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

MEMBERS' HANDBOOK

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Document Reference and Title	***Instructions***	***Explanations***
VOLUME I		
Contents of Volume I	Discard existing page i & replace with revised page i.	Revised contents page
PROFESSIONAL ETHICS		
Code of Ethics for Professional Accountants (Revised)	Replace the cover page, pages 3 and 111-185 with revised cover page, pages 3 and 111-185	- Note
GENERAL GUIDANCE		
Statement 1.303 Restrictions on Appointments as Secretaries and Directors of Audit Clients	Replace page 1 with revised page 1	- Note

Note:

The Institute has updated "Part D: Additional Ethical Requirements" and "Part E: Specialized Areas of Practice" of the Code of Ethics for Professional Accountants and Statements 1.303 in response to the new Hong Kong Companies Ordinance ("CO") (Cap. 622). Such updates reflect the latest requirements of the new CO and are effective immediately upon release.

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

MEMBERS' HANDBOOK
CONTENTS OF VOLUME I

(Updated to May 2015)

COE
Revised ~~January 2015~~May 2015

Effective on 1 January 2011
(including subsequent amendments as indicated)

Code of Ethics for Professional Accountants

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

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

CONTENTS

PART D: ADDITIONAL ETHICAL REQUIREMENTS

SECTION 400

Introduction

400.1 This Part 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 IESBA Code of Ethics for Professional Accountants. The existing additional ethical requirements are primarily derived from local legal or regulatory requirements.

400.2 The sections under this Part 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 Parts A to C. 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.

400.3 The sections under this Part 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 Parts A to C which are adopted from the IESBA Code of Ethics for Professional Accountants. 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.

400.4 Until the sections under this Part are updated, where members encounter situations where a requirement under this Part is:

(a) more stringent than a provision in Part A, B or C, the requirement under this Part should prevail; or

(b) in conflict with or less stringent than a provision in Part A, B or C, the relevant provision in Part A, B or C should be followed.

SECTION 410

Unlawful Acts or Defaults by Clients of Members

This section should be read in conjunction with Section 140 "Confidentiality".

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. This section gives guidance to members concerning these areas of difficulty. 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. These areas of difficulty involve not only questions of professional conduct but also important legal considerations.

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

410.1 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.

410.2 The Guidelines which follow are intended to assist members in the discharge of their professional responsibilities 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 consult a solicitor if in doubt.

410.3 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. However, the duty of confidentiality is not absolute. Where, for example, members acquire information in the course of an audit showing that 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.

Relations Between a Member and His Client

Disclosure of Information by His Client to a Member

410.4 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.

410.5 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.

410.6 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.

410.7 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

410.8 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. Therefore where a member becomes aware that a client has committed a default or unlawful act, the member should in principle keep the matter between himself and his client.

410.9 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.

410.10 However, the confidentiality, whether arising from contract - paragraph 410.8 above - or as a matter of public interest - paragraph 410.9 above - is by no means absolute. There will be circumstances where a member is (1) *required* to disclose to others knowledge of defaults or criminal acts acquired in the course of such confidential relationship and (2) *free* to make such disclosure (refer paragraph 410.3 above).

Obligation to Disclose

410.11 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.

410.12 The only exception to the above rule - paragraph 410.11 - 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.

410.13 Where a member is approached by the police, the Inland Revenue Department, the 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 should be emphasized that, broadly speaking, members are under no general duty to "co-operate" with the authorities by "assisting" in their investigations - unless so expressly authorised by their clients or required to do so by law. Accordingly, if thus approached, the member should state that he is not in a position to discuss his client's affairs. In these circumstances it is advisable for members to seek legal advice to clarify the legal aspects of their positions.

410.14 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. Generally speaking, unless the notice is addressed to the member, the member should assume that he is under no legal requirement to produce the documents to anyone

except his client, and that he would be acting contrary to his fiduciary duties to his client to do so.

410.15 Likewise, if the notice requires the giving of information (rather than the production of documents) the considerations set out in paragraph 410.14 will generally apply.

410.16 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.

Freedom to Disclose

410.17 As the duty of confidentiality is not absolute, there will be circumstances where a member is free to disclose defaults or unlawful acts, either because there is some obligation which overrides the duty of confidence (examples are statutory notices referred to in paragraph 410.11), or it is in the member's own interests to make the disclosure.

410.18 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

410.19 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.

