATF's RBA Guidance for Accountants**.

610.2.2 A risk-based approach ("RBA") is recognised as an effective way to combat ML/TF. It helps ensure that measures to prevent or mitigate ML/TF are proportionate to the risks identified and to facilitate decisions on how to allocate resources in the most effective way.

610.2.3 While there are no universally accepted methodologies that prescribe the nature and extent of an RBA, an effective RBA involves identifying and categorising ML/TF overall risks at the client level and establishing reasonable measures based on risks identified. An effective RBA will allow practices to exercise reasonable business judgment with respect to their clients.

610.2.4 The type and extent of measures to be taken in relation to the items in paragraph 610.1.1 above should be appropriate and reasonable having regard to the risk of ML/TF. There is no one-size-fits-all approach. Some of the factors to be considered include:

- The nature, size and complexity of the practice's business
- The geographical spread of client operations and the practice's operation
- The extent to which the practice is dealing directly with the customer or through other intermediaries or third parties.

610.2.5 An effective RBA will enable practices to subject clients to proportionate controls and oversight by determining:

(a) the extent of CDD to be performed on the direct client; the extent of the measures to be undertaken to verify the identity of any beneficial owner and any person purporting to act on behalf of the client (see Section 620);
(b) the level of ongoing monitoring to be applied to the relationship (see Section 630); and
(c) measures to mitigate any risks identified.

610.2.6 A reasonably designed RBA should assist practices to effectively manage potential ML/TF risks, rather than prohibiting practices from engaging in transactions with clients or establishing business relationships with potential clients. It should also not be designed to prevent practices from finding innovative ways to diversify their business.

610.2.7 The identification of risks associated with clients, services (including delivery channels), and geographical locations, is not a static assessment and may change over time, depending on how circumstances develop, and how threats evolve. Practices may therefore have to adjust their risk assessment of a particular client from time to time, based upon information obtained, and also review the extent and frequency of the CDD and ongoing monitoring to be applied to the client. Further information on ongoing monitoring is contained in Section 630.

610.2.8 More broadly, practices should keep their policies and procedures under review and assess that their risk mitigation procedures and controls are working effectively.

610.3 Management oversight

610.3.1 The senior management of a practice are responsible for managing the business effectively and in compliance with relevant legal and regulatory requirements, which should include adequate oversight in relation to AML/CFT. As such:

(a) They must be satisfied that the AML/CFT controls are capable of addressing the practice's ML/TF identified risks;
(b) they should appoint a partner, director or equivalent as a compliance officer ("CO"), who has overall responsibility for the establishment and maintenance of the practice's AML/CFT controls; and
(c) they must appoint a senior member of the practice's staff as the MLRO, who is the central reference point for making STRs. Where appropriate, the MLRO may be the same person as the CO.

610.3.2 To enable the CO and MLRO to discharge their responsibilities effectively, the senior management should, as far as practicable, ensure that the CO and MLRO are:

(a) subject to any constraints, having regard to the size of the practice, independent of operational and business functions;
(b) based in Hong Kong;
(c) of a sufficient level of seniority and authority;
(d) afforded regular contact with, and, when required, direct access to, the senior management to ensure that the senior management are able to satisfy themselves that their statutory obligations are being met and that the business is taking sufficiently robust measures to protect itself against the risks of ML/TF;
(e) fully conversant with the practice's statutory and regulatory requirements and the ML/TF risks arising from the business;
(f) capable of accessing, on a timely basis, all available information (both from internal sources, such as CDD records, and external sources, such as notices and circulars from the Institute); and
(g) equipped with sufficient resources, including staff and appropriate cover for their absence.

Indicative roles of CO and MLRO

610.3.3 The CO would generally act as the focal point within a practice for the oversight of all activities relating to the prevention and detection of ML/TF and providing support and guidance to the senior management to ensure that ML/TF risks are adequately managed. Typically the CO would have responsibility for:

(a) reviewing the practice's AML/CFT systems to ensure they are up to date and meet current statutory and regulatory requirements; and

(b) oversight of the practice's AML/CFT controls, including monitoring their effectiveness and enhancing the controls and procedures where necessary.

610.3.4 Areas which may be considered by the CO, include:

(a) how the AML/CFT controls are to be managed and tested;

(b) identifying and addressing significant deficiencies in the controls;

(c) mitigating ML/TF risks arising from business relationships and transactions with persons from countries that do not apply, or insufficiently apply, the FATFRs;

(d) communicating key AML/CFT issues to the senior management, including, where appropriate, significant compliance deficiencies;

(e) considering changes that may need to be made or proposed as a result of new legislation, regulatory requirements or guidance relevant to AML/CFT;

(f) training of staff for AML/CFT purposes.

610.3.5 The MLRO must play an active role in the identification and reporting of suspicious transactions. The MLRO's principal functions would normally include:

(a) reviewing internal disclosures and exception reports and, in light of available relevant information, determining whether or not it is necessary to make an STR to the **Joint Financial Intelligence Unit** ("JFIU")[6];

(b) maintaining records related to such internal reviews;

(c) providing guidance on how to avoid "tipping off", where disclosures are made; and

(d) acting as the main point of contact with the JFIU, law enforcement, and any other competent authorities in relation to ML/TF prevention and detection, investigation or compliance.

Compliance function

610.3.6 The compliance function of a practice should review the implementation of the AML/CFT controls, (including, the controls for recognising and reporting suspicious transactions), to ensure effectiveness. The frequency and extent of the review should be commensurate with the risks of ML/TF and the size of the practice's business. Where appropriate, practices may engage an external party to conduct the review.

610.3.7 Where practicable, practices should establish an independent compliance function which should have a direct line of communication to the senior management.

Staff screening

610.3.8 Practices should establish, maintain and operate appropriate procedures in order to be satisfied of the integrity of any new employees.

6 JFIU was established in 1989 and is run jointly by the Hong Kong Police Force and Customs and Excise Department. Its role is to receive, analyse and store suspicious transactions reports, and disseminate them to the appropriate investigative units.

610.4 Business conducted outside Hong Kong

610.4.1 Practices with overseas branches/ offices, or subsidiary undertakings, must adopt a group AML/CFT policy to ensure that branches/ offices and subsidiary undertakings that carry on the same business as the practice in a place outside of Hong Kong have procedures in place to comply with CDD and RK requirements, similar to those imposed under Schedule 2 of AMLO, to the extent permitted by the law of that location.

610.4.2 If the law of the place at which a branch/ office, or subsidiary undertaking carries on business does not permit the application of any procedures relating to any of the requirements referred to in 610.4.1, the practice shall (a) inform the Institute and (b) take additional measures to effectively mitigate the risk of ML/TF faced by the branch/ office, or subsidiary undertaking as a result of its inability to comply with the requirements.

SECTION 620

Customer Due Diligence

General requirements

620.1 When carrying out any of the services specified in paragraphs 600.2.1 and 600.2.2, practices must perform the following CDD measures:

(a) identify the client and verify the client's identity using documents, data or information provided by a government body or other reliable, independent source;

(b) where there is a beneficial owner[7] in relation to the client (subject to certain limited exceptions indicated below) identify and take reasonable measures to verify the beneficial owner's identity, so that the practice is satisfied that it knows who the beneficial owner is, including in the case of a legal person or trust[8], measures to enable the practice to understand the ownership and control structure of the legal person or trust;

(c) understand and, as appropriate, obtain information on the purpose and intended nature of the business relationship (if any) to be established with the practice, unless the purpose and intended nature are obvious; and

(d) if a person purports to act on behalf of the client:
(i) identify the person and take reasonable measures to verify the person's identity using documents, data or information provided by a government body or other reliable and independent source;
(ii) verify the person's authority to act on behalf of the client; and

Practices must adopt enhanced due diligence measures in relation to high-risk clients (including foreign "politically exposed persons" or "PEPs"), and may adopt simplified due diligence measures in certain specified circumstances.

620.2 Introduction to CDD

620.2.1 CDD information is an important element in recognising whether there are grounds for knowledge or suspicion of ML/TF. It is intended to enable practices to form a reasonable belief that they know the true identity of each client and, with an appropriate degree of confidence, know the type of business and transactions that the client is likely to undertake and the source and intended use of funds.

620.2.2 Practices must, therefore, identify, and verify the identity of their clients, to the extent necessary to provide them with reasonable assurance that the information they have is an appropriate and sufficient indication of the client's true identity. In general, a standard level of due diligence should be applied to all clients, with the possibility to carry out simplified CDD ("SDD") in lower-risk scenarios. In contrast, enhanced CDD ("EDD") must be applied in respect of clients or circumstances determined to be of higher ML/TF risk.

620.2.3 Practices may have other client acceptance and continuance procedures, for example, to ensure compliance with independence requirements and to avoid conflicts of interest.

7 For definitions, see Appendix E.

8 For the purpose of these Guidelines, a trust means an express trust or any similar arrangement for which a legally-binding document (i.e., a trust deed or in any other form) is in place.

The CDD may either be integrated with those procedures or addressed separately. Initial CDD information assists in client acceptance decisions and also enables practices to form expectations of their client's behaviour, which provides some assistance on detecting potentially suspicious behaviour during the business relationship.

620.2.4 In determining what constitutes "reasonable measures" to verify the identity of a beneficial owner and understand the ownership and control structure of a legal person or trust, and/or to verify the identity of a person who purports to act on behalf of a client, practices should consider and give due regard to the ML/TF risks posed by a particular client and a particular business relationship. Examples of possible risk factors are set out in Appendix B.

620.3 Circumstances where CDD should be applied

620.3.1 CDD requirements must generally be applied:

(a) before establishing a business relationship with a client;
(b) before carrying out for the client an occasional transaction involving an amount equal to or above HK$120,000 or an equivalent amount in any other currency, whether the transaction is carried out in a single operation or in several operations that appear to be linked;
(c) where there may be a suspicion of ML/TF; or
(d) when there is doubt about the veracity or adequacy of any information previously obtained for the purpose of identifying the client or verifying the client's identity.

Pre-existing clients

620.3.2 Practices must perform the CDD measures set out in these Guidelines in respect of pre-existing clients (with whom the business relationship was established before the Guidelines came into effect), in addition to the situations in paragraph 620.3.1 (c) and (d):

(a) when a transaction takes place with regard to the client, which is:
    (i) by virtue of the amount or nature of the transaction, unusual or suspicious;
    (ii) not consistent with the practice's knowledge of the client or the client's business or risk profile, or with its knowledge of the source of the client's funds; or
(b) when a material change occurs in the way in which the client's business in conducted.

620.3.3 Practices should, in any case, over time, review the information known about pre-existing clients, assess the ML/TF risks of such clients and seek more information if necessary. Requirements for ongoing monitoring also apply to pre-existing clients (see Section 630).

620.3.4 If a practice is unable to comply with paragraph 620.3.2, AMLO[9] requires that the business relationship with the client be terminated as soon as practicable.

620.4 Client acceptance/risk assessment and risk categories

620.4.1 Practices should assess the ML/TF risks of individual clients when evaluating their clients during the acceptance stage and when taking on new engagements for pre-existing clients.

620.4.2 While a risk assessment should always be performed at the inception of a client relationship, for some clients, a comprehensive risk profile may only become evident once the service has begun, making ongoing monitoring a fundamental component of a reasonably designed RBA. Practices may therefore have to adjust their risk assessment

9 See AMLO, Schedule 2, section 6(2)

of a particular client from time to time, or based upon information received, and review the extent and frequency of the CDD and ongoing monitoring to be applied to the client.

620.4.3 While there is no agreed upon definitive set of risk factors and no one methodology to apply these risk factors in determining the ML/TF risk rating of clients, as indicated in Appendix B, relevant factors can, generally speaking, be organised into three broad categories, which, in practice, are often inter-related, namely, client risk, country or geographic risk, and service, including delivery channel, risk.

620.4.4 Factors that may indicate a higher level of client risk include:

(a) Indications that the client is attempting to obscure understanding of its business, ownership or the nature of its transactions

(b) Indications of certain transactions, structures, geographical locations, international activities, or other factors, that are not in keeping with the practice's understanding of the client's business or economic situation

(c) Client industries, sectors or categories where opportunities for ML/TF are particularly prevalent.

620.4.5 However, not all clients falling into such risk categories are necessarily high-risk clients. After adequate review, it may be determined that a particular client is pursuing a legitimate purpose. Provided the economic rationale for the structure and/or activities or transactions of a client can be made clear, if called upon to do so, a practice may be able to demonstrate that the client is carrying out legitimate operations for which there is a satisfactory explanation and non-criminal purpose.

620.4.6 As regards country or geographic risk, this, in conjunction with other risk factors, may provide useful information as to potential ML/TF risks. Clients may be judged to pose a higher than normal risk where they, or their source or destination of funds, are located in a country that is, e.g., subject to sanctions, identified by the FATF, or other credible sources, as lacking an appropriate AML/CFT regime, or identified by credible sources as having significant level of corruption or providing support to terrorists or terrorist activities.

620.4.7 A balanced and common sense approach should be adopted with regard to clients connected with jurisdictions which do not, or which insufficiently, apply the FATF recommendations (see paragraphs 620.12.22-620.12.25). While extra care may be justified in such cases, it is not a requirement to refuse to do any business with such clients or automatically to classify them as high risk and subject them to an EDD process. Rather, practices should weigh all the circumstances of the particular situation and assess whether there is a higher than normal risk of ML/TF.

620.5 Identification and verification of the client's identity

620.5.1 Practices must identify the customer and verify the client's identity by reference to documents, data or information provided by a reliable and independent source, such as a governmental body, public register, or other source generally recognised as being reliable and independent. Copies of all reference source documents, data or information used to verify the identity of the client should be retained (see Section 660). Where the client is unable to produce original documents, practices may consider accepting documents that are certified to be true copies by an independent, qualified person (see paragraph 620.12.4-620.12.5).

620.5.2 Appendix C contains further information on documents generally recognised as appropriate, independent and reliable sources for the purposes of verifying the identity of natural persons, legal persons and trusts.

620.6 Identification and verification of a beneficial owner

620.6.1 A beneficial owner is normally an individual, or individuals, who ultimately own or control the client, or on whose behalf a service is being provided. For a client who is an individual, not acting in an official capacity on behalf of a legal person or trust, the client him/herself is normally the beneficial owner. There is no requirement to make proactive searches for beneficial owners in such a case, but practices should make appropriate enquiries where there are indications that the client is not acting on his/her own behalf.

620.6.2 Where an individual is identified as a beneficial owner, practices should endeavour to obtain identification information of the kind set out in Part I of Appendix C.

620.6.3 Generally, however, the verification requirements are different for a client and a beneficial owner. The obligation to verify the identity of a beneficial owner is to take reasonable measures, based on an assessment of the ML/TF risks, so that the practice is satisfied that it knows who the beneficial owner is.

620.6.4 Practices should identify all beneficial owners of a client. A beneficial owner in relation to a corporation is an individual who owns or controls, directly or indirectly, more than 25% of the issued share capital or voting rights, or who exercises ultimate control over the management, of the corporation. If the corporation is acting on behalf of another person, reference to "beneficial owner" means that other person. There are equivalent definitions for the beneficial owner of a partnership or trust (see Appendix E).

620.7 Identification and verification of a person purporting to act on behalf of the client

620.7.1 If a person purports to act on behalf of the client, practices must:

(a) identify the person and take reasonable measures to verify the person's identity on the basis of documents, data or information provided by-
  (i) a governmental body;
  (ii) any other source generally recognised as being reliable and independent
(b) verify the person's authority to act on behalf of the client.

