



MEMBERS' HANDBOOK

Update No. 168

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Document Reference and Title

Instructions

Explanations

VOLUME III

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Discard HKSA 315 (Clarified) revised in July 2012.

Superseded by HKSA 315 (Revised)

HKSA 610 (Clarified) *Using the Work of Internal Auditors*

Discard HKSA 610 (Clarified) revised in May 2013.

Superseded by HKSA 610 (Revised 2013)

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Note:

1. PN 740 has been revised as a result of the Listing Rules amendments relating to continuing connected transactions published by The Stock Exchange of Hong Kong Limited in March 2014. These amendments were made to implement proposals in the consultation conclusions on "Review of Connected Transaction Rules" and "Proposed Changes to Align the Definitions of Connected Person and Associate in the Listing Rules". These amendments came into effect on 1 July 2014.

There is no material change in the reporting requirements of PN 740 except for the changes in the reference numbers and wordings of the revised Main Board Listing Rules and GEM Listing Rules. The revised PN 740 is effective upon issue.



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

PRACTICE NOTE 740

AUDITOR'S LETTER ON CONTINUING CONNECTED TRANSACTIONS UNDER THE HONG KONG LISTING RULES

*(Issued June 2010; revised April 2015;
Effective upon issue)*

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AUDITOR'S LETTER ON CONTINUING CONNECTED TRANSACTIONS UNDER THE HONG KONG LISTING RULES

The purpose of Practice Notes issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is to assist the auditor in applying Hong Kong Engagement Standards of general application to particular circumstances and industries.

Practice Notes are persuasive rather than prescriptive. However they are indicative of good practice and have similar status to the explanatory material in Hong Kong Engagement Standards. This Practice Note provides guidance to assist the auditor to fulfill the objectives of the engagement. The auditor should be prepared to explain departures when called upon to do so.

Introduction

1. The purpose of this Practice Note is to provide guidance to auditors as to their responsibilities and procedures when an auditor is engaged by a Hong Kong listed issuer to report on continuing connected transactions pursuant to Chapter 14A of the Main Board Listing Rules or Chapter 20 of the GEM Listing Rules issued by The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The term "auditor" is used throughout this Practice Note, not because the auditor is performing an audit function but because engagements to issue a letter under Chapter 14A of the Main Board Listing Rules or Chapter 20 of the GEM Listing Rules on continuing connected transactions is expected to be performed by the same independent auditor who audited the annual financial statements of the entity. This Practice Note primarily addresses the significant issues commonly encountered by the auditor when undertaking the engagement and summarises the principal matters which should be taken into consideration by the auditor when designing, carrying out, and evaluating the outcome of, his procedures.
2. Chapter 14A of the Main Board Listing Rules and Chapter 20 of GEM Listing Rules set out a number of requirements in respect of connected transactions which are intended to ensure that when the listed issuer enters into connected transactions, the interests of shareholders as a whole are taken into account by a listed issuer and to provide certain safeguards against a listed issuer's directors, management and substantial shareholders (or their associates) taking advantage of their positions. Amongst other things, the Listing Rules require certain continuing connected transactions be approved by independent shareholders, reviewed by independent non-executive directors ("INEDs"), and be subject to reporting and announcement requirements. In particular, Main Board Listing Rule 14A.56 and GEM Listing Rule 20.54 require that each year, a listed issuer should request its auditor to issue a letter in respect of continuing connected transactions. Main Board Listing Rule 14A.71(6)(b) / GEM Listing Rule 20.69(6)(b) requires that the listed issuer's board of directors must state in the annual report whether its auditor has confirmed the matters stated in Main Board Listing Rule 14A.56 / GEM Listing Rule 20.54.
3. It should be borne in mind that the definition of "connected person" in accordance with the Listing Rules is different from the definition of "related party" as set out in Hong Kong Accounting Standard 24 (Revised) ("HKAS 24") "Related Party Disclosures". However, there are many similarities in the issues associated with related parties and connected persons.
4. Related party / connected person relationships and transactions are often a common feature of commerce and business. Related party / connected person relationships could also have an effect on an entity's financial and operating policies. An entity may enter into transactions with related parties / connected persons that any other third party would not and that could have a material effect on the entity's performance and financial position. Related party / connected person relationships may also give rise to higher risk of management and substantial shareholders taking advantage of their position and not acting in the interests of minority shareholders.

5. An auditor undertaking an engagement with reference to this Practice Note would undertake a limited assurance engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" ("HKSAE 3000") to enable him to express a conclusion whether, on the basis of the work undertaken, anything has come to the auditor's attention that causes the auditor to believe that the matters in respect of which he is required to report (as more fully explained in this Practice Note) have not been complied with, in all material respects.
6. This Practice Note has been prepared to give guidance in respect of such a limited assurance engagement undertaken in accordance with HKSAE 3000. The auditor makes inquiries, and performs analytical and other review procedures in order to reduce to a moderate level the risk of expressing an inappropriate conclusion when the information in respect of the disclosed continuing connected transactions is materially misstated in the listed issuer's annual report.
7. The objective of an engagement undertaken with reference to this Practice Note differs significantly from that of an audit conducted in accordance with Hong Kong Standards on Auditing (HKSAAs). An engagement under this Practice Note does not provide a basis for expressing an opinion on whether the continuing connected transactions disclosed in the listed issuer's annual report give a true and fair view, or are presented fairly, in all material respects, in accordance with an applicable financial reporting framework or whether the listed issuer has complied with all the applicable requirements of the Listing Rules in respect of continuing connected transactions.
8. This Practice Note has been prepared in consultation with the Stock Exchange and staff at the Hong Kong Securities and Futures Commission (SFC) and is based on the Stock Exchange's Listing Rules effective from 1 July 2014. A summary of relevant Listing Rules is set out in Appendix 1 to this Practice Note.