410.20 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.

410.21 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.

410.22 With regard to paragraphs 410.20 and 410.21 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

410.23 Fraudulent evasion and attempted evasion of taxes are criminal offences.

410.24 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.

410.25 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

410.26 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

410.27 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 410.28 to 410.47 below.

Taxation Frauds and Negligence Involving Accounts

Presumption as to returns statements and forms submitted by one person on behalf of another

410.28 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

410.29 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 410.8 to 410.18 above).

410.30 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.

410.31 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, but he is under no legal duty to furnish details of the reasons why the accounts are defective and normally it would be improper for him to do so without first obtaining the client's consent. (For the circumstances in which he could do so see paragraphs 410.8 to 410.18 above). Although members are normally under no legal duty to furnish such information to the Inland Revenue Department, attention is drawn to sections 51(4) and 51B of the Inland Revenue Ordinance. Under these sections the Inland Revenue Department may require members to furnish such 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.

Accounts currently being prepared or audited

410.32 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).

410.33 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, no further legal duty rests on the member and he has no responsibility towards the Inland Revenue Department and no authority to give information. It would normally be improper for him to do so unless the Inland Revenue Department invokes section 51(4) or 51B of the Inland Revenue Ordinance. (For the circumstances in which he could do so see paragraphs 410.8 to 410.18 above).

410.34 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 410.28).

(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 direct responsibility towards the Inland Revenue Department and no authority to give any information. 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. The Inland Revenue Department may however invoke section 51(4) or 51B of the Inland Revenue Ordinance to obtain relevant information from members. (For a discussion of the circumstances in which he may do this see paragraphs 410.8 to 410.18 above).

(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.

410.35 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

410.36 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 410.33 to 410.35 would then apply.

Taxation Frauds and Negligence not Involving Accounts

410.37 Paragraphs 410.28 to 410.36 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 further duty and it would normally be improper for him to make any disclosure to the Inland Revenue Department. (For the circumstances in which disclosure may be justified see paragraphs 410.8 to 410.18 above). 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, but he is under no

duty to give further details and it would normally be improper for him to do so without first obtaining the consent of the client. (For the circumstances in which he could do so see paragraphs 410.8 to 410.18 above).

In the case of either a or b above, the Inland Revenue Department may invoke section 51(4) or 51B to obtain such further details as may be relevant.

General Professional Duty to Give Guidance

410.38 The advice given in preceding paragraphs is in no way intended to assist a member to shield a client from the consequences of having defrauded the Crown of tax, or of having been negligent in regard to tax matters. 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.

410.39 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.

410.40 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.

410.41 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 and such as to safeguard his own position and reputation. It is to this position that the whole of this section is directed.

Statutory Provisions Relating to Disclosure of Information

410.42 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.

410.43 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.

410.44 As indicated in paragraphs 410.31 and 410.37b 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. Subject thereto, a member normally ought not to take any independent action that may bring the affairs of a client under the scrutiny of the Investigation Section of the Inland Revenue Department without first obtaining the consent of the client. This point can be of considerable

importance 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 professional relationship between a member and his client is normally such as to debar a member from co-operating in this way with the Department and his proper course in such circumstances is so to inform the Department. (For a discussion of the circumstances in which a member would be justified in an action see paragraphs 410.8 to 410.18 above).

Members' Working Papers

410.45 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 410.42 and 410.43 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 410.8 to 410.18 above).

410.46 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.

410.47 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 (for the circumstances in which he could do so see paragraphs 410.8 to 410.18 above) but the client is not in a position to instruct him to do so. Even if the client's consent is obtained, it would not place the member under any obligation to the Inland Revenue Department as it could in no way affect his right to maintain the privacy of his own property. Subject to these fundamental considerations, the opinion of the Council on the items listed in the preceding paragraph is as follows:

(a) with regard to the analyses, schedules and correspondence referred to in paragraph 410.46 (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 410.46 (d) and (e) may well be of a highly confidential nature. They should not be produced to the Inland Revenue Department unless the accountant considers there are exceptional circumstances, in which event he should if possible obtain his client's authority covering the specific documents which it is desired to produce and before doing so should advise his client to seek legal advice if there is any doubt as to the wisdom of

giving such authority. If his client will not give his authority the accountant will seldom be justified in producing the papers to the Inland Revenue Department. (For the circumstances in which he may do so see paragraphs 410.8 to 410.18 above).