620.7.2 In taking reasonable measures to verify the identity of persons purporting to act on behalf of clients (e.g., authorised account signatories and attorneys), practices should endeavour to obtain the same kind of identification information as that set out in Appendix C.

620.7.3 Practices should also obtain written authority[10] verifying that the individual purporting to represent the client is authorised to do so.

620.8 Characteristics and evidence of identity

620.8.1 If suspicions are raised in relation to the veracity any document offered, practices should take practical and proportionate steps to establish whether the document offered is genuine, or has been reported as lost or stolen (e.g., searching publicly-available information, approaching relevant authorities or requesting corroboratory evidence from the client. Where suspicion cannot be eliminated, the document should not be accepted and consideration should be given to making an STR.

620.8.2 Where documents are in a foreign language, practice should take appropriate steps to be reasonably satisfied that the documents provide evidence of the client's identity.

[10] For a corporation, the board resolution or similar written authority should be obtained.

620.9 Purpose and intended nature of business relationship

620.9.1 Unless the purpose and intended nature are obvious, practices must obtain information from all new clients to satisfy themselves as to the intended purpose and reason for establishing the relationship, and document the information. Depending on the practice's risk assessment of the situation, relevant information may include:

(a) nature and details of the business/occupation/employment;
(b) the anticipated level and nature of the activity that is to be undertaken through the relationship (e.g., the services that are likely to be required);
(c) location of client;
(d) the expected source and origin of any funds to be used in the relationship; and
(e) initial and ongoing source(s) of wealth or income.

620.10 Timing of identification and verification of identity

General requirement

620.10.1 Generally, the CDD process, i.e., obtaining information on the client and beneficial owners, and about the purpose and intended nature of the business relationship, must be completed before establishing any client relationship and/or before carrying out occasional transactions or assignments, other than in exceptional cases, as set out in 620.10.3.

620.10.2 In normal circumstances, where practices are unable to complete the CDD process as indicated above, they must not establish a client relationship or carry out any occasional transactions or assignments with that client. They should also assess whether this failure, in itself, provides grounds for knowledge or suspicion of ML/TF and making a report to the JFIU.

Delayed client identity verification and failure to complete verification

620.10.3 Exceptionally, practices may verify the identity of the client and, to the extent necessary, any beneficial owner, after establishing the business relationship, provided that:

(a) any risk of ML/TF arising from the delayed verification of the client's or beneficial owner's identity can be effectively managed; and
(b) it is necessary not to interrupt the normal course of business with the client;

620.10.4 This discretion must not be used to defer CDD procedures unnecessarily, in particular, where:

(a) there may be some indications of ML/TF;
(b) practices become aware of anything that gives rise to doubt the identity or intentions of the client or beneficial owner; or
(c) the relationship is assessed to pose a higher risk.

620.10.5 Verification of identity must be concluded within a reasonable timeframe thereafter. Where this cannot be done, practices shall as soon as reasonably practicable suspend or terminate the service or relationship, unless there is a reasonable explanation for the delay[11].

620.10.6 Practices should assess whether a failure to complete the desired verification of itself provides grounds for knowledge or suspicion of ML/TF and for making an STR to the

[11] For reference only, the Hong Kong Monetary Authority specifies the following timeframes:
(a) completing such verification no later than 30 working days after the establishment of business relations;
(b) suspending business relations with the client and refraining from carrying out further activities or transactions (except, where relevant, to return funds to their sources, to the extent that this is possible) if such verification remains uncompleted 30 working days after the establishment of business relations; and
(c) terminating business relations with the client if such verification remains uncompleted 120 working days after the establishment of business relations.

JFIU.

Keeping client information up-to-date

620.10.7 Once the identity of a client has been satisfactorily verified, there is no obligation to re-verify identity (unless doubts arise as to the veracity or adequacy of the evidence previously obtained). However, steps should be taken from time to time to ensure that the client information obtained for the purposes of CDD is up to date and relevant, by undertaking periodic reviews of existing records of clients. An appropriate time to do so is upon certain trigger events such as when:

(a) a significant or unusual activity or transaction is to take place[12];
(b) a material change occurs in the client's ownership and/or activities – practices are advised to consider at least annually whether there have been changes suggesting that a full reappraisal would be sensible[13];
(c) a practice's client documentation standards change substantially; or
(d) a practice is aware that it lacks sufficient information about the client concerned.

In all cases, the factors determining the period of review or what constitutes a trigger event should be set out in the practice's policies and procedures. (See also Section 630 of these Guidelines.)

620.10.8 All clients assessed as high risk should be subject to an ongoing review of their profile to ensure the CDD information retained on them remains up to date and relevant. It would be prudent to review the risk category of other clients at least on an annual basis.

620.11 Application of simplified client due diligence

When SDD can be conducted generally

620.11.1 Where the risks of ML/TF are lower, practices may perform SDD measures, which take into account the nature of the lower risk. The simplified measures should be commensurate with the lower risk factors (e.g., a lower risk for identification and verification purpose at the client acceptance stage does not automatically mean that the same client is lower risk at the ongoing monitoring stage). Examples of possible SDD measures are:

(a) Verifying the identity of the client and the beneficial owner after the establishment of the business relationship.
(b) In some circumstances, not trying to identify the beneficial owner (see paragraph 620.11.6).
(c) Reducing the frequency of client identification updates.
(d) Reducing the degree of ongoing monitoring and scrutinising of activities.
(e) Not collecting specific information to understand the purpose and intended nature of the business relationship, but inferring the purpose and nature from the type of transactions or business relationship established.

620.11.2 SDD measures shall not be adopted whenever there may be a suspicion of ML/TF, when a practice doubts the veracity or adequacy of any client identification/ verification information previously obtained, even though the client or the activity may fall within the scope of paragraphs 620.11.5, 620.11.9 and 620.1.10 below, or where specific higher-risk scenarios apply, e.g., where the client is from, or based in, a higher-risk country or jurisdiction.

620.11.3 Practices should set out in their internal procedures what is considered to constitute reasonable grounds to conclude that a client can be subject to SDD measures. Where

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12 "Significant" is not necessarily linked to monetary value. It may include activities that are unusual or not in line with the practice's knowledge of the client.

13 Reference should also be made to AMLO Schedule 2, section 6.

SDD is performed, the grounds for and details of the risk assessment, and the nature of the SDD measures, should be documented. Practices may have to substantiate these grounds to the Institute or other relevant authorities**.**

620.11.4 The following are some examples where SDD measures may be adopted:
(a) Reliable information on the client is publicly available.
(b) The practice is familiar with the client's AML/CFT controls due to previous dealings with the client.
(c) The client is a listed company that is subject to regulatory disclosure requirements, or an FI that is subject to and supervised for compliance with AML/CFT requirements consistent with standards set by the FATF.

Specific types of client to which SDD may be applied

620.11.5 AMLO indicates that it is not necessary to identify and verify the identity of any beneficial owner, in the circumstances set out in paragraph 620.3.1(a) or (b), where the client is:
(a) a Hong Kong SAR Government entity or a public body in Hong Kong;
(b) a government or public body in an equivalent jurisdiction (see subsection 620.15);
(c) a corporation listed on a stock exchange;
(d) an FI, as defined in AMLO;
(e) an institution incorporated or established in an equivalent jurisdiction which carries on a business similar to an FI, is subject to AML/CFT requirements consistent with standards set by the FATF and is supervised for compliance with those requirements by an authority in that jurisdiction that performs functions similar to a relevant authority[14];
(f) an investment vehicle where the person responsible for carrying out the CDD-related measures in relation to all the investors of the investment vehicle is-
(i) an FI;
(ii) an institution incorporated or established in Hong Kong, or in an equivalent jurisdiction, which has measures in place to ensure compliance with requirements similar to those imposed under Schedule 2 of AMLO, and is supervised for compliance with those requirements.

620.11.6 If a client not falling within paragraph 620.11.5 has in its ownership chain an entity falling within the scope of that paragraph, it is not necessary to identify or verify the beneficial owners of that entity or of any person in that chain beyond that entity, in the circumstances referred to in paragraph 620.3.1(a) or (b).

Foreign financial institutions

620.11.7 For ascertaining whether an institution meets the criteria set out in paragraph 620.11.5(f) it will generally be sufficient for practices to verify that the institution is on the list of authorised (and supervised) FIs in the jurisdiction concerned.

Listed companies

620.11.8 For relevant listed companies, it will be generally sufficient for practices to obtain proof of listed status on a stock exchange. In other cases, practices should endeavour to obtain the identification information for a legal person of the kind set out in Appendix C.

Government and public bodies

620.11.9 Public body includes:
(a) any executive, legislative, municipal or urban council;

14 I.e., the regulators of relevant FIs in Hong Kong

(b) any government department or undertaking;
(c) any local or public authority or undertaking;
(d) any board, commission, committee or other body, whether paid or unpaid, appointed by the Chief Executive of the Hong Kong SAR or the government; and
(e) any board, commission, committee or other body that has power to act in a public capacity under or for the purposes of any enactment.

SDD in relation to specific products

620.11.10 It is not necessary to identify and verify the identity of any beneficial owner of the client, in the circumstances referred to in paragraph 620.3.1(a) or (b), if the practice has reasonable grounds to believe that the product to which the transaction relates is:
(a) a provident, pension, retirement or superannuation scheme (however described) that provides retirement benefits to employees, where contributions to the scheme are made by way of deduction from income from employment and the scheme rules do not permit the assignment of a member's interest under the scheme; or
(b) an insurance policy of the kind stipulated in Schedule 2, section 4(5) of AMLO.

Solicitor's client accounts

620.11.11 If a client of a practice is a solicitor or a firm of solicitors, the practice is not required to identify any beneficial owner of the customer account opened by the practice's client in the circumstances referred to in paragraph 620.3.1(a) or (b), provided that the following criteria are satisfied:
(a) the customer account is kept in the name of the practice's client ;
(b) moneys or securities of the client's customers in the client account are mingled; and
(c) the client account is managed by the client as agent of those customers.

620.12 Application of enhanced client due diligence

High-risk situations

620.12.1 In situations that, by their nature, present a higher risk of ML/TF, practices must carry out additional measures or EDD[15] to mitigate the risk of ML/TF. (Examples of possible risk factors are indicated in Appendix B.) Depending upon whether the business relationship is to be or has been established, EDD must include:
(a) obtaining the approval of the senior management to commence or continue the relationship, as applicable; and
(b) taking reasonable measures to establish the relevant client's or beneficial owner's source of wealth and of the funds that are or will be involved in the business relationship, or other additional mitigation measures, e.g.:
  (i) obtaining additional information on the intended nature of the business relationship (e.g., anticipated account activity);
  (ii) obtaining additional information on the client (e.g., connected parties[16], accounts or relationships) and updating the client profile more regularly;
  (iii) conducting enhanced monitoring of the business relationship, by increasing the number and timing of the controls applied and selecting patterns of transactions that need further examination.

Client not physically present for identification purposes

620.12.2 Practices must apply equally effective client identification procedures and ongoing

15 Additional measures should be documented in the practice's policies and procedures.

16 Consideration may be given to obtaining, and taking reasonable measures to verify, the addresses of directors and account signatories.

monitoring standards for clients not physically present for identification purposes as for those where the client is available for interview[17]. Where a client has not been physically present for identification purposes, practices will generally not be able to determine that the documentary evidence of identity actually relates to the client they are dealing with. Consequently, there are increased risks and practices must carry out at least one of the following measures to mitigate the risks posed:

(a) further verifying the client's identity on the basis of documents, data or information referred to in paragraph 620.5, but not previously used for the purposes of verifying the client's identity;
(b) taking supplementary measures to verify the information relating to the client that has been obtained by the practice.

620.12.3 Consideration should be given on the basis of the ML/TF risk to obtaining copies of documents that have been certified by a suitable certifier.

Suitable certifiers and the certification procedure

620.12.4 Use of an independent suitable certifier guards against the risk that documentation provided does not correspond to the client whose identity is being verified. However, for certification to be effective, the certifier will need to have seen the original documentation. Suitable persons to certify verification of identity documents may include:

(a) an intermediary specified in paragraphs 620.13.7-620.13.9;
(b) a member of the judiciary in an equivalent jurisdiction;
(c) an officer of an embassy, consulate or high commission of the country of issue of documentary verification of identity; and
(d) a Justice of the Peace.

620.12.5 Practices should exercise caution when considering accepting certified copy documents, especially where such documents originate from a country perceived to represent a high risk, or from unregulated entities in any jurisdiction.

Politically exposed persons

General

620.12.6 Much international attention has been paid in recent years to the risks associated with providing financial and business services to those with a prominent political profile or holding senior public office because their office and position may render such PEPs vulnerable to corruption. The risks increase when the person concerned is from a foreign country with widely-known problems of bribery, corruption and financial irregularity within their governments and society, particularly where such countries do not have adequate AML/CFT standards.

620.12.7 While the statutory definition of PEPs in AMLO (see paragraph 620.12.9) includes only individuals entrusted with a prominent public function in a place outside the People's Republic of China[18], domestic PEPs may also present, by virtue of the positions they hold, a high risk situation in which EDD should be applied. Practices should therefore adopt an RBA in determining whether to also apply the measures in paragraph 620.12.14 to domestic PEPs.

620.12.8 The statutory definition does not automatically exclude sub-national political figures. In determining what constitutes a prominent public function, practices should consider

[17] This is not restricted to being physically present in Hong Kong; a face-to face meeting could take place outside Hong Kong.

[18] Under the Interpretation and General Clauses Ordinance (Cap. 1), the definition of the People's Republic of China includes Hong Kong, Taiwan and Macau.

factors such as persons with significant influence in general, significant influence over or control of public procurement, state-owned enterprises, etc.

(Foreign) PEPs

620.12.9 A PEP is defined in AMLO as:

(a) an individual who is or has been entrusted with a prominent public function in a place outside the People's Republic of China, and
    (i) includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official;
    (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i);
(b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a) above, or a spouse or a partner of a child of such an individual; or
(c) a close associate of an individual falling within paragraph (a).

620.12.10 AMLO defines a "close associate" as:

(a) an individual who has close business relations with a person falling under paragraph 620.12.9(a) above, including an individual who is a beneficial owner of a legal person or trust of which the relevant person is also a beneficial owner; or
(b) an individual who is the beneficial owner of a legal person or trust that is set up for the benefit of a person falling under paragraph 620.12.9(a).

620.12.11 Practices should establish and maintain effective procedures for determining whether a client or a beneficial owner of a client is a PEP. Risk can be reduced by conducting EDD before establishing the business relationship and ongoing monitoring where the practice knows or suspects that the client relationship is with, or involves, a PEP.

620.12.12 Practices may use publicly-available information and/or screening against commercially available databases, or refer to relevant reports and databases on corruption risk published by specialised national, international, non-governmental and commercial organisations to assess which countries are most vulnerable to corruption (e.g., Transparency International's "Corruption Perceptions Index") and should be vigilant where either the country to which the client has business connections, or the business/ industrial sector, is more vulnerable to corruption.

620.12.13 Specific risk factors practices should consider in handling a business relationship (or potential relationship) with a PEP include:

(a) any particular concern over the country where the PEP holds his/her public office or has been entrusted with his/her public functions, taking into account his position;
(b) any unexplained sources of wealth or income (i.e., value of assets owned not in line with the PEP's income level);
(c) expected receipts of large sums from governmental bodies or state-owned entities;
(d) source of wealth described as commission earned on government contracts;
(e) request by the PEP to associate any form of secrecy with a transaction; and
(f) use of government accounts as the source of funds in a transaction.