Directors' responsibilities

9. The directors of a listed issuer are responsible for the identification of all connected transactions, including continuing connected transactions, the disclosures of connected transactions in the listed issuer's annual report, obtaining the independent shareholders' approval for connected transactions where required, and the listed issuer's compliance with the Listing Rules and relevant laws and regulations.
10. The directors are responsible for ensuring that the listed issuer has appropriate internal controls in place over the identification, recording, authorization and reporting of all connected transactions. This responsibility means that the listed issuer should implement adequate internal controls to ensure that connected persons as well as all transactions with connected persons are appropriately identified in the listed issuer's information system; and to prevent and detect fraud and error.
11. When the listed issuer engages its auditor to report on continuing connected transactions pursuant to the Listing Rules, the listed issuer is responsible for ensuring the auditor is granted sufficient access to records of the listed issuer and the connected persons pursuant to the Main Board Listing Rule 14A.58 / GEM Listing Rule 20.56.
12. Under Main Board Listing Rule 14A.59 / GEM Listing Rule 20.57, a listed issuer must promptly notify the Stock Exchange and publish an announcement if the INEDs and / or the auditor cannot confirm the matters required under the Main Board Listing Rules 14A.55 and / or 14A.56 or GEM Listing Rules 20.53 and / or 20.54. The Stock Exchange may require the listed issuer to re-comply with the announcement and shareholders' approval requirements and may impose additional conditions.

13. Main Board Listing Rule 14A.57 / GEM Listing Rule 20.55 requires that a copy of the auditor's letter on continuing connected transactions must be provided to the Stock Exchange at least 10 business days before the bulk printing of the listed issuer's annual report. The listed issuer's directors are responsible for ensuring that the auditor is provided on a timely basis with the information the auditor requires to enable the letter to be issued in accordance with the Stock Exchange's timeline. For example, under paragraph 49 of this Practice Note, when a listed issuer engages its auditor to issue a letter with reference to this Practice Note, the auditor should obtain a representation letter from the listed issuer's directors. If the listed issuer needs to convene a board meeting to approve and issue that representation letter, the listed issuer should schedule the board meeting sufficiently ahead of the date of bulk printing of the annual report to take account of the Stock Exchange's timeline for receipt of the auditor's letter. The listed issuer's directors are also responsible for providing the auditor's letter to the Stock Exchange.
14. Under Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53, the INEDs are responsible for reviewing, and confirming in the annual report whether the continuing connected transactions have been entered into:
 - (a) in the ordinary and usual course of business of the listed issuer's group;
 - (b) on normal commercial terms or better; and
 - (c) according to the agreement governing them on terms that are fair and reasonable and in the interests of the listed issuer's shareholders as a whole.
15. If the INEDs are unable to issue an unmodified confirmation required by Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53, the listed issuer is required under Listing Rule 14A.59 / GEM Listing Rule 20.57 to promptly notify the Stock Exchange and publish an announcement. In such circumstances, the auditor should discuss with the INEDs and management and consider the implications on his work and letter.

Auditor's responsibilities

16. When reporting on continuing connected transactions pursuant to Chapter 14A of the Main Board Listing Rules or Chapter 20 of the GEM Listing Rules, the auditor would normally perform his work with reference to this Practice Note and the related engagement terms agreed between the listed issuer and the auditor. In this respect, the auditor should plan the engagement so that it will be performed effectively. The auditor should discuss with management the timing of the provision of the required information in order to allow sufficient time for the auditor to complete his work for the purpose of issuing his letter within the Stock Exchange's timeline.
17. The auditor should consider procedures performed during the course of the audit of the listed issuer's financial statements for the same period in respect of related party transactions, and considers the outcome of those procedures to the extent that they are relevant to his engagement to report on continuing connected transactions.
18. When carrying out his work with reference to this Practice Note, the auditor would carry out his work as a limited assurance engagement. The auditor should comply with the HKICPA's Code of Ethics for Professional Accountants and implement quality control procedures. The ethical requirements govern the auditor's professional responsibilities in the following areas: independence, integrity, objectivity, professional competence and due care, confidentiality, professional behavior, and technical standards. The elements of quality control that are relevant to an individual engagement include leadership responsibilities for quality on the engagement, ethical requirements, acceptance and continuance of client relationships and specific engagements, assignment of engagement teams, engagement performance, and monitoring.

19. The auditor reports on the continuing connected transactions that are disclosed in the annual report and should exercise his professional judgment as to the scope and extent of procedures necessary. Main Board Listing Rule 14A.56 / GEM Listing Rule 20.54 contemplates that when reporting on continuing connected transactions the auditor issues a letter addressed to the listed issuer's board of directors.

General considerations

Completeness