Other Taxes and Duties

410.48 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 410.23 to 410.26 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 410.29 to 410.41 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.

Special Areas

Special Points in Connection with Companies

410.49 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 Revenue 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 Revenue the advice should be given to the directors.

Qualifications in the Auditor's Report

410.50 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.

410.51 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 440 "Changes in a Professional Appointment" for further guidance.

410.52 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

410.53 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

410.54 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 410.29 to 410.31 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 would need in some circumstances to consider whether he should inform the relevant Stock Exchanges of what he had discovered. Before making any such communication, therefore, 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

410.55 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 Revenue he should confine his reply to a statement that he has been removed from office at general meeting called specially for that purpose and that the enquiries should accordingly be addressed to the company.

Companies in Liquidation

410.56 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.

410.57 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. A member who is approached in this way need not give to the police any information obtained in the course of his professional duties and normally he should not do so unless he has the permission of the liquidator (the liquidator being the person who could exercise the right of the company to release the auditor from his duty of confidence). But such a release should not normally be sought by the member. His 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. There may, however, be exceptional circumstances in which a member would be justified in giving assistance or information without referring to the liquidator. (For a discussion of these circumstances see paragraphs 410.8 to 410.18 above).

410.58 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

410.59 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.

410.59A 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.

410.59B 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 410.59 and 410.59A in relation to an associated body corporate of the company.

Special Points In Connection with Sole Traders and Partnerships

410.60 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.

410.61 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, in doing so he would of course not pass on information which he does not believe to be correct or which he knows to be incorrect.

410.62 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 410.29 to 410.31. 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 410.54(c).

Special Points in Connection with Independent Commission Against Corruption Investigation Procedures

410.63 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

410.64 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

410.65 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

410.66 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

410.67 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

410.68 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, urge his client to report the offence to the ICAC. If the client fails to do so, then the member should review his position having regard to paragraphs 410.8 to 410.18 above.

410.69 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

410.70 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.

410.71 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

410.72 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.

410.73 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

410.74 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

410.75 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

410.76 Members should familiarise themselves with the provisions of section 25 of the Drug Trafficking (Recovery of Proceeds) Ordinance and in particular with subsection (1).

410.77 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.

410.78 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

410.79 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 the Institute's Statement 1.207 "Changes in a Professional Appointment" 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 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.

410.80 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) where a member has unconfirmed suspicion but no actual knowledge that the client has defrauded the Inland Revenue Department or been guilty of some other unlawful act or default, no general rule can be laid down as to whether and if so in what detail he should communicate his suspicion to a prospective successor who communicates with him. It must rest with the individual member in the particular circumstances of the case to determine what he considers to be a proper course. Where, however, there has been failure or refusal by the client to supply the member with information required by him for the performance of his duties, he should in any event so inform a prospective successor who communicates with him;

(e) 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 statements of the Council of 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;

(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.

410.81 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.

Prosecution of a Client or Former Client

410.82 It follows from paragraphs 410.8 to 410.18 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, Independent Commission Against Corruption 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. A member should therefore be careful, and if time allows seek legal advice, before volunteering any such information. If he is requested to give information he should discover from the person requesting the information whether or not he has a statutory right to demand it. Unless it is clear that there is statutory authority for the request and that the member is bound to give the information the member would be wise to decline to do so until he has obtained his client's authority to give the information or has consulted his solicitor and been advised that he should give the information whether or not his client consents. He should state that in the meanwhile he is not in a position to discuss his client's affairs.

410.83 A member should not normally appear in Court as a witness for the Crown 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.

410.84 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 411

Unlawful Acts or Defaults by or on Behalf of a Member's Employer

This section should be read in conjunction with Section 140 "Confidentiality".

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

411.1 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.

411.2 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 consider reporting the matter to non-executive directors 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. Guidance is provided below on reporting suspected defaults or unlawful acts to third parties outside the organisation for which he works.

Part 2 - Relations between a Member and His Employer

Disclosure of Information by His Employer to a Member

411.3 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

411.4 There is no general obligation in law for a member who becomes aware that a default or unlawful act has been committed by or on behalf of his employer to disclose what he knows to any third party. Rather 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.

411.5 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.

411.6 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 be free to do so if he wishes and may conclude that it is right to do so in the public interest or for his own protection. Obligation to disclose and freedom to disclose are dealt with at paragraphs 411.7 – 411.8 and 411.9 - 411.13 respectively below.