620.12.14 When practices know that a particular client or beneficial owner is a PEP, before establishing a business relationship, or continuing an existing business relationship, where the client or the beneficial owner is subsequently found to be a PEP, they must apply the following EDD measures:

(a) obtain approval from the senior management;
(b) take reasonable measures to establish the client's or the beneficial owner's source of wealth and the source of the funds involved in the business

relationship; and

(c) if a practice proceeds to establish a relationship or to continue an existing relationship, it should apply enhanced monitoring to the relationship in accordance with the assessed risks.

620.12.15 It is for practices to decide the measures they deem reasonable to establish the source of funds and wealth, in accordance with their assessment of the risks,.

Domestic PEPs

620.12.16 For the purposes of these Guidelines, a domestic PEP is defined as:

(a) an individual who is or has been entrusted with a prominent public function in a place within the People's Republic of China, and
  (i) includes a head of state, head of government, senior politician, senior government, judicial or military official, senior executive of a state-owned corporation and an important political party official;
  (ii) but does not include a middle-ranking or more junior official of any of the categories mentioned in subparagraph (i);

(b) a spouse, a partner, a child or a parent of an individual falling within paragraph (a) above, or a spouse or a partner of a child of such an individual; or

(c) a close associate of an individual falling within paragraph (a) (see paragraph 620.12.10).

620.12.17 Practices must take reasonable measures to determine whether an individual is a domestic PEP. If an individual is known to be a domestic PEP, a practice must perform a risk assessment to determine whether the individual poses a higher risk of ML/TF. Domestic PEP status in itself does not automatically confer higher risk. In any situation that a practice assesses to present a higher risk of ML/TF, it must apply the EDD and monitoring referred to in paragraph 620.12.14.

620.12.18 Practices should retain a copy of the assessment and should review the assessment whenever concerns as to the activities of the individual arise.

Senior management approval

620.12.19 As regards the level of management personnel who may approve the establishment or continuation of a relationship where EDD applies, the approval process should take into account the advice of a practice's CO, where one has been appointed. In general the more potentially sensitive the PEP, the higher the approval process should be escalated.

Periodic reviews

620.12.20 Foreign PEPs, and also domestic PEPs assessed to present a higher ML/TF risk, must be subject to a minimum annual review. CDD information should be reviewed to ensure that it remains up to date and relevant.

Bearer shares

620.12.21 Bearer shares lack the regulation and control of common shares because ownership is not recorded. Therefore, if practices come across companies with capital in the form of bearer shares, they should adopt procedures to establish the identities of the holders and beneficial owners of such shares and ensure that they are notified whenever there is a change of holder or beneficial owner.

Jurisdictions that do not apply, or insufficiently apply, the FATFRs, or otherwise posing higher ML/TF risk

620.12.22 Practices should give particular attention to, and exercise extra care in respect of:
(a) client relationships with, and the provision of ad hoc services to, persons (including legal persons and FIs) from or in jurisdictions that do not apply, or which insufficiently apply, the FATFRs; and
(b) transactions and businesses connected with jurisdictions assessed as higher ML/TF risk.

620.12.23 In determining which jurisdictions either do not apply, or insufficiently apply, the FATFRs, or which may otherwise pose a higher risk, practices should consider, among other things:
(a) information that may be issued by the Institute from time to time (see paragraph 620.12.25);
(b) whether the jurisdiction is subject to sanctions, embargoes or similar measures imposed by, for example, the Security Council of the United Nations ("UN Security Council")(see Section 650);
(c) whether the jurisdiction is identified by credible sources as lacking appropriate AML/CFT laws, regulations and other measures[19];
(d) whether the jurisdiction is identified by credible sources as providing funding or support for terrorist activities or has designated terrorist organisations operating within it; and
(e) whether the jurisdiction is identified by credible sources as having significant levels of corruption, or other criminal activity.

620.12.24 Practices should be aware of the potential reputational risk of conducting business in jurisdictions that do not apply, or insufficiently apply, the FATFRs, or other jurisdictions known to apply inferior standards for the prevention of ML/TF. If practices established in Hong Kong have office in such jurisdictions, practices should ensure that the controls adopted in such overseas units are, as far as possible, similar to those adopted in Hong Kong.

620.12.25 Where the requirement is called for by the FATF, or in other circumstances independent of the FATF, but also considered to be higher risk, the Institute may advise practices to undertake EDD measures, proportionate to the nature of the risks.

620.13 Reliance on CDD performed by intermediaries

General

620.13.1 Practices may rely upon an intermediary to perform any part of the CDD measures specified in subsection 620.1, subject to confirming that the intermediary has adequate AML/ CFT controls in place and the other considerations set out in this section. However, the ultimate responsibility for ensuring that CDD requirements are met remains with practices.

620.13.2 Reliance on third parties may occur through, e.g., introductions made by another member of the same network or referrals from other practices or other professionals.

620.13.3 Written confirmation shall be obtained from the intermediary that:

[19] "Credible sources" refers to information that is produced by well-known bodies generally regarded as reputable, which make such information publicly and widely available. In addition to the FATF and FATF-style regional bodies, such sources may include, but are not limited to, supra-national or international bodies such as the International Monetary Fund, and the Egmont Group of Financial Intelligence Units, as well as relevant national government bodies and non-government organisations. The information provided by these credible sources does not have the effect of law or regulation and should not be viewed as an automatic determination that something is of higher risk.

(a) it agrees to perform the role; and
(b) it will provide without delay a copy of any document or record obtained in the course of carrying out the CDD measures on behalf of the practice, upon request.

620.13.4 Practices should obtain satisfactory evidence to confirm the status and eligibility of the intermediary. Such evidence may comprise evidence from the intermediary of its status, regulation, policies and procedures.

620.13.5 Practices that carry out a CDD measure by means of an intermediary must as soon as possible after the intermediary has carried out that measure, obtain from the intermediary the data or information that the intermediary has obtained in the course of carrying out that measure. This does not require obtaining at the same time a copy of the document, or a record of the data or information, that is obtained by the intermediary.

620.13.6 Where these documents and records are kept by the intermediary, practice must obtain an undertaking from the intermediary to keep all underlying CDD information throughout the continuance of the practice's business relationship with the client and for at least five years beginning on the date on which the relationship of the client with the practice ends. An undertaking must also be obtained from the intermediary to supply copies of all underlying CDD information where the intermediary is about to cease trading or will no longer continue to act as an intermediary for the practice.

Domestic intermediaries

620.13.7 Practices may rely upon the following to perform any part of the CDD measures:
(a) certain types of FIs, as specified in AMLO, Schedule 2, section 18(3)(b) (i.e., an authorised institution, a licensed corporation, an authorised insurer, an appointed insurance agent or an authorised insurance broker); or
(b) a DNFBP, provided that the intermediary is able to satisfy the practice it has adequate procedures in place to prevent ML/TF.

Overseas intermediaries

620.13.8 Practices may rely upon an overseas intermediary carrying on business or practising in an equivalent jurisdiction to perform any part of the CDD measures, only where the intermediary:
(a) falls into one of the following categories of businesses or professions:
  (i) an institution that carries on in the jurisdiction a business similar to those referred to in paragraph 620.13.7(a);
  (ii) a lawyer, a notary public; an auditor, a professional accountant, a trust or company service provider, or a tax adviser practising in the jurisdiction;
  (iii) a trust company carrying on trust business in the jurisdiction;
  (iv) a person who carries on in the jurisdiction a business similar to that carried on by an estate agent; and
(b) is required under the law of the jurisdiction concerned to be registered or licensed or is regulated under the law of that jurisdiction;
(c) has measures in place to ensure compliance with CDD and RK requirements similar to those under Schedule 2 of AMLO, and is supervised for compliance with those requirements by an authority in that jurisdiction similar to any of the relevant authorities or regulatory bodies (as applicable) in Hong Kong.

620.14 Prohibition on anonymous accounts

620.14.1 Practices should not assist new or existing clients to open or maintain anonymous accounts or accounts in fictitious names.

620.15 Jurisdictional equivalence

Determination of jurisdictional equivalence

620.15.1 Jurisdictional equivalence is an important aspect in the application of CDD measures above. "Equivalent jurisdiction" is defined in AMLO as meaning:

(a) a jurisdiction that is a member of the FATF (other than Hong Kong); or

(b) a jurisdiction that imposes requirements similar to those imposed under Schedule 2 of AMLO.

620.15.2 Practices may, therefore, need to consider which jurisdictions, other than FATF members, apply requirements similar to those imposed under Schedule 2 of AMLO (or these Guidelines) for jurisdictional equivalence purposes. When doing so practices should document their assessment, which may include consideration of the following positive or negative factors:

(a) membership of a regional group of jurisdictions that admit jurisdictions that have demonstrated a commitment to combating ML/TF, and which have appropriate legal and regulatory regimes;

(b) mutual evaluation reports undertaken by the FATF, FATF-style regional bodies, the International Monetary Fund and the World Bank, etc., bearing in mind that mutual evaluation reports are at a “point in time”;

(c) lists of jurisdictions published by the FATF with strategic AML/CFT deficiencies;

(d) information that may be circulated by the Institute from time to time alerting practices to jurisdictions regarded as having poor AML/CFT controls;

(e) lists of jurisdictions, entities and individuals that are involved, or that are alleged to be involved, in activities that cast doubt on their integrity in relation to AML/CFT, published by specialised national, international, non-governmental and commercial organisations (e.g., Transparency International’s "Corruption Perceptions Index"; and

(f) guidance provided at paragraph 620.12.25.

SECTION 630

Ongoing Monitoring

General requirements

630.1 Effective ongoing monitoring is vital for understanding of clients' business and an integral part of effective AML/CFT controls. It helps practices to know their clients and to detect unusual or suspicious transactions.

630.1.1 **When carrying out any of the services specified in paragraphs 600.1.2 and 600.2.2, practices shall monitor their business relationships with clients by:**

(a) reviewing from time to time documents, data and information relating to the client, obtained by the practice for the purposes of complying with AMLO, to ensure that they are up to date and relevant;

(b) paying attention to transactions carried out for the client to ensure that they are consistent with the practice's knowledge of the client and the client's nature of business, risk profile and source of funds. An unusual activity may be in the form of one that is inconsistent with the expected pattern for that client, or with the normal business activities for the type of product or service that is being delivered; and

(c) identifying transactions that are complex, involve unusually large sums of money, or unusual patterns of activity, which have no apparent economic or lawful purpose, examining the background and purposes of those transactions and recording their findings in writing.

630.1.2 A failure to conduct proper ongoing monitoring could expose practices to potential abuse by criminals, and may call into question the adequacy of controls, or the prudence and integrity of a practice's management.

630.1.3 Possible characteristics practices should consider monitoring include:
(a) the nature and type of activities (e.g., abnormal amounts or frequency);
(b) the nature of a series of transactions;
(c) the amount of any transactions, paying particular attention to particularly substantial transactions;
(d) the geographical origin/destination of a payment or receipt; and
(e) the client's normal activity or turnover.

630.1.4 Practices should be vigilant for significant changes in relation to the basis of the business relationship with the client over time. These may include where:
(a) new products or services that pose higher risk are introduced;
(b) new corporate or trust structures are created;
(c) the stated activity or turnover of a client changes or increases; or
(d) the nature, frequency or size of activities changes, etc.

630.1.5 Where transactions are complex, involve unusually large sums of money, or unusual patterns of activity, and have no apparent economic or lawful purpose, practices must examine the background and purpose, including, where appropriate, the circumstances, of the transactions. The findings of these examinations must be properly documented in writing. Proper records of decisions made, by whom, and the rationale for them will help to demonstrate that a practice is handling unusual or suspicious activities appropriately.

630.1.6 Where the basis of the business relationship changes significantly, practices should carry out further CDD procedures to ensure that the ML/TF risk involved and basis of the relationship are fully understood. Ongoing monitoring procedures should take account of the above changes.

630.2 Risk-based approach in relation to monitoring

630.2.1 The extent of monitoring should be linked to the risk profile of the client, determined through the risk assessment. To be most effective, resources should be targeted towards business relationships presenting a higher risk of ML/TF. At the same time practices should also periodically review the risk profile of their clients generally as part of their ongoing monitoring, and may need to re-categorise individual clients, as appropriate.

630.2.2 Practices must take additional measures, such as conducting more frequent reviews, when monitoring relationships that are assessed as posing a higher risk, e.g., where:

(a) a client has not been physically present for identification purposes; or

(b) a client, or a beneficial owner of a client is known to the practice, from public information or information in its possession, to be a PEP.

Pre-existing clients

630.2.3 In relation to pre-existing clients, when practices perform ongoing monitoring before they first carrying out CDD measures in relation to the client, under AMLO, practices are required only to review the documents, data and information relating to the client that are held by them at the time that they conduct the review.

SECTION 640

Making Suspicious Transaction Reports

General requirements[20]

640.1 DTROP and OSCO (section 25A) require a person to report if he/she knows or suspects any property to be the proceeds of drug trafficking or an indictable offence, respectively. UNATMO (section 12(1)) requires a person to report if he/she knows or suspects that any property is terrorist property.

640.1.1 **Once knowledge or suspicion of an ML/TF transaction or activity has been established, the following general requirements apply:**

(a) Practices must make a report to an authorised officer[21] even where no service has been provided by the practice[22] A member working in a practice may discharge his/her responsibility by making a report to the MLRO designated by his/her employer;

(b) the report must be made as soon as is reasonably practical after the suspicion or knowledge is first established; and

(c) practices must ensure that they have in place internal controls to prevent any partner, director, or employee committing the offence of "tipping off" the client, or any other person who is the subject of the report. Practices should also take care that their line of enquiry with the client is such that tipping off cannot be construed to have taken place.

Under Hong Kong laws, the requirement to make suspicious transaction reports is not limited to any particular services or situations and, therefore, it applies to all services provided by practices.

640.2 Legal requirements in relation to making suspicious transaction reports

640.2.1 Under sections 25A(1) of DTROP/ OSCO, a person must make a disclosure to an authorised officer as soon as it is reasonable for him/her to do so, if he/she knows or suspects that any property:

(a) in whole or in part, directly or indirectly, represents the proceeds of[23];
(b) was used in connection with; or
(c) is intended to be used in connection with,

drug trafficking/ an indictable offence/.

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20 See also the Institute's **frequently-asked questions on suspicious transaction reporting**.

21 See Footnote 1.

22 The reporting obligations of section 25A(1) DTROP/OSCO and section 12(1) UNATMO apply to "any property" and require a person to report suspicions of ML/TF, irrespective of the amount involved. These provisions establish a reporting obligation whenever a suspicion arises, without reference to transactions *per se.* Thus, the obligation to report applies whether or not a transaction was actually conducted and also covers attempted transactions.

23 DTROP/OSCO, section 25A(1).

640.2.2 Under section 12(1) of UNATMO, where a person knows or suspects that any property is terrorist property, the person must disclose to an authorised officer the information or other matter:
(a) on which the knowledge or suspicion is based; and
(b) as soon as is practicable after that information or other matter comes to the person's attention.

640.2.3 It is an offence under section 25A of DTROP/OSCO and section 14(5) of UNATMO, carrying a maximum penalty of three months imprisonment and a fine at **level 5**[24], to fail to make a disclosure to an authorised officer where a person has the requisite knowledge or suspicion.

640.2.4 Once an employee has reported his/her suspicion to an appropriate person (see Section 2 on the appointment and roles of an MLRO) and in accordance with the procedure established by his/her employer for the making of such disclosures, he/she has fully satisfied the statutory obligation[25].