Obligation to Disclose

411.7 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.

411.8 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.

Freedom to Disclose

411.9 A member is free to disclose information, whatever its nature, where that freedom is expressly provided by statute (see paragraphs 411.15 and 411.16 below) or where disclosure is authorised by the employer either expressly or by implication. A member is also free to disclose information which would otherwise be confidential, where such disclosure is justified in the public interest or required for the protection of the member's own interest. These two exceptions are discussed in paragraphs 411.10 to 411.11 below.

Disclosure in the Public Interest

411.10 In certain circumstances information which would otherwise be confidential, will cease to be so if the information is such that disclosure is justified in the "public interest", for example, where the employer has committed or proposes to commit a crime, fraud or misdeed. Whilst it is a concept recognised by the courts, no definition of "public interest" has ever been given by the courts.

This state of the law leaves the member with a difficult decision as to whether matters which he may wish to disclose are subject to a duty of confidentiality or whether that duty has ceased because their disclosure is justified in the public interest. It is, in any case, clear that these exceptions to the duty of confidentiality cover only disclosure to "one who has a proper interest to receive the information" [Per Denning LJ in Initial Services v Putterill, 1968]. The proper authorities may, for example, be the police, the Department of Trade and Industry or a regulatory body, and will depend upon the particular circumstances. Where information is relevant to the auditor's performance of his duties, disclosure to the auditor may be appropriate.

Matters which should be taken into account when considering whether or not disclosure is justified in the public interest include the following which are not meant to be exhaustive:

- the relative size of the amounts involved and the extent of the likely financial damage;
- whether members of the public are likely to be affected;
- the possibility of likelihood of repetition;
- the reasons for the employer's unwillingness to disclose the matters to the proper authority;
- the gravity of the matter; and
- any legal advice obtained.

Bearing in mind the profession's widely perceived role in upholding the public interest, members need to weigh the public interest in maintaining confidentiality against the public interest in disclosure to the proper authority. Determination of where the balance of public interest lies will require very careful consideration and it will often be appropriate before making a decision to take legal advice or to consult the Institute's Registrar. A record should be kept of any advice or authority received from a member's employer as well as of any legal or other advice obtained in the course of deciding whether or not to disclose information.

Disclosure for the Protection of the Member's Own Interest

411.11 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

411.12 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 410 and Statement 1.301.)

411.13 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

411.14 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 will not ordinarily be at liberty to comply with the bodies' requests without his employer's consent. A member who is in any doubt as to the position should consult the Institute's Registrar or take legal advice promptly.

Prosecution of an Employer or Former Employer

411.15 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 act with caution. He should ascertain whether or not the person requesting information has a legal right to demand it, and unless obliged to give the information by court order or some statutory authority should decline to do so unless he has the authority of his employer or former employer, or is so advised by an independent legal or professional adviser.

Part 3 - Members' Own Relations with Authorities and Third Parties

Criminal Offences

411.16 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.

411.17 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.

411.18 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.

411.19 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).

411.20 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.

411.21 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

411.22 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 420

Use of Designations and Institute's Logo

This section should be read in conjunction with Section 150 "Professional Behaviour".

Use of Designations

Designations of Certified Public Accountant

Certified Public Accountant

420.1 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).

420.2 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.

420.3 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

420.4 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.

420.5 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

420.6 Under the PAO, the use of the description "Certified Public Accountant (Practising)" is restricted to a certified public accountant holding a practising certificate.

420.7 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

420.8 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

420.9 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

420.10 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.

420.11 Guidelines on the use of the logo of the Institute are available on the Institute's website.

SECTION 430

Ethics in Tax Practice

This section should be read in conjunction with Section 200 "Introduction" to Professional Accountants in Public Practice.

Fundamental Principles

430.1 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 100 "Introduction and Fundamental Principles", paragraphs 100.4 and expanded upon in the rest of the Code.

Development of the Fundamental Principles

430.2 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.

430.3 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.

430.4 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.

430.5 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.

430.6 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) give no further information to the authorities without the consent of the client, unless required to do so by law.

430.7 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.

430.8 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.

430.9 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. Normally, the member is not obligated to inform the Inland Revenue Department, nor may he do so without his client's permission.

(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 and should give no further information to the authorities without the consent of the client, unless required to do so by law.