640.2.5 Filing an STR to the JFIU provides a statutory defence to the offence of ML/TF in respect of the acts disclosed in the report, provided:
(a) the STR is made before a person undertakes the disclosed acts and the acts are undertaken with the consent of the JFIU; or
(b) the STR is made after a person has performed the disclosed acts and the report is made on the person's own initiative and as soon as it is reasonable for the person to do so[26].

640.2.6 A disclosure under section 25A of DTROP/OSCO or section 12 of UNATMO will not be a breach of contract, enactment, rule of conduct, or provision restricting disclosure of information. The person making the disclosure will not be liable in damages for loss arising out of the disclosure[27].

(See Appendix A for further information on DTROP, OSCO and UNATMO)

640.2.7 CDD and ongoing monitoring provide the basis for recognising unusual and suspicious transactions and events. The key is to know enough about a client's business to recognise that an activity or transaction, or a series of transactions, is unusual and, from an examination of the unusual, to be able to conclude whether there is a suspicion of ML/TF.

640.2.8 Practices must ensure members of staff are made aware of their statutory obligations and that sufficient guidance and training are provided to enable them to recognise when ML/TF may be taking place[28]. Staff also need to be sensitive to the risk of tipping off during their client work (see paragraphs 640.2.16-640.2.21).

640.2.9 For a person to have knowledge or suspicion, he/she does not need to know the nature of the criminal activity underlying the ML, or that the proceeds themselves have definitely arisen from the criminal offence.

640.2.10 General suspicious transactions indicators and further examples of situations that could give rise to suspicions are provided in Appendix D. The examples are not intended to be exhaustive and are only indications of the most basic ways in which money may be laundered. However, identification of any of the circumstances similar to those listed in

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24 Standard levels of fines under various ordinances are specified in Schedule 8, Criminal Procedure Ordinance.

25 DTROP/OSCO, section 25A(4); UNATMO, section 12(4)

26 DTROP/OSCO, section 25A(2); UNATMO, section 12(2).

27 DTROP/OSCO, section 25A(3); UNATMO section 12(3).

28 See Section 8 of these Guidelines for further information on staff hiring and training.

Appendix D, may prompt further investigations and, at least, be a trigger for making initial enquiries about the source of funds and the nature of the client's activities.

640.2.11 Practices should also be aware of elements of individual transactions that could indicate property involved in TF. The FATF has issued **Guidance for Financial Institutions in Detecting Terrorist Financing**, which may also be a useful reference for practices.

Timing and manner of reports

640.2.12 In making STRs to the JFIU, the use of a standard form or the use of the e-channel "STREAMS"[29] by registered users is encouraged by the JFIU. Further details of reporting methods and advice may be found on the JFIU website. In the event that an STR is urgent, particularly when the matter is part of an ongoing investigation, this should be indicated in the STR. Where exceptional circumstances exist in relation to an urgent STR, an immediate notification to the JFIU by telephone would be desirable.

640.2.13 Depending on when knowledge or suspicion arises, an STR may be made either before a suspicious transaction or activity occurs (whether the intended transaction ultimately takes place or not), or after a transaction or activity has been completed.

640.2.14 The law requires the STR to be made together with any matter on which the knowledge or suspicion is based. The need for prompt disclosures is especially important where a client has instructed a practice to move funds or other property, make cash available for collection, or carry out significant changes to the business relationship. In such circumstances, an urgent notification to the JFIU by telephone would be desirable.

640.2.15 Knowledge or suspicion that any property represents the proceeds of an indictable offence should normally be reported within the jurisdiction where the knowledge or suspicion arises and where the records of the related activities are held. However, in certain cases, e.g., when there is a very clear nexus with Hong Kong, even though the knowledge or suspicion may arise outside Hong Kong, reporting to the JFIU may be required, but only if section 25A of DTROP/OSCO applies[30].

Tipping off

640.2.16 A person commits an offence of "tipping off", under DTROP/OSCO or UNATMO[31], if, knowing or suspecting that an STR has been made, he/she discloses to any other person any matter that is likely to prejudice an investigation that might be conducted following the original disclosure. An offence of tipping off carries a maximum penalty, upon conviction, of imprisonment for three years and a fine of $500,000.

640.2.17 A risk exists that clients could be unintentionally tipped off when practices are seeking to extend their CDD obligations during the establishment or course of the business relationship, or when conducting occasional or ad hoc transactions or services. If further enquiries of a client become necessary, where it is known or suspected that an STR has already been made, the client should not be made aware that relevant agencies have been alerted about his/her name.

640.2.18 A client's awareness of a possible STR or investigation could prejudice future efforts to investigate the suspected ML/TF operation. Therefore, if practices form a suspicion that

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29 STREAMS (Suspicion Transaction Report and Management System) is a web-based platform to assist in the receipt, analysis and dissemination of STRs. Use of STREAMS is recommended, especially for practices which make frequent reports. Further details may be obtained from the JFIU.

30 Section 25(4) of OSCO stipulates that an indictable offence includes conduct outside Hong Kong which would constitute an indictable offence if it had occurred in Hong Kong. Therefore, where a practice in Hong Kong has information regarding ML/TF, irrespective of the location, it should consider seeking clarification from and making a report to the JFIU.

31 DTROP/OSCO section 25A(5); UNATMO section 12(5)

activities or transactions relate to ML/TF, they should take into account the risk of tipping off when completing the CDD process. Practices shall ensure that their employees are aware of and sensitive to these issues when conducting CDD.

640.2.19 A person cannot be held liable for a tipping-off offence unless that person knows or suspects that an STR has been made, either internally or to the JFIU, or alternatively knows or suspects that the law enforcement agencies are conducting or intending to conduct an ML/TF investigation in relation to the persons or entities concerned.

640.2.20 Therefore, unless a staff member making enquiries has knowledge or suspicion of a current or impending investigation, where a practice is seeking additional information during preliminary enquiries of a prospective client, this should not give rise to a tipping-off offence. However, if the enquiries lead to a subsequent report being made, then the client shall not be informed or alerted.

640.2.21 It is a defence that it was not known or suspected that the disclosure was likely to prejudice an investigation. Therefore, where a practice communicates suspicions of ML/TF activities to a client's senior management, internal auditors, or other person responsible for monitoring, or reporting, ML/TF, the practice should first be satisfied, as far as possible, that:

(a) the persons to whom it is communicating its suspicions are not implicated in the suspected ML/TF; and
(b) the information communicated will not be passed to others who may prejudice the investigation or proposed investigation.

640.3 Internal reporting and recording

640.3.1 As indicated in Section 2, practices must appoint an MLRO as a central reference point for reporting suspicious transactions. The MLRO should:

(a) be responsible for making STRs to the JFIU;
(b) keep a register of all reports made to him/her by employees, and by the practice to the JFIU;
(c) on request by the employee concerned, provide a written acknowledgement of a report made to him/her by an employee; and
(d) it is also advisable for the MLRO to keep a record of discussions relating to internal reports.

640.3.2 Where staff members working in a practice have knowledge or suspicion of matters referred to in paragraphs 640.2.1 or 640.2.2, they should inform the MLRO, regardless of whether they believe an STR has already been made by another person to the JFIU or other authorities.

640.3.3 The MLRO should consider all internal disclosures he/she receives in the light of full access to all relevant documentation and other parties. He/she should play an active role in the identification and reporting of suspicious transactions. The MRLO should promptly evaluate, whether in his/her view, there are suspicious circumstances that would require a report to be made to the JFIU. If there are, the MLRO shall report all relevant details to the JFIU, without undue delay and should co-operate with any resulting JFIU investigation. If, on the other hand, a decision is made not to make an STR, the MRLO must document the reasons.

640.3.4 To enable the MLRO to fulfil his/her functions, practices should ensure that he/she receives full co-operation from all staff and access to all relevant documentation so that the MLRO is in a position to decide whether there is knowledge or suspicion of ML/TF.

640.3.5 When reporting suspicious transactions to the JFIU, sufficient information should be provided, including, e.g., the following details, as applicable[32]:

(a) personal particulars of the person or company involved, e.g., name, identity card or passport number, date of birth, address, telephone number, and bank account number;
(b) details of the suspicious transaction;
(c) the reason why the transaction is suspicious, i.e., which suspicious activity indicators are present;
(d) the explanation, if any, given by the person or company about the transaction.

640.3.6 To assist the disclosure of all relevant information, JFIU have provided **a form** on its website. An STR to the JFIU can be made through STREAMS, by email, fax, mail or telephone.

640.3.7 Practices must establish and maintain procedures to ensure that:

(a) staff are made aware of the identity of the MLRO and of the procedures to follow when making an internal disclosure report; and
(b) disclosure reports reach the MLRO without undue delay.

640.3.8 While practices may allow staff members to consult with supervisors or managers before deciding whether to draw up a report to the MLRO, in the normal course of events, any report raised by staff should not be filtered out by supervisors or managers who have no responsibility for the ML reporting/ compliance function. The legal obligation is to report as soon as it is reasonable to do so, so reporting lines should be as short as possible with the minimum number of people between the staff with the suspicion and the MLRO. This ensures speed, confidentiality and accessibility to the MLRO.

640.3.9 All suspicious activities reported to the MLRO must be documented (in urgent cases this may follow an initial discussion by telephone). The report should include the full details of the client and as full a statement as possible of the information giving rise to the suspicion.

640.3.10 The MLRO should acknowledge receipt of the report and at the same time provide a reminder of the obligation to avoid tipping off. The tipping-off obligation includes circumstances where a suspicion has been raised internally, but has not yet been reported to the JFIU.

640.3.11 The reporting of a suspicion in respect of a transaction or event does not remove the need to report further suspicious transactions or events in respect of the same client. Further suspicious transactions or events, whether of the same nature or different to the previous suspicion, must continue to be reported to the MLRO, who must make further reports to the JFIU, if appropriate.

640.3.12 When evaluating an internal report, the MLRO should take reasonable steps to consider all relevant information, including CDD and ongoing monitoring information available within or to the practice concerning the entity or entities to which the report relates. This may include:

(a) reviewing of other transaction patterns and volumes through connected accounts;
(b) reviewing any previous patterns of instructions, the length of the business relationship and reference to CDD and ongoing monitoring information and documentation; and
(c) appropriate questioning of the client (e.g., as suggested in the systematic

32 See the JFIU website: https://www.jfiu.gov.hk/en/str_main.html.

approach to identifying suspicious transactions recommended by the JFIU[33]).

640.3.13 As part of the review, other clients and/or services may need to be examined. The need to search for information concerning, e.g., connected relationships should strike an appropriate balance between the statutory requirement to make a timely STR to the JFIU and any delays that might arise in searching for more relevant information concerning connected accounts or relationships. The evaluation process, along with any conclusions drawn, should be documented.

640.3.14 If, after completing the evaluation, the MLRO decides that there are grounds for knowledge or suspicion, he/she must disclose the information to the JFIU, together with the information on which that knowledge or suspicion is based, as soon as it is reasonable to do so after his/her evaluation is complete. Providing the MLRO acts conscientiously and in good faith, there should not be any issue of failing to report where he/she concludes that there is no suspicion, after taking into account all available information. It is however essential for MLROs to keep proper records of their deliberations and actions taken to demonstrate that they have acted reasonably. The MLRO may wish to obtain legal advice, as necessary.

640.3.15 In relation to section 25A(2) of DTROP/OSCO and section 12(2) of UNATMO, a member who has made a report should, where appropriate, seek permission from the JFIU to continue to perform his/her duties in relation to the client. Where applicable, such consent should be sought through the MLRO.

640.3.16 In certain circumstances, it may not be feasible to curtail a service that is known, or suspected, to be related to ML/TF, before informing the JFIU, or to do so would likely frustrate efforts to pursue the beneficiaries of a suspected ML/TF operation. Where possible, the MLRO should, nevertheless, be alerted to the situation.

640.3.17 It is not an offence where a person, prior to making an STR, deals with property which he knows, or has reasonable grounds to believe, represents the proceeds of an indictable offence, provided that a disclosure is made on his/her own initiative, as soon as reasonable after performing the act (see paragraph 640.2.5).

640.3.18 While a practice may consider communicating its suspicions to a client's regulator if this is permitted and appropriate, this is not a substitute for reporting to the JFIU.

640.3.19 A practice may wish to terminate its relationship with a client that is being, or is likely to be, investigated. However, before terminating a relationship, the practice should consider liaising with the JFIU, or the investigation officer, to ensure that the termination does not tip off the client, or prejudice the investigation. In more complex situations, a practice may also wish to take legal advice on the implications of termination under the terms of the contract.

640.3.20 Practices should note that the statutory duty to make STRs, where applicable, overrides the duty of confidentiality owed to clients and, as indicated above (see paragraph 640.2.6), a disclosure made to the JFIU will be not be a breach of contract, enactment, rule of conduct or provision restricting the disclosure of information. The person who made it will not be liable in damages for loss arising out of the disclosure. At the same time it should be noted that this protection extends only to the disclosure of knowledge or suspicion of ML/TF, and any matter on which that knowledge or suspicion is based. STRs should be made in good faith and based on genuine knowledge or suspicion. If in doubt, practices should consider seeking legal advice before making a disclosure.

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33 For details, see: **https://www.jfiu.gov.hk/en/str_ask.html**

Recording internal reports and reports to the JFIU

640.3.21 Practices must establish and maintain a record of all ML/TF reports made to the MLRO. The record should include details of the date that the report was made, the staff members subsequently handling the report, the results of the assessment, whether the report resulted in a disclosure to the JFIU, and information to allow the papers relevant to the report to be located.

640.3.22 Practices must also establish and maintain a record of all STRs made to the JFIU. The record should include details of the date of the STR, the person who made the report, and information to allow the papers relevant to the STR to be located. This record may be combined with the record of internal reports, if considered appropriate.

640.4 Post-reporting matters

640.4.1 Practices should note the following:

(a) Filing an STR to the JFIU provides a statutory defence to ML/TF only in relation to the acts disclosed in that particular report. It does not absolve practices from the legal, reputational or regulatory risks associated with the continuing assignment or client relationship;

(b) a "consent" response from the JFIU to a pre-transaction STR should not be construed as a "clean bill of health" for the continuing assignment or client relationship, or an indication that the assignment or relationship does not pose a risk to the practice;

(c) practices should conduct an appropriate review of a business relationship upon the filing of an STR to the JFIU, irrespective of any subsequent feedback provided by the JFIU;

(d) once practices have concerns about an assignment or a client relationship, they should take appropriate action to mitigate the risks. Filing an STR with the JFIU and continuing with the assignment or relationship, without any further consideration of the risks and the imposition of appropriate controls to mitigate the risks identified, would not be a sufficient response;

(e) relationships reported to the JFIU should be subject to an appropriate review by the MLRO and, if necessary, the issue should be escalated to the practice's senior management to determine how to handle the relationship, in order to mitigate any potential legal or reputational risks, in line with the practice's business objectives, and its capacity to mitigate the risks identified; and

(f) practices are not obliged to continue specific assignments and/or client relationships if such action would place them at risk. It is recommended to indicate any intention to terminate an assignment or relationship in the initial STR to the JFIU, thereby allowing the JFIU to comment, at an early stage, on such a course of action.

640.4.2 The Institute understands that the JFIU will acknowledge receipt of an STR made under section 25A of DTROP/OSCO or section 12 of UNATMO. If there is no need for imminent action, consent will usually be given in writing for the practice to continue with the relevant activity or transaction, under the provisions of section 25A(2) of DTROP/OSCO. For STRs submitted via "STREAMS", an e-receipt will be issued via the same channel. The JFIU may, on occasion, seek additional information or clarification of matters on which the knowledge or suspicion is based.

640.4.3 Whilst there is no statutory requirement to provide feedback arising from investigations, the JFIU provides feedback in its quarterly report[34] and, the Institute also understands, upon request, to a disclosing practice in relation to the current status of the investigation.

[34] The purpose of the quarterly report, which is relevant to all financial sectors, is to raise AML/CFT awareness. It consists of two parts, (i) analysis of STRs and (ii) matters of interest and feedback. The report is available through the JFIU's website at **www.jfiu.gov.hk.** A password is required. Details may be found under the typologies and feedback section of the website or by contacting the JFIU directly.

640.4.4 After initial analysis by the JFIU, STRs that are to be pursued are allocated to financial investigation officers for further investigation. Practices should respond to production orders within the required time limits and provide the information or material that falls within the scope of such orders. Where a practice encounters difficulty in complying with the timeframes stipulated, the MLRO should at the earliest opportunity contact the officer-in-charge of the investigation for further guidance.

640.4.5 Upon the conviction of a defendant, a court may order the confiscation of relevant criminal proceeds and a practice may be served with a Confiscation Order, in the event that it holds property belonging to that defendant that is deemed by the courts to represent a benefit from the crime. A court may also order the forfeiture of property where it is satisfied that the property is a terrorist property.

640.5 Organisations other than member practices

640.5.1 Members working in organisations other than practices should ascertain whether their employers have procedures for making STRs through a CO/ MLRO. As indicated above, employees who make reports in accordance with procedures laid down by their employers are regarded as complying with the relevant laws[35]. In the absence of any employer's procedures, STRs would need to be made direct to the JFIU.

640.5.2 Members working in the banking, insurance and securities industries are advised to familiarise themselves with AMLO and guidelines on AML/CFT issued by the relevant financial services regulator. It should be noted that, under AMLO, it is a criminal offence if a person who is an employee of an FI or is employed to work for an FI, or is concerned in the management of an FI, (i) knowingly, or (ii) with intent to defraud the FI or any relevant authority, causes or permits the FI to contravene a specified provision of AMLO. The maximum penalty upon conviction on indictment, in the case of (i), is imprisonment for two years and fine of $1 million and, in the case of (ii), imprisonment for seven years and fine of $1 million[36].

[35] See Footnote 26.

[36] AMLO, section 5.

SECTION 650

Financial Sanctions and Terrorist Financing

General requirements

650.1 In relation to targeted financial sanctions and the financing of terrorism/ proliferation of weapons of mass destruction, practices must take note of and comply with their legal obligations, which include considering the need to make STRs.

650.1.1 Targeted financial sanctions are a specific type of sanctions decided by the UN Security Council for freezing funds, financial assets and economic resources owned or controlled, directly or indirectly, by designated individuals or entities and for preventing funds, financial assets or economic resources from being made available to such individuals and entities. Practices may refer to sanctions lists maintained by the UN Security Council and its Sanctions Committees. The lists are available on the webpages of the **relevant committees**.

650.1.2 The United Nations Sanctions Ordinance (Cap. 537) ("UNSO") empowers the Chief Executive of the Hong Kong SAR to make regulations to implement sanctions decided by the UN Security Council, including targeted financial sanctions against individuals or entities designated by the UN Security Council or its committees. Designated individuals and entities are specified by notice published in the Gazette.

650.1.3 Under the regulations made under the UNSO, it is an offence to make available any funds or other financial assets or economic resources to, or for the benefit of, such designated person or entity, as well as those acting on their behalves, at their direction, or owned or controlled by them; or to deal with any funds, other financial assets or economic resources belonging to, or owned or controlled by, such persons and entities, except under the authority of a licence granted by the Chief Executive. Offenders are subject to a maximum sentence of 7 years' imprisonment and an unlimited amount of fine. These prohibitions are relevant not only to FIs, but also to DNFBPs, including accountants, and practices must take steps to keep themselves informed of the current list of designated individuals and entities. For enquiries about licence applications, practices should approach the Commerce and Economic Development Bureau.

650.1.4 The Institute may inform members from time to time of designations published in the Government Gazette pursuant to regulations made under the UNSO.

650.1.5 Practices should conduct name checks of their clients and their beneficial owners against the latest lists of the designated individuals and entities. Practices should report to the Institute any actions taken in compliance with the targeted financial sanctions, including attempted transactions.

650.1.6 While practices will not normally have any obligation under Hong Kong laws to have regard to lists issued by organisations or authorities in other jurisdictions, practices with overseas offices may need to be aware of the scope and focus of relevant sanctions regimes in those jurisdictions.

Terrorist financing

650.1.7 TF generally refers to the carrying out of transactions involving property owned by terrorists, or that has been, or is intended to be, used to assist the commission of terrorist acts. Initially, this was not part of the AML regime, but subsequently the AML framework was expanded to include special recommendations on TF. With ML, the focus is on the handling of criminal proceeds, i.e., the source of property is what matters.

With TF, however, the focus is on the destination or use of property, which may have originated from legitimate sources.

650.1.8 The UN Security Council passed UN Security Council Resolution (UNSCR) 1373 (2001), which calls on all member states to act to prevent and suppress the financing of terrorist acts. The **UN Counter Terrorism Committee** has issued relevant guidance in relation to the implementation of UNSCRs.

650.1.9 UN has also published the names of individuals and organisations subject to UN financial sanctions in relation to involvement with ISIL (Da'esh), Al-Qa'ida, and the Taliban under relevant UNSCRs (e.g., UNSCR 1267 (1999), 1989 (2011) and 2253 (2015)). All UN member states are required under international law to freeze the funds and economic resources of any legal persons named in this list and to report any suspected name matches to the relevant authorities.

650.1.10 UNATMO was enacted in 2002 to give effect to the mandatory elements of UNSCR 1373 and the FATFRs relating to TF.

650.1.11 The Secretary for Security of the Hong Kong SAR ("S for S") has the power to freeze suspected terrorist property and may direct that a person must not deal with the frozen property except under the authority of a licence. Contraventions are subject to a maximum penalty of seven years imprisonment and an unspecified fine.

650.1.12 Section 8 of UNATMO does not affect a freeze per se; it prohibits a person from (i) making available any property or financial services to, or for the benefit of, a person he/she knows, or has reasonable grounds to suspect, is a terrorist or terrorist associate, in the absence of a licence granted by S for S; and (ii) collecting property or soliciting financial (or related) services for the benefit of a person he/she knows, or has reasonable grounds to suspect, is a terrorist or terrorist associate. Contraventions are subject to a maximum sentence of 14 years imprisonment and an unspecified fine.

650.1.13 S for S can license exceptions to the prohibitions to enable frozen property and economic resources to be unfrozen and to allow payments to be made to, or for the benefit of, a designated party under UNATMO.

650.1.14 Where a person is designated by a committee of the UN Security Council as a terrorist, generally, that person's details will subsequently be published in a notice under section 4 of UNATMO in the Government Gazette.

650.1.15 For lists of designated persons, reference may be made to various sources, including relevant designations by overseas authorities, such as the designations made by the US Government under relevant Executive Orders. The Institute may draw practices' attention to such designations from time to time.

650.1.16 Practices must have controls in place to conduct checks against relevant lists of terrorists, etc., for screening purposes and must take reasonable steps to ensure that their sources of information are up to date.

Proliferation of weapons of mass destruction

650.1.17 Under the Weapons of Mass Destruction (Control of Provision of Services) Ordinance (Cap. 526), it is an offence for a person to provide any services where that person believes or suspects, on reasonable grounds, that those services may be connected to weapons of mass destruction proliferation in or outside Hong Kong. The provision of services is widely defined and includes the lending of money or other provision of financial assistance as well as the provision of professional services.

650.2 Database maintenance and screening (clients and payments)

650.2.1 Practices must establish CFT policies and procedures and take measures to ensure compliance with the relevant regulations and legislation on TF. Staff must be made aware of their legal obligations and suitable guidance and training should be provided to them. The controls for identification of suspicious transactions must cover TF as well as ML.

650.2.2 It is important that practices should be able to identify and report transactions with terrorist suspects and designated parties. They should, therefore, consider maintaining a list or database of names and particulars of terrorist suspects and designated parties, which consolidates the various lists that have been made known to them, or making arrangements to access lists or databases maintained by third party service providers.

650.2.3 Practices should ensure that the relevant designations are included on any list or in any database that they maintain. It should, in particular, include the lists published in the Government Gazette and those designated under the US Executive Order 13224. It should also be subject to timely updating when there are changes, and made easily accessible by staff for the purpose of identifying suspicious transactions.

650.2.4 Ongoing screening by practices of their complete client base is an important part of the internal controls to prevent TF and sanction violations, and may be achieved by:

(a) screening clients against current terrorist and sanction designations at the establishment of the relationship; and

(b) as soon as practicable after new terrorist and sanction designations are made known, or come to the attention of a practice, ensuring that these new designations are screened against a practice's client base.

650.2.5 Where relevant, the screening procedures should extend to the connected parties of the client using an RBA.

650.2.6 Enhanced checks should be conducted before establishing a business relationship or processing a transaction, where possible, if there are circumstances giving rise to suspicion.

650.2.7 In order to be able to demonstrate compliance with the provisions of this section, the screening and any results must be documented or recorded electronically.

650.2.8 If practices suspect that an activity or transaction is terrorist related, they must make an STR to the JFIU. Even if there is no evidence of a direct terrorist connection, the activity or transaction should still be reported to the JFIU if it looks suspicious, as it may emerge subsequently that there is a terrorist link.

650.2.9 The legislation in Hong Kong provides exemptions from civil and criminal liability which applies to practices when sharing third-party information obtained from their clients for the purpose of preventing and suppressing TF. The sharing of information potentially relating to TF is not restricted by the Personal Data Privacy Ordinance (Cap. 486).

650.2.10 Where an STR is made pursuant to paragraph 650.2.8, practices must not disclose to another person any information or matters, which are likely to prejudice the investigation, as tipping off is also an offence under UNATMO.

SECTION 660

RECORD KEEPING

General requirements

660.1 In relation to any of the services specified in paragraphs 600.2.1 and 600.2.2, practices must prepare, maintain and retain documentation and records on their business relations with, and transactions for, clients, as are necessary and sufficient to achieve the record-keeping objectives indicated below and fulfil any related legal or regulatory requirements, and which are appropriate to the scale, nature and complexity of their businesses. The information maintained must be sufficient is to ensure that:

(a) any client and, where appropriate, the beneficial owner of the client, can be properly identified and verified;

(b) the audit trail for particular transactions and properties dealt with by a practice that relates to any client and, where appropriate, the beneficial owner of the client, is clear and complete;

(c) the original or suitable copies of all relevant client and transaction records and information are available on a timely basis to the Institute or other relevant authority, upon appropriate authority; and

(d) practices are able to show evidence of compliance with any relevant requirements specified in other sections of these Guidelines (e.g., relating to client identification, verification and risk assessments, STRs, and staff training).

Records in relation to particular transactions and clients must be retained for at least five years after the transaction has been completed or the business relationship has ended, as applicable.

660.1.1 RK is an essential part of the AML/CFT regime and can facilitate the detection, investigation and confiscation of criminal or terrorist property or funds. RK can help investigating authorities to establish a profile of a suspect and trace criminal or terrorist property or funds. It can assist the court to examine all relevant past businesses activities to assess whether the property or funds are the proceeds of, or relate to, criminal or terrorist offences.

660.1.2 Records must be kept of clients' identity, the supporting evidence of verification of identity (including the original and any updated records), the practice's business relationships with clients (including any non-engagement related documents relating to the client relationship) and details of any occasional transactions and monitoring of the relationship. Historic as well as current records should be retained.

660.1.3 Practices should also store securely information relating to both internal reports received by the MLRO and disclosures to the JFIU. It is also advisable that evidence of assessments of the training needs of staff and steps taken to meet those needs be retained.

660.2 Retention of records relating to client identity and business relationships

660.2.1 Practices must keep:

(a) the original or a copy of the documents, and a record of the data and information, obtained in the course of identifying and verifying the identity of clients, beneficial owners of the client, beneficiaries and persons who purport to act on behalf of the client, and other connected parties of the client;

(b) any additional information on a client and/or beneficial owner of the client that may be obtained for the purposes of EDD or ongoing monitoring;

(c) where applicable, the original or a copy of the documents, and a record of the data and information, on the purpose and intended nature of the business relationship;

(d) the original or a copy of business correspondence[37] with the client and any beneficial owner of the client (which, at a minimum, should include business correspondence material to CDD measures or significant changes to the business relationship or activities);

(e) the original or a copy of the documents, and a record of the data and information, obtained in connection with occasional transactions, which should be sufficient to permit reconstruction of individual transactions or business engagements.

660.2.2 AMLO requires that all relevant documents and records must be kept throughout the business relationship with or transaction for the client and retained for a period of at least five years after the end of the business relationship or transaction, as applicable. Information relating to STRs must also be retained for at least five years after receipt by the MLRO. Staff training records should be retained for a similar period. Either the original document or information, or an electronic copy, should be retained.

660.2.3 As practices need to maintain records for a wide range of purposes to comply with legal and professional requirements for the retention of documentation, the general documentation retention systems employed within the practice may be sufficient, provided that they are of an adequate scope and standard.

660.2.4 Records of internal reports are not considered to form part of client assignment working papers, and so it is advisable that such records be kept in a secure form, separately from the practice's normal methods for retaining client work documents. This is to guard against inadvertent disclosure to any party who may have or seek access to the client working paper files, where AML/CFT matters are not relevant to the purpose for which they are examining the file.

660.3 Manner in which records are to be kept

660.3.1 AMLO states that records required to be kept must be kept in the following way[38]:

(a) if the record consists of a document, either (i) the original of the document must be kept; or (ii) a copy of the document must be kept either on microfilm or in the database of a computer;

(b) if the record consists of data or information, a record of the data or information must be kept either on microfilm or in the database of a computer.

660.3.2 Irrespective of where identification and transaction records are held, practices are required to comply with all legal and regulatory requirements in Hong Kong.

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[37] Practices are not expected to keep each and every piece of correspondence, such as a series of emails with the client; the expectation is that sufficient correspondence is kept to demonstrate compliance with the Guidelines and to enable STRs to be substantiated and effectively followed up.

[38] Schedule 2, section 21

SECTION 670

STAFF HIRING AND TRAINING

GENERAL REQUIREMENTS

670.1 Practices' AML/CTF policies, procedures and controls must cover employee hiring and training.

670.1.1 As indicated in Section 610, the development of internal policies, procedures and controls should include screening procedures to ensure adequate standards when hiring employees. It is in the practices own interest to hire people who are capable of complying with the fundamental principles.

670.1.2 Staff training is an important element of an effective system to prevent and detect ML/TF activities. The effective implementation of even a well-designed internal control system can be compromised if staff members using the system are not adequately trained.

670.1.3 Practices must provide appropriate AML/CFT training to their staff and should have a clear and well-articulated policy for ensuring that relevant members of staff receive adequate AML/CFT training.

670.1.4 The timing and content of training for different groups of staff may be adapted by practices for their own needs, with due consideration given to the size and complexity of their business and the type and level of ML/TF risk. The frequency of training should be sufficient to ensure that members of staff maintain up-to-date AML/CFT knowledge and competence. Staff should be trained in what they need to do to carry out their particular role with respect to AML/CFT. This is especially important before new staff commence work.