SECTION 431

Corporate Finance Advice

This section should be read in conjunction with Section 200 "Introduction" to Professional Accountants in Public Practice.

Introduction

431.1 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").

431.2 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.

431.3 Failure to follow such guidance does not of itself necessarily constitute misconduct, but means that 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.

431.4 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.

431.5 A definition of corporate finance activities is set out in Annex I.

Objectivity and Integrity

431.6 Section 110 "Integrity", Section 120 "Objectivity" and Section 290 "Independence – Assurance Engagements" include the guidance on integrity, objectivity and independence for members which is applicable to corporate finance activities.

431.7 Subject to paragraph 431.6 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

431.8 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.

431.9 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

431.10 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".)

431.11 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.

431.12 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.

431.13 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

431.14 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.

431.15 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.

431.16 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.

431.17 A firm should not act or continue as lead adviser for two or more clients if the disclosure called for in paragraph 431.16 would materially prejudice the interests of a client.

431.18 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).

431.19 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.

431.20 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.

431.21 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

431.22 Where a firm acts or continues to act for two or more clients following disclosure in accordance with paragraph 431.16, 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.

431.23 Any decision on the part of a sole practitioner should take account of the fact that the safeguards at (a) to (c) of paragraph 431.22 will not be available to him. Similar considerations apply to a small practice.

Documents for Client and Public Use/Confidentiality

431.24 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 Section 140 “Confidentiality”).

431.25 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.

431.26 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.

431.27 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.

431.28 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.

431.29 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.

431.30 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.

431.31 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)

431.32 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.

431.33 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.

431.34 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.

431.35 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

431.36 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.

431.37 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

431.38 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 431.22 above).

431.39 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

431.40 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 431.22 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)

431.41 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 431.22 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

431.42 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

431.43 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.

431.44 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

431.45 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.

431.46 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.

431.47 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

431.48 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 431

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 431

Guidance Note

Compliance with the Hong Kong Takeovers and Share Repurchase Codes

(see paragraph 431.32 of Section 431)

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 431 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 440

Changes in a Professional Appointment

This section should be read in conjunction with Section 210 "Professional Appointment".

The Statement

Preamble

440.1 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.

440.2 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

440.3 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.

440.4 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.

440.5 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.

440.6 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.

440.7 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.

[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.

440.8 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

440.9 The same principles apply in respect of changes of appointment for all other recurring professional work.

440.10 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

440.11 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 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. 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.

440.12 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 440.2 to offer full co-operation to the member carrying out the new assignment.

Audit Appointments

440.13 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.

440.14 The client has an indisputable right to choose its auditors and other professional advisors and to change to others if it so decides.

440.15 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.

440.16 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.

440.17 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.

440.18 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.

440.19 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.

440.20 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 440.13, 440.14 and 440.17, 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.

440.21 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.

440.22 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.

440.23 Where an existing auditor believes but cannot be certain that the client or its directors or servants may have been guilty of some unlawful act or default, or that any aspect of the conduct of the client or its directors or servants which is relevant to the carrying out of an audit ought to be investigated, he should impart his belief to a proposed new auditor who communicates with him in accordance with this section.

440.24 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.

440.25 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.

440.26 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.

440.27 [Not used]

440.28 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

440.29 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

440.30 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

440.31 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

440.32 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

440.33 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

440.34 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

440.35 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.

440.36 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

440.37 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 38-42 contain a non-exhaustive summary of the relevant provisions.

440.38 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.

440.39 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.

440.40 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.

440.41 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.

440.42 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.

440.43 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 441

Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong

This section should be read in conjunction with Section 210 "Professional Appointment".

441.1 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.

441.2 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.

441.3 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.

441.4 This section should be read in conjunction with Section 210 "Professional Appointment" and Section 440 "Changes in a Professional Appointment".

441.5 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.

441.6 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.

441.7 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

441.8 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.

441.9 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

441.10 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).

441.11 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.

441.12 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.

441.13 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.

441.14 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.

441.15 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.

441.16 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.

441.17 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 440 "Changes in a Professional Appointment", the outgoing auditors can refer the incoming auditors to their Letter of Resignation or Termination.

The Incoming Auditors

441.18 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.

441.19 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

441.20 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.

441.21 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.

441.22 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.

441.23 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 441.22 above. However, it should be noted that such an approach should not unduly delay the listed issuer's announcement of the change of auditors.