670.1.5 Staff members should be made aware of:

(a) The practice's statutory obligations and their own role in relation to AMLO, particularly Schedule 2 of AMLO;
(b) the practice's and their own statutory obligations to report suspicious transactions under DTROP, OSCO and UNATMO, and the possible consequences of breaches of those obligations;
(c) other statutory and regulatory obligations in respect of AML/CFT under DTROP, OSCO, UNATMO, and UNSO that may concern the practice and themselves, and the possible consequences of breaches of those obligations;
(d) the practice's controls (policies and procedures) relating to AML/CFT, including suspicious transaction identification and reporting; and
(e) new and emerging techniques, methods, trends, etc. in ML/TF, to the extent that such information is needed by the staff to carry out their particular roles in the practice with respect to AML/CFT.

670.1.6 Depending on the seniority and nature of work of different groups of staff, training should include:

(a) an introduction of the background to ML/TF;
(b) the need to identify and report suspicious transactions to the MLRO, and information on the offence of "tipping off";
(c) training in circumstances that may give rise to suspicion, and relevant policies and procedures, including, for example, lines of reporting and when extra vigilance might be required (e.g., circumstances requiring EDD);
(d) appropriate training on client verification and relevant processing procedures.

670.1.7 COs and other managerial staff, including internal audit, where applicable, may require additional, higher-level training covering:

(a) all aspects of the practice's AML/CFT regime;
(b) the practice's controls (policies and procedures) in relation to CDD and RK requirements that are relevant to their job responsibilities;
(c) specific training in relation to their responsibilities for supervising or managing staff, auditing the system and performing random checks, as well as making STRs to the JFIU.

670.1.8 MLROs[39] may require more specific training:

(a) on their responsibilities for assessing reports submitted to them and making STRs to the JFIU; and
(b) to keep abreast of AML/CFT requirements and developments generally.

670.1.9 Practices may consider including available FATF papers and typologies as part of the training materials. All materials should be up to date and in line with current requirements and standards.

670.1.10 Practices must maintain records of staff training (e.g., who has been trained and when, and the type of the training provided).

670.1.11 Practices should monitor the effectiveness of the training. This may be achieved by:

(a) checking staff's understanding of the practice's policies and procedures to combat ML/TF, their understanding of their statutory and regulatory obligations, and also their ability to recognise suspicious transactions and the risks of tipping off; and
(b) monitoring the compliance of staff with the practice's AML/CFT controls, as well as monitoring the quality and quantity of internal reports, so that further training needs may be identified and appropriate action can be taken.

39 As noted in Section 610, in some practices, the CO and the MLRO may be the same person

Appendices A – E

Further information and examples for reference

APPENDIX A

Further information on the Financial Action Task Force, money laundering /terrorist financing and relevant legislation

Background on FATF

1. FATF is an inter-governmental body formed in 1989 that sets the international AML standards. Its mandate was expanded in October 2001 to CFT. In order to ensure full and effective implementation of its standards at the global level, the FATF monitors compliance by conducting evaluations on jurisdictions and undertakes follow-up after the evaluations, including identifying high-risk and uncooperative jurisdictions which could be subject to enhanced scrutiny by the FATF or counter-measures by the FATF members and the international community at large. Many major economies have joined the FATF which has developed into a global network for international cooperation that facilitates exchanges between member jurisdictions.

2. As a member of the FATF, Hong Kong is obliged to implement the AML/CFT requirements as promulgated by the FATF and it is essential that Hong Kong complies with the international AML/CFT standards in order to safeguard its reputation and standing as an international financial centre.

Processes commonly involved in ML

3. There are three common stages in ML, and they frequently involve numerous transactions. These stages are:
   (a) Placement - the physical disposal of cash proceeds derived from illegal activities;
   (b) Layering - separating illicit proceeds from their source by creating complex layers of financial transactions designed to disguise the source of the money, subvert the audit trail and provide anonymity; and
   (c) Integration - creating the impression of apparent legitimacy to criminally derived wealth. In situations where the layering process succeeds, integration schemes effectively return the laundered proceeds back into the general financial system and the proceeds appear to be the result of, or connected to, legitimate business activities.

DTROP and OSCO

4. DTROP, which was introduced in 1989, provides for the tracing, confiscation and recovery of the proceeds of drug trafficking and creates a criminal offence of laundering such proceeds. OSCO was introduced in 1994 and key provisions of it were modelled on DTROP. OSCO extends the scope of the money laundering offences to cover the proceeds of indictable offences generally.

5. Some of the relevant provisions of DTROP and OSCO are summarised below.

Dealing in the proceeds of crime

6. Under section 25 of both DTROP and OSCO, it is a serious offence, carrying a maximum penalty, upon conviction, of 14 years' imprisonment and a fine of five million dollars, to deal with any property, knowing or having reasonable grounds to believe that it, in whole or in part, directly or indirectly, represents the proceeds of an indictable offence. "Dealing" has quite a wide definition, including receiving or acquiring, disguising and disposing of property.

7. As regards the interpretation of "having reasonable grounds to believe", in the case of ***HKSAR v Pang Hung Fai***[40], the Court of Final Appeal ("CFA"), referencing the judgment of the Appeal

[40] Paragraphs 52 and 70 of *HKSAR v Pang Hung Fai* [2014] HKCFA 96*; Seng Yuet Fong v HKSAR* [1999] 2 HKC 833 at 836E-F.

Committee of the CFA, in ***Seng Yuet Fong v HKSAR***, stated: "To convict, the jury had to find that the accused had grounds for believing; and there was the additional requirement that the grounds must be reasonable: That is, that anyone looking at those grounds objectively would so believe."

8. The CFA also considered that the terminology of "subjective" and "objective" tests, which had appeared in decisions following the line of authority from the case of ***HKSAR v Shing Siu Ming & Others***, was unnecessarily complicated and liable to confuse.

9. "Proceeds of an offence" has a broad definition that include payments or rewards, property derived from such payments or rewards, or any financial advantage (which could include, e.g., a cost saving).

10. "Indictable offence" is defined in the Crimes Ordinance (Cap. 200), as "any offence other than an offence which is triable only summarily". This means that an offence that may be tried either summarily or on indictment is regarded as an indictable offence for the purposes of DTROP/ OSCO, and consequently the range of relevant offences is broad. The offences listed in Schedules 1 and 2 of OSCO are examples of indictable offences.

11. Various court decisions have interpreted the offence under section 25 quite widely. For example, it is unnecessary for the prosecution to prove that a specific indictable offence has been committed[41] or to specify an indictable offence in the charge[42].

12. It is a defence to a charge of dealing for a person to prove that, as required under section 25A(1):
    (a) he/she had intended to disclose knowledge or suspicion that property represented the proceeds of, was used or was intended to be used in connection with, an indictable offence, together with any matter on which that knowledge or suspicion was based, to an authorised officer, as soon as it was reasonable for him/her to do so; and
    (b) he/she has a reasonable excuse for his/her failure to make a disclosure.

13. It should be noted that, references to an indictable offence in sections 25 and 25A of DTROP/ OSCO include conduct outside of Hong Kong that would have constituted an indictable offence had it taken place here. Therefore, it may be an offence for a person to deal with criminal proceeds, under section 25(1), or fail to disclose, under section 25A(1), even if the relevant action or crime took place outside Hong Kong. This provision should not be interpreted too narrowly. For example, the evasion of taxes in another jurisdiction may be an indictable offence in this context, even though the specific type of tax in question, e.g., capital gains tax, may not exist in Hong Kong. On the other hand, this does not imply that, ordinarily, a person is expected to know the law of other jurisdictions, or that a person could be in breach of the law in Hong Kong if he acted in a particular way without having such knowledge.

Reporting suspicious transactions

14. As explained in section 640 of these Guidelines, both DTROP and OSCO have requirements, under section 25A, to report suspicious transactions, which apply to everybody in Hong Kong. A person should make a disclosure to an authorised officer as soon as it is reasonable for him/her to do so, if he/she knows or suspects that any property:
    (a) in whole or in part, directly or indirectly, represents the proceeds of an indictable offence;
    (b) was used in connection with an indictable offence; or
    (c) is intended to be used in connection with an indictable offence.

41 *HKSAR v Li Ching* CACC 436/1997; [1997] 4 HKC 108; *HKSAR v Wong Ping Shui & Others* [2000] 1 HKC 600, which was affirmed by the Appeal Committee of the Court of Final Appeal in FAMC 1/2001.

42 *Lam Hei Kit v HKSAR* FAMC 27/2004.

15. "Authorised officer" means[43]:
    (a) any police officer;
    (b) any member of the Customs and Excise Service established by section 3 of the Customs and Excise Service Ordinance (Cap. 342); and
    (c) any other person authorised in writing by the Secretary for Justice for the purposes of this Ordinance.

16. An offence of failing to make a disclosure, in accordance with section 25A, carries a maximum penalty, upon conviction, of imprisonment for three months and a fine at **level 5**.

17. There are other provisions in DTROP/ OSCO, regarding investigation and access to information, of which members may wish to take note.

UNATMO

18. UNATMO is directed primarily towards implementing Resolution 1373 of the United Nations Security Council, dated 28 September 2001, to prevent the financing of terrorist acts. Among other things, it criminalises the supply of funds and making funds, or financial services, available to terrorists or terrorist associates. It permits terrorist property to be frozen and subsequently forfeited.

Reporting under UNATMO

19. UNATMO, which was introduced in 2002, requires a person to report to an authorised officer if he knows or suspects that any property is terrorist property.[44]

20. Relevant definitions under UNATMO include the following:
    "Authorised officer" means[45]:
    (a) a police officer;
    (b) a member of the Customs and Excise Service established by section 3 of the Customs and Excise Service Ordinance (Cap. 342);
    (c) a member of the Immigration Service established by section 3 of the Immigration Service Ordinance (Cap. 311); or
    (d) an officer of the Independent Commission Against Corruption established by section of the Independent Commission Against Corruption Ordinance (Cap. 204).

    "Terrorist property" means:
    (a) the property of a terrorist or terrorist associate; or
    (b) any other property consisting of funds that:
        (i) is intended to be used to finance or otherwise assist the commission of a terrorist act; or
        (ii) was used to finance or otherwise assist the commission of a terrorist act.

    "Terrorist" means a person who commits, or attempts to commit, a terrorist act, or participates in, or facilitates the commission of, a terrorist act.

    "Terrorist act" refers to the use, or threat, of action, where this is intended to:
    (a) cause serious violence against a person;
    (b) cause serious damage to property;
    (c) endanger a person's life, other than that of the person committing the action;
    (d) create serious risk to the health or safety of the public or a section of the public;
    (e) seriously interfere with or seriously disrupt an electronic system; or
    (f) seriously interfere with or seriously disrupt an essential service, facility or system, whether

43 In practice STRs will generally be made to the JFIU, which is a joint unit of the Hong Kong Police Force and Customs and Excise Department.

44 UNATMO, section 12(1).

45 See Footnote 44.

public or private; and

(g) and the use or threat is:

(i) intended to compel the government, or to intimidate the public, or a section of the public; and

(ii) made for the purpose of advancing a political, religious or ideological cause.

(Paragraphs (d), (e) and (f) do not include the use or threat of action in the course of any advocacy, protest, dissent or industrial action.)

"Terrorist associate" means an entity owned or controlled, directly or indirectly, by a Terrorist.

21. Notices of the names of persons designated as terrorists or terrorist associates are published in the Government Gazette, under section 4 of UNATMO, from time to time. The notices reflect designations made by the United Nations Committee pursuant to UNSC Resolution 1267. UNATMO provides that it should be presumed, in the absence of contrary evidence, that a person specified in such notices is a terrorist or a terrorist associate.

Knowledge vs. suspicion

22. There is a statutory obligation to report where there is knowledge or suspicion of ML/TF. Generally speaking, knowledge is likely to include:
(a) actual knowledge;
(b) knowledge of circumstances which would indicate facts to a reasonable person; and
(c) knowledge of circumstances which would put a reasonable person on inquiry.

23. Suspicion, on the other hand, is more subjective. For example, according to the guidance issued by the Consultative Committee of Accountancy Bodies in the United Kingdom[46], in relation to the United Kingdom legislation, having knowledge means actually knowing that something is the case, whereas, suspicion, according to case law, is a state of mind more definite than speculation. While suspicion is personal and falls short of proof based on firm evidence[47], it must be based on some evidence, even if that evidence is tentative.[48]

24. In the case of Queensland Bacon PTY Ltd v Rees[49], it was stated: "…A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to a slight opinion, but without sufficient evidence".

25. In the more recent case of **Da Silva**[50], the court stated: "It seems to us that the essential element in the word "suspect" and its affiliates, in this context, is that the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice."[51]

Investigations and access to information

26. DTROP, OSCO and UNATMO also contain provisions on investigations and access to information, which include protection for legal privilege.

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46 The Consultative Committee of Accounting Bodies ("CCAB"), *Anti-money laundering guidance for the accountancy sector*, 2008. (**http://www.ccab.org.uk/PDFs/CCAB%20guidance%202008-8-26.pdf**, paragraph 2.25). See also the revised CCAB guidance, August 2017 (**https://www.ccab.org.uk/documents/TTCCABGuidance2017regsAugdraftforpublication.pdf**, paragraph 6.1.5).

47 Ibid.

48 Ibid., paragraph 2.26.

49 [1966] 115 CLR 266 at 303, per Kitto J

50 Da Silva [2006] EWCA Crim 1654, at16.

51 Ibid.

AMLO

27. AMLO sets out CDD and RK requirements for FIs and DNFBPs and the powers of relevant authorities and regulatory bodies to supervise compliance. It also covers regulation of money services and licensing of money service operators and the licensing of trust or company service providers.

28. Parts 2 and 3 of Schedule 2 cover the specifics of the CDD and RK requirements.

29. Section 7 of AMLO authorises a relevant authority (i.e., primarily the financial service regulators) or regulatory body, which includes the Institute in relation to members and member practices, to publish any guideline that it considers appropriate to provide guidance on the operation of Schedule 2. Under section 7(4), a failure by a person to comply with a guideline in published under section 7 does not, by itself, render the person liable to judicial or other proceedings, but the guideline is admissible in evidence in court proceedings under AMLO, and if any provision of the guideline appears to the court to be relevant to any question arising in the proceedings, the provision must be taken into account in determining that question.

30. Under AMLO, FIs and certain DNFBPs may rely on CDD conducted by some types of intermediary, including certified public accountants practising in Hong Kong, subject to specific conditions. This may be relevant where, for example, an intermediary is introducing or acting on behalf of its client and it could be, for example, an overseas network firm introducing a client to a CPA firm in Hong Kong.

APPENDIX B

Examples of possible risk factors when adopting a risk-based approach

Part I

Client risk

1. It is important to consider who clients are, what they do, and any other information that may suggest the client is of higher risk. Vigilance is required, for example, where the client has a legal form that enables individuals to divest themselves of ownership of property whilst retaining an element of control over it, or to retain anonymity, such as:
   (a) companies that can be incorporated without the identity of the ultimate underlying principals being disclosed;
   (b) certain forms of trusts or foundations, where knowledge of the identity of the true underlying principals or controllers cannot be guaranteed;
   (c) provision for nominee shareholders; and
   (d) companies issuing bearer shares.

2. Risks may be inherent in the nature of the activities of the client and the possibility that the activity, transaction and/or related transaction may itself be criminal, or where the business/industrial sector to which a client has business connections is more vulnerable to corruption For example, the arms trade and the financing of it is a type of activity that poses multiple ML/TF and other risks, e.g.:
   (a) corruption risks arising from procurement contracts;
   (b) risks in relation to PEPs; and
   (c) terrorism and TF risks as shipments may be diverted.

3. Some clients, by their nature or behaviour might present a higher risk of ML/TF. Factors might include:
   - the public profile of the clients indicating involvement with, or connection to, PEPs;
   - complexity of the relationship, including use of corporate structures, trusts and the use of nominee and bearer shares, where there is no clear legitimate commercial rationale;
   - a request to remain anonymous or use undue levels of secrecy with a transaction;
   - involvement in cash-intensive businesses;
   - nature, scope and location of business activities generating the funds/assets, having regard to sensitive or high-risk activities; and
   - where the origin of wealth (for high risk clients and PEPs) or ownership cannot be easily verified.

4. Other general factors that may indicate a higher than normal ML/TF risk in relation to clients include:

   i) <u>Reduced transparency</u>

   - lack of face-to-face introduction of client;
   - subsequent lack of contact, when this would normally be expected;
   - beneficial ownership is unclear;
   - position of intermediaries is unclear;
   - inexplicable changes in ownership;
   - company activities are unclear;
   - legal structure of client has been altered numerous times (name changes, transfer of ownership, change of corporate seat);
   - management appear to be acting according to instructions of unknown or inappropriate person(s);
   - unnecessarily complex client structure;

- reason for client choosing the firm is unclear, given the firm's size, location or specialism;
- frequent or unexplained change of professional adviser(s) or members of management;
- the client is reluctant to provide all the relevant information or the practice has reasonable doubt that the provided information is incorrect or insufficient.

ii) Transactions or structures out of line with business profile

- client instructions or funds outside of their personal or business sector profile;
- individual or classes of transactions that take place outside the established business profile, and expected activities/ transaction;
- employee numbers or structure out of keeping with size or nature of the business (for instance the turnover of a company is unreasonably high considering the number of employees and assets used);
- sudden activity from a previously dormant client;
- client starts or develops an enterprise with unexpected profile or early results;
- indicators that client does not wish to obtain necessary governmental approvals/filings, etc.;
- clients who offer to pay extraordinary fees for services which would not ordinarily warrant such a premium; and
- payments received from unassociated or unknown third parties and payments for fees in cash where this would not be a typical method of payment.

iii) Higher risk sectors and operational structures

- entities with a high level of transactions in cash or readily transferable assets, among which illegitimate funds could be obscured;
- frequent involvement with PEPs;
- investment in real estate at a higher/lower price than expected;
- large international payments with no business rationale;
- unusual financial transactions with unknown source;
- clients with multijurisdictional operations that do not have adequate centralised corporate oversight; and
- clients incorporated in jurisdictions that permit bearer shares.

iv) The existence of fraudulent transactions, or ones which are improperly accounted for, should always be considered suspicious

These might include:
- over and under invoicing of goods/services;
- multiple invoicing of the same goods/services;
- falsely described goods/services – over and under shipments (e.g., false entries on bills of lading); and
- multiple trading of goods/services.

Service risk

5. The characteristics of the services being offered, or intended to be offered, and the extent to which these may be vulnerable to ML/TF abuse, should also be considered. In this connection, it is important to assess the risks of any new services before they are introduced and, where necessary, ensure appropriate additional measures and controls are implemented to mitigate and manage the associated ML/TF risks.

6. Factors presenting higher risk may include services that inherently provide more anonymity. Other services that may be provided by accountants and which (in some circumstances) risk being used to assist money launderers may include:

- misuse of pooled client accounts or safe custody of client money or assets;
- advice on the setting up of legal arrangements, which may be used to obscure ownership or real economic purpose (including setting up of trusts, companies or change of name/corporate seat or other complex group structures);
- misuse of introductory services, e.g. to financial institution.

Country risk[52]

7. Clients with residence in or connection with high-risk jurisdictions; for example countries:

- identified by the FATF or other credible sources as jurisdictions with strategic AML/CFT deficiencies[53];
- subject to sanctions, embargos or similar measures issued by the UN;
- identified by credible sources as having significant levels of corruption, or other criminal activity
- identified by credible sources as providing funding or support for terrorist activities, or that have designated terrorist organisations operating within them.

8. For this purpose, practices may make reference to publicly available information or relevant reports and databases on corruption risk published by specialised national, international, non-governmental and commercial organisations (e.g., Transparency International's "Corruption Perceptions Index", which ranks countries according to their perceived level of corruption).

Delivery channel risk

9. Consider their service delivery channels and the extent to which these may be vulnerable to ML/TF abuse. These may include, for example, delivery where a non-face-to-face approach is used. Services engaged through intermediaries may also increase risk, as the business relationship between the client and a practice may become indirect.

Part II

Variables that may impact on risk

1. Indicated below are some factors that may increase or decrease risk in relation to particular clients, client engagements or practising environments.

- Involvement of financial institutions or other DNFBPs;
- sophistication of client, including complexity of control environment;
- sophistication of transaction/scheme;.
- role or oversight of another regulator;
- the regularity or duration of the relationship. Long-standing relationships involving frequent client contact throughout the relationship may present less risk;
- clients who are employment-based or with a regular source of income from a known legitimate source, which supports the activity being undertaken;

52 In assessing country risk associated with a client, consideration may be given to local legislation (UNSO, UNATMO, etc.), data available from the United Nations, the International Monetary Fund, the World Bank, the FATF, etc. and the practice's own experience or the experience of other group entities (where the practice is part of an international network which may have indicated weaknesses in other jurisdictions).

53 See paragraphs 620.12.22-620.12.25.

- clients who have a reputation for probity in the local communities;
- clients with a sound reputation, e.g., well-known, reputable private companies, with a long history that is well documented by independent sources, including information regarding their ownership and control;
- clarity in terms of the purpose of the relationship and the need for the practice to provide services;
- familiarity with a country, including knowledge of local laws and regulations as well as the structure and extent of regulatory oversight;
- country location of the client; and
- unexplained urgency of assistance required.

APPENDIX C

Examples of sources and content of information for client identification/ verification purposes

Part I

Reliable and independent sources for client identification purposes

1. The identity of an individual physically present in Hong Kong may be verified by reference to their Hong Kong identity card or travel document. Hong Kong residents' identity may be identified and/or verified by reference to their Hong Kong identity card, certificate of identity or document of identity. The identity of non-residents can be verified by reference to their valid travel document.

2. For non-resident individuals who are not physically present in Hong Kong, their identity may be identified and/or verified by reference to the following documents:
   (a) a valid international passport or other travel document; or
   (b) a current national (i.e., government or state-issued) identity card bearing the photograph of the individual; or
   (c) current valid national (i.e., government or state-issued) driving licence incorporating photographic evidence of the identity of the applicant, issued by a competent national or state authority. International drivers' permits and licences are not included for this purpose.

3. "Travel document" means a passport or some other document furnished with a photograph of the holder establishing the identity and nationality, domicile or place of permanent residence of the holder; for example:
   (a) Permanent Resident Identity Card of Macau Special Administrative Region;
   (b) Mainland Travel Permit for Taiwan Residents;
   (c) Seaman's Identity Document (issued under and in accordance with the International Labour Organisation Convention/Seafarers Identity Document Convention 1958);
   (d) Taiwan Travel Permit for Mainland Residents;
   (e) Permit for residents of Macau issued by Director of Immigration;
   (f) Exit-entry Permit for Travelling to and from Hong Kong and Macau for Official Purposes; and
   (g) Exit-entry Permit for Travelling to and from Hong Kong and Macau.

4. A corporate client may be identified and/or verified by performing a company registry search in the place of incorporation and obtaining a full company search report.

5. For jurisdictions that do not have national identity cards and where clients do not have a travel document or driving licence with a photograph, applying an RBA, other documents may be accepted as evidence of identity. Wherever possible such documents should have a photograph of the individual.

Part II

Appropriate identification and verification information

A. Natural persons

<u>Identification</u>

1. Generally, the following identification information should be collected in respect of personal clients who need to be identified:
   (a) full name;
   (b) date of birth;

(c) nationality; and
(d) identity document type and number.

Verification (Hong Kong residents)

2. For Hong Kong permanent residents, an individual's name, date of birth and identity card number may be verified by reference to his/her Hong Kong Identity Card. A copy of the individual's identity card may be retained.

3. For minors born in Hong Kong who are not in possession of a valid travel document or Hong Kong Identity Card[54], their identity may be verified by reference to their Hong Kong birth certificate. Whenever establishing relations with a minor, the identity of the minor's parent or guardian representing or accompanying the minor may also be recorded and verified in accordance with the above requirements.

4. For non-permanent residents, an individual's name, date of birth, nationality and travel document number and type may be verified by reference to a valid travel document (e.g., an unexpired international passport). A copy of the "biodata" page, which contains the bearer's photograph and biographical details, may be retained.

5. Alternatively, an individual's name, date of birth, identity card number may be verified by reference to their Hong Kong identity card, and the individual's nationality by reference to:
(a) a valid travel document;
(b) a relevant national (i.e. government or state-issued) identity card bearing the individual's photograph; or
(c) any government or state-issued document which certifies nationality.

Verification (non-residents)

6. For non-residents who are physically present in Hong Kong for verification purposes, an individual's name, date of birth, nationality and travel document number and type may be verified by reference to a valid travel document (e.g., an unexpired international passport). A copy of the "biodata" page which contains the bearer's photograph and biographical details may be retained.

7. For non-residents who are not physically present in Hong Kong for verification purposes, the individual's identity, including name, date of birth, nationality, identity or travel document number and type may be verified by reference to:
(a) a valid travel document;
(b) a relevant national (i.e. government or state-issued) identity card bearing the individual's photograph;
(c) a valid national driving licence bearing the individual's photograph; or
(d) other suitable alternatives, such as those mentioned in Part I.

8. Where a client has not been physically present for identification purposes, additional measures may need to be carried out (see paragraphs 620.12.2–620.12.3 of these Guidelines).

54 All residents of Hong Kong who are aged 11 and above are required to register for an identity card. Hong Kong permanent residents will have a Hong Kong Permanent Identity Card. The identity card of a permanent resident (i.e., a Hong Kong Permanent Identity Card) will have on the front of the card a capital letter "A" underneath the individual's date of birth.

Address identification

9. The residential address (and permanent address if different) of a direct client with whom a business relationship is being established may be obtained, as this is useful for verifying an individual's identity and background.

10. It is the trustee of a trust who enters into a business relationship or carries out a transaction on behalf of the trust who will be considered to be the client. The address of the trustee in a direct client relationship may therefore be obtained.

Other considerations

11. The standard identification requirement is likely to be sufficient for most situations. If, however, the client, or the service, is assessed to present a higher ML/TF risk because of the nature of the client, his/her business, his/her location, or because of the product features, etc., it may be considered whether additional identity information may need to be provided, and/or whether to verify additional aspects of identity.

B. Legal persons and trusts

General

1. For legal persons, the principal requirement is to look behind the immediate client to identify those who have ultimate control or ultimate beneficial ownership over the business and the client's assets. Normally particular attention may be paid to persons who exercise ultimate control over the management of the client.

2. The residential address (and permanent address if different) of beneficial owners may be obtained.

3. Where the owner is another legal person or trust, the objective is to undertake reasonable measures to look behind that legal person or trust and to verify the identity of beneficial owners. What constitutes control for this purpose will depend on the nature of the institution, and may vest in those who are mandated to manage funds, accounts or investments without requiring further authorisation.

4. For a client other than a natural person, the client's legal form, structure and ownership should be fully understood and, additionally, information should be obtained on the nature of its business and the reasons for seeking the service, unless the reasons are obvious.

5. Reviews should be conducted from time to time to ensure the client information held is up to date and relevant; methods by which a review could be conducted include conducting company searches, seeking copies of resolutions appointing directors, noting the resignation of directors, or by other appropriate means.

6. Many entities operate internet websites, which contain information about the entity. It should be borne in mind that this information, although helpful in providing much of the materials that might be needed in relation to the client, its management and business, may not be independently verified.

Corporations

Identification information

7. Generally, the information below may be obtained as the standard requirement; thereafter, on the basis of the ML/TF risk, it can be decided whether further verification of identity may be required and, if so, the extent of that further verification. It can also be decided whether additional information in respect of the corporation, its operation and the individuals behind it should be obtained:

(a) full name;
(b) date and place of incorporation;
(c) registration or incorporation number; and
(d) registered office address in the place of incorporation.

If the business address of the client is different from the registered office address in (d) above, information on the business address may be obtained.

8. In the course of verifying the client's information mentioned in paragraph 7, the following information may also be obtained:
(a) a copy of the certificate of incorporation and business registration (where applicable);
(b) a copy of the company's memorandum and articles of association which evidence the powers that regulate and bind the company; and
(c) details of the ownership and structure control of the company (e.g., an ownership chart).

9. The names of all directors[55] may be recorded and their identities verified using an RBA.

10. Where possible, the following may be done:
(a) confirm the company is still registered and has not been dissolved, wound up, suspended or struck off;
(b) independently identify and verify the names of the directors and shareholders recorded in the company registry in the place of incorporation; and
.

11. The information in paragraph 10 above may be verified from:

For a locally-incorporated company -
(a) conducting a file search at the Hong Kong Companies Registry and obtaining a company report[56];

For a company incorporated overseas -
(a) conducting a similar company search enquiry of the registry in the place of incorporation and obtaining a company report;
(b) obtaining a certificate of incumbency[57] or equivalent issued by the company's registered agent in the place of incorporation; or
(c) obtaining a similar or comparable document to a company search report or a certificate of incumbency certified by a professional third party in the relevant jurisdiction, verifying that the information at paragraph 10, contained in the document, is correct and accurate.

12. If, following paragraph 11, a company search report has been obtained, which contains information such as certificate of incorporation, company's memorandum and articles of association, etc, the same information need not be obtained again from the client pursuant to paragraph 8.

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55 It may, of course, already be required to identify a particular director if the director acts as a beneficial owner or a person purporting to act on behalf of the customer (e.g., account signatories).(see subsections 620.6 and 620.7 of these Guidelines).

56 Alternatively, a certified true copy of a company search report, certified by a company registry or professional third party may be obtained from the client. The company search report should have been issued within the last 6 months. It is not sufficient for the report to be self-certified by the client.

57 A certified true copy of a certificate of incumbency certified by a professional third party may be accepted. The certificate of incumbency should have been issued within the last 6 months. It is not sufficient for the certificate to be self-certified by the client.

C. Beneficial owners

Corporations

1. In relation to beneficial owners of corporations, in normal, non-high risk, situations, AMLO requires verification of the identity of a beneficial owner where that person is:
   (a) an individual who –
      (i) owns or controls, directly or indirectly, including through a trust or bearer shareholding, more than 25% of the issued share capital of the corporation;
      (ii) is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights at general meetings of the corporation; or
      (iii) exercises ultimate control over the management of the corporation; or
   (b) if the corporation is acting on behalf of another person, means that other person.

2. The identity of beneficial owners should be identified and recorded, and reasonable measures taken to verify the identity of:
   (a) all shareholders holding more than 25% of the voting rights or share capital;
   (b) any individual who exercises ultimate control over the management of the corporation; and
   (c) any person on whose behalf the client is acting.

3. For companies with multiple layers in their ownership structures, an understanding should be obtained of the ownership and control structure of the company. The intermediate layers of the company should be identified. The manner in which this information is collected should be determined, for example by obtaining a director's declaration incorporating or annexing an ownership chart describing the intermediate layers (the information to be included should be determined on a risk sensitive basis but, at a minimum, should include company name and place of incorporation, and where applicable, the rationale behind the particular structure employed). The objective should always be to follow the chain of ownership to the individuals who are the ultimate beneficial owners of the direct client of a practice and to verify the identity of those individuals.

4. It is would not be necessary, as a matter of routine, to verify the details of the intermediate companies in the ownership structure of a company. Complex ownership structures (e.g., structures involving multiple layers, different jurisdictions, trusts, etc.) without an obvious commercial purpose pose an increased risk and may require further steps to be satisfied on reasonable grounds as to the identity of the beneficial owners.