441.24 If the outgoing auditors write in accordance with paragraph 441.22 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.

441.25 The outgoing auditors should note that if they were to report those matters to the SEHK, there might be a breach of confidentiality.

441.26 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 450

Practice Promotion

This section should be read in conjunction with Section 250 "Marketing Professional Services".

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

450.1 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.

450.2 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.

450.3 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.

450.4 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

450.5 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.

450.6 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").

450.7 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.

450.8 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

450.9 The general principles set out in this Part must be observed in respect of any practice promotion activities.

450.10 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.

450.11 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.

450.12 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.

450.13 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

450.14 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).

450.15 An advertisement should be clearly identified as such.

450.16 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.

450.17 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”.

450.18 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.

450.19 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

450.20 This Part sets out prohibitions and restrictions on the use of certain media for practice promotion activities including publicity and advertising.

450.21 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

450.22 Except as permitted by paragraph 450.23 below, members should not mail, deliver or send directly or indirectly (whether by mail, fax, electronic mail or other means) material promoting their services.

450.23 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

450.24 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

450.25 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 460

Clients' Monies

This section should be read in conjunction with Section 270 "Custody of Client Assets".

The Statement

460.1 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

460.2 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.

460.3 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.

460.4 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.

460.5 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 460.7 below.

460.6 Save as referred to in paragraph 460.5 above, no monies other than clients' monies should be paid into a client account.

460.7 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.

460.8 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.

460.9 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.

460.10 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 460.4. 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.

460.11 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.

460.12 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.

PART E – SPECIALIZED AREAS OF PRACTICE

SECTION 500
PROFESSIONAL ETHICS IN LIQUIDATION AND INSOLVENCY
(EFFECTIVE ON 1 APRIL 2012)
CONTENTS

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 Part A of the Code of Ethics for Professional Accountants ("the Code").

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 under paragraph 100.5 of this Code. The five fundamental principles are:

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

(b) *Objectivity* – to not allow bias, conflict of interest or undue influence of others to override professional or business judgements

(c) *Professional Competence and Due Care* – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques, and 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 and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the insolvency practitioner or third parties.

(e) *Professional Behaviour* – to comply with relevant laws and regulations and avoid any action that discredits 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 100.6 to 100.11 of this 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 section 250 of the Code "Marketing Professional Services" and section 450 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.

STATEMENT 1.303

GENERAL GUIDANCE
RESTRICTIONS ON APPOINTMENTS AS SECRETARIES AND DIRECTORS OF AUDIT CLIENTS

(Issued August 1999; revised September 2004 (name change); revised May 2015)

1. The Companies Ordinance provides, at section 393(2) that:

"The following are disqualified for appointment as auditor of a company under this Subdivision -

(a) a person who is an officer or employee of the company;

(b) a person who is a partner or employee of a person mentioned in paragraph (a);

(c) a person who –

(i) is, by virtue of paragraph (a) or (b), disqualified for appointment as auditor of any other undertaking that is a subsidiary undertaking, or a parent undertaking, of the company or is a subsidiary undertaking of that parent undertaking; or

(ii) would be so disqualified if the undertaking were a company"

2. Section 2 of the Companies Ordinance states that officer, in relation to a body corporate, includes a director, manager or company secretary of the body corporate. Section 2 also states that manager, in relation to a company –

(a) means a person who performs managerial functions in relation to the company under the directors' immediate authority; but

(b) excludes –

(i) a receiver or manager of the company's property; and

(ii) a special manager of the company's estate or business appointed under section 216 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32).

Therefore, an individual cannot hold the posts of auditor and secretary to a company. Furthermore, an individual who is a partner in a firm of certified public accountants (practising) cannot hold the post of auditor to a company if one of his fellow partners is also acting as secretary to that company.

3. A director has a duty of care and a direct control over the administration of a company. Hence, the professional independence of a member may be impaired if he is acting both as a director and an auditor of a company.

Accordingly, no partner or employee of a firm of certified public accountants (practicing) or director or employee of any of its controlled or affiliated companies can be a director of a company which is audited by that firm. Neither can a limited liability company controlled by or affiliated in any way with a firm of certified public accountants (practicing) serve as a director in any way of a company which is audited by the firm.

4. The restrictions in (2) and (3) above refer to partners of a firm of certified public accountants (practising), and they apply equally to directors of a corporate practice.