5. The need to verify the intermediate corporate layers of the ownership structure of a company will therefore depend upon the overall understanding of the structure, the assessment of the risks and whether the information available is sufficient in the circumstances to consider whether adequate measures have been taken to identify the beneficial owners.

6. Where the ownership is dispersed, the focus should be on on identifying and taking reasonable measures to verify the identity of those who exercise ultimate control over the management of the company.

Partnerships and unincorporated bodies

7. Partnerships and unincorporated bodies, although principally operated by individuals or groups of individuals, are different from individuals, in that there is an underlying business. This business is likely to have a different ML/TF risk profile from that of an individual.

8. In relation to beneficial owners of partnerships, in normal, non-high risk, situations, AMLO requires verification of the identity of a beneficial owner, where that person is:
   (a) an individual who
      (i) is entitled to or controls, directly or indirectly, more than a 25% share of the capital or profits of the partnership;

(ii) is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights in the partnership; or
(iii) exercises ultimate control over the management of the partnership; or

(b) if the partnership is acting on behalf of another person, means the other person.

9. In relation to an unincorporated body other than a partnership, beneficial owner:
(a) means an individual who ultimately owns or controls the unincorporated body; or
(b) if the unincorporated body is acting on behalf of another person, means the other person.

10. Generally, the following information in relation to the partnership or unincorporated body may be obtained:
(a) the full name;
(b) the business address; and
(c) the names of all partners and individuals who exercise control over the management of the partnership or unincorporated body, and names of individuals who own or control more than 25% of its capital or profits, or of its voting rights.

11. In cases where a partnership arrangement exists, a mandate from the partnership authorising the business activity and conferring authority on those who will undertake it may usually be obtained.

12. The identity of the client should be verified using evidence from a reliable and independent source. Where partnerships or unincorporated bodies are well-known, reputable organisations, with long histories in their industries, and with substantial public information about them, their partners and controllers, confirmation of the client's membership of a relevant professional or trade association is likely to be sufficient to provide such reliable and independent evidence of the identity of the client. Reasonable measures will generally still need to be taken to verify the identity of the beneficial owners of the partnerships or unincorporated bodies.

13. Other partnerships and unincorporated bodies have a lower profile, and generally comprise a much smaller number of partners and controllers. In verifying the identity of such clients, regard may be had to the number of partners and controllers. Where these are relatively few, the client may be treated as a collection of individuals; where numbers are larger, it may be decided whether to continue to regard the client as a collection of individuals, or whether to be satisfied with evidence of membership of a relevant professional or trade association. In either case, the partnership deed (or other evidence in the case of sole traders or other unincorporated bodies), may be sought to ascertain that the entity exists, unless an entry in an appropriate national register may be checked.

14. In the case of associations, clubs, societies, charities, religious bodies, institutes, mutual and friendly societies, co-operative and provident societies, satisfaction should be obtained as to the legitimate purpose of the organisation, e.g., by requesting sight of the constitution.

Trusts

General

15. A trust does not possess a separate legal personality. It cannot form business relationships or carry out one-off or ad hoc transactions itself. It is the trustee who enters into a business relationship or carries out transactions on behalf of the trust and who is considered to be the client (i.e. the trustee is acting on behalf of a third party – the trust and the individuals concerned with the trust).

16. In relation to beneficial owners of trusts, in normal, non-high risk, situations, AMLO requires verification of the identity of a beneficial owner, where that person is:
(a) an individual who is entitled to a vested interest in not less than 25% of the capital of the trust property, whether the interest is in possession or in remainder or reversion

and whether it is defeasible or not;
(b) the settlor of the trust;
(c) a protector or enforcer of the trust; or
(d) an individual who has ultimate control over the trust.

17. The following identification information in respect of a trust on whose behalf the trustee (i.e., the client) is acting may be obtained:
(a) the name of the trust;
(b) date of establishment/settlement;
(c) the jurisdiction whose laws govern the arrangement, as set out in the trust instrument;
(d) the identification number (if any) granted by any applicable official bodies (e.g. tax identification number or registered charity or non-profit organisation number);
(e) identification information of trustee(s), in line with guidance for individuals or corporations;
(f) identification information of settlor(s) and any protector(s) or enforcers, in line with the guidance for individuals/corporations; and
(g) identification information of known beneficiaries. Known beneficiaries mean those persons or that class of persons who can, from the terms of the trust instrument, be identified as having a reasonable expectation of benefiting from the trust capital or income.

Verifying the trust

18. Generally, the name and date of establishment of a trust should be verified and appropriate evidence to verify the existence, legal form and parties to it, i.e., trustee, settlor, protector, beneficiary, etc. may be obtained. The beneficiaries should be identified as far as possible, where defined. If the beneficiaries are yet to be determined, the focus may be on identifying the settlor and/or the class of persons in whose interest the trust is set up. The most direct method of satisfying this requirement is to review the appropriate parts of the trust deed.

19. Reasonable measures to verify the existence, legal form and parties to a trust, having regard to the ML/TF risk, may include:
(a) reviewing a copy of the trust instrument and retaining a redacted copy;
(b) by reference to an appropriate register [58] in the relevant country of establishment;
(c) a written confirmation from a trustee acting in a professional capacity[59]; or
(d) a written confirmation from a lawyer who has reviewed the relevant instrument.

20. Reasonable measures may still need to be taken to verify the actual identity of the individual parties (i.e., trustee, settlor, protector, beneficiary, etc.).

21. Where only a class of beneficiaries is available for identification, the focus may be on seeking to ascertain and name the scope of the class (e.g., children of a named individual).

22. Particular care may need to be taken in relation to trusts created in jurisdictions where there is no AML/CFT framework similar to Hong Kong's.

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[58] In determining whether a register is appropriate, regard should be had to adequate transparency (e.g., a system of central registration where a national registry records details on trusts and other legal arrangements registered in that country). Changes in ownership and control information would need to be kept up-to-date.

[59] "Trustees acting in their professional capacity" in this context means that they act in the course of a profession or business which consists of or includes the provision of services in connection with the administration or management of trusts (or a particular aspect of the administration or management of trusts).

APPENDIX D

SUSPICIOUS TRANSACTION INDICATORS AND EXAMPLES OF SITUATIONS THAT COULD GIVE RISE TO SUSPICIONS

General indicators

1. The types of transactions that may be used for ML/TF are wide-ranging and so it is not possible to specify all the transactions that might arouse suspicion.

2. Indicators of suspicious transactions should be considered, such as the nature and parties involved, including the involvement of jurisdictions that insufficiently apply FATFRs and persons designated as terrorists published in the Government Gazette.

3. Particular care should be taken when, for example, companies have very complex ownership structures that do not seem to serve any legitimate purpose, or when a company is incorporated or administered in a jurisdiction designated by FATF among the Non-Cooperative Countries and Territories. More information on these countries/ territories can be found on the FATF website.

4. The JFIU state that common indicators of suspicious activities associated with ML/TF in Hong Kong include:[60]
   - (a) large or frequent cash transactions, either deposits or withdrawals;
   - (b) suspicious activity based on transaction patterns, e.g.,
     - (i) accounts used as a temporary repository for funds;
     - (ii) a period of significantly increased activity amid relatively dormant periods;
     - (iii) "Structuring" or "smurfing" i.e., many lower-value transactions conducted when one, or a few, large transactions could be used. This is common in incoming remittances from countries with value-based transaction reporting requirements, e.g., frequent remittances just below AU$10,000 from Australia or US$10,000 from United States;
     - (iv) "U-turn" transactions, i.e., where money passes from one person or company to another and then back to the original person or company; and
     - (v) increased level of account activity on the first banking day after Hong Kong horse racing, normally Mondays and Thursdays, which may indicate illegal bookmaking.
   - (c) involvement of one or more of the following entities, which are common in money laundering,
     - (i) shelf or shell companies;
     - (ii) companies registered in a known "tax haven" or "off-shore financial centre";
     - (iii) company formation agent, or secretarial company, as the authorised signatory of the bank account;
     - (iv) remittance agents or money changers; and
     - (v) casinos.
   - (d) currencies, countries or nationals of countries, commonly associated with international crime, or drug trafficking, or identified as having serious deficiencies in their AML/CFT regimes;
   - (e) clients who refuse, or are unwilling, to provide explanations of financial activities, or provide explanations assessed to be untrue;
   - (f) activity that is unexpected of clients, considering existing knowledge about the clients and their previous financial activity. For personal accounts, relevant considerations include clients' age, occupation, residential address, general appearance, type and level of previous financial activity. For company accounts, relevant considerations include the type and level of activity;
   - (g) countries, or nationals of countries, commonly associated with terrorist activities or

60 See the JFIU website at: **https://www.jfiu.gov.hk/en/str_screen.html**

the persons or organisations designated as terrorists or their associates; and

(h) international and domestic PEPs; that is, individuals who hold important positions in governments or the public sector, who may be more vulnerable to corruption and involvement in abuse of public funds.

Situations that may give rise to suspicions

5. Examples of situations that could give rise to suspicion, depending on the circumstances, include the following:
   (a) activities, service requests or transactions that have no apparent legitimate purpose and/or appear not to have a commercial rationale;
   (b) activities, service requests or transactions that involve apparently unnecessary complexity or which do not constitute the most logical, convenient or secure way to do business;
   (c) where the service or transaction being requested by the client, without reasonable explanation, is out of the ordinary range of services normally requested;
   (d) where, without reasonable explanation, the size or pattern of activities or transactions is out of line with any pattern that has previously emerged;
   (e) where the client refuses to provide the information requested without reasonable explanation or otherwise refuses to cooperate with the CDD and/or the ongoing monitoring process;
   (f) where a client that has entered into a business relationship uses the relationship for a single service or for only a very short period without a reasonable explanation;
   (g) the extensive use of trusts or offshore structures in circumstances where the client's needs are inconsistent with the use of such services;
   (h) activities or transactions involving high-risk jurisdictions without reasonable explanation, which are not consistent with the client's declared business dealings or interests; and
   (i) unnecessary routing of funds or other property from/to third parties or through third party accounts.

6. Reference can also be made to:
   (a) Suspicious transaction indicators for accountants in the publication, **Anti-Money Laundering & Counter Terrorist Financing**, published by the Narcotics Division, Security Bureau, June 2009 (paragraph 4.5).
   (b) Characteristics of financial transactions that may be a cause for increased scrutiny contained in Annex 1 of FATF's **Guidance for Financial Institutions in Detecting Terrorist Financing**.
   (c) Relevant overseas examples, such as the general and accountancy-specific suspicious transaction indicators in **Guideline 2: Suspicious Transactions**, issued by the Financial Transactions and Reports Analysis Centre of Canada.

APPENDIX E: Glossary of key terms and abbreviations, and definitions

Terms / abbreviations	Meaning
AMLO	Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions and Designated Non-Financial Businesses and Professions) Ordinance (Cap. 615)
AML/CFT	Anti-money laundering and counter financing of terrorism
Beneficial owner	(a) In relation to a corporation— (i) means an individual who— A. owns or controls, directly or indirectly, including through a trust or bearer share holding, more than 25% of the issued share capital of the corporation; B. is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights at general meetings of the corporation; or C. exercises ultimate control over the management of the corporation; or (ii) if the corporation is acting on behalf of another person, means the other person; (b) in relation to a partnership— (i) means an individual who— A. is entitled to or controls, directly or indirectly, more than a 25% share of the capital or profits of the partnership; B. is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights in the partnership; or C. exercises ultimate control over the management of the partnership; or (ii) if the partnership is acting on behalf of another person, means the other person; (c) in relation to a trust, means— (i) an individual who is entitled to a vested interest in more than 25% of the capital of the trust property, whether the interest is in possession or in remainder or reversion and whether it is defeasible or not; (ii) the settlor of the trust; (iii) a protector or enforcer of the trust; or (iv) an individual who has ultimate control over the trust; and (d) in relation to a person not falling within paragraph (a), (b) or (c)— (i) means an individual who ultimately owns or controls the person; or (ii) if the person is acting on behalf of another person, means the other person.

Business relationship	A business relationship between a person and a practice is a business, professional or commercial relationship: (i) that has an element of duration; or (ii) that the practice, at the time the person first contacts it in the person's capacity as a potential client of the practice, expects to have an element of duration. ***This can be distinguished from an occasional or ad hoc assignment or transaction, which is an assignment or transaction by a practice for a client with which the practice does not have a business relationship.***
CDD	Client due diligence
CO	Compliance officer
Connected parties	Connected parties to a client include the beneficial owner and any natural person having the power to direct the activities of the client. For the avoidance of doubt, the term connected party will include any director, shareholder, beneficial owner, signatory, trustee, settlor/grantor/founder, protector(s), or defined beneficiary of a legal arrangement.
DNFBP (under AMLO)	Designated non-financial businesses and professions means: (a) an accounting professional; (b) an estate agent; (c) a legal professional; or (d) a TCSP licensee; "*accounting professional*" means— (a) a certified public accountant or a certified public accountant (practising), as defined by section 2(1) of the Professional Accountants Ordinance (Cap. 50); (b) a corporate practice as defined by section 2(1) of the Professional Accountants Ordinance (Cap. 50); or (c) a firm of certified public accountants (practising) registered under Part IV of the Professional Accountants Ordinance (Cap. 50); "*TCSP licensee*" is a person licensed under AMLO to carry on a trust or company service business, *"Trust or company service"* as defined in Schedule 1 Part 1 of AMLO, i.e., those services referred to in paragraph 600.2.2 of these Guidelines
DTROP	Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405)
EDD	Enhanced client due diligence

FATF	Financial Action Task Force
FATFR	Financial Action Task Force Recommendations
FI	Financial institution
ICO	Insurance Companies Ordinance (Cap. 41)
Individual	Individual means a natural person, other than a deceased natural person.
Institute	Hong Kong Institute of Certified Public Accountants
JFIU	Joint Financial Intelligence Unit
Minor	Minor means a person who has not attained the age of 18 years (Interpretation and General Clauses Ordinance (Cap. 1) - section 3)
MLRO	Money laundering reporting officer
Money laundering	As defined in Schedule 1 of AMLO. (See also section 600.3 of these Guidelines)
ML/TF	Money laundering and/or terrorist financing
Occasional transaction	A transaction between a DNFBP and a client who does not have a business relationship with the DNFBP
OSCO	Organised and Serious Crimes Ordinance (Cap. 455)
PEP	Politically exposed person
Relevant authority	As defined in AMLO, Schedule 1, Part 2, which are the regulators for the FIs and licensed money service operators
RBA	Risk-based approach to CDD and ongoing monitoring
Regulatory body	As defined in AMLO, Schedule 1, Part 2, which are the regulator for the DNFBPs , including, for an accounting professional, the HKICPA
RK	Record-keeping
Schedule 2	Schedule 2 to the AMLO
SDD	Simplified client due diligence

Senior management	Senior management means partners, directors (or board) and senior managers (or equivalent) of a firm who are responsible, either individually or collectively, for management and supervision of the firm's business. This may include a firm's chief executive officer, managing director, or other senior operating management personnel (as the case may be).
SFO	Securities and Futures Ordinance (Cap. 571)
STR	Suspicious transaction report; also referred to as "report" or "disclosure"
Terrorist financing	As defined in Schedule 1 of AMLO. (See also section 600.3 of these Guidelines)
Trust	For the purposes of the guideline, a trust means an express trust or any similar arrangement for which a legal-binding document (i.e. a trust deed or in any other form) is in place.
UNATMO	United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575)
UNSO	United Nations Sanctions Ordinance (Cap. 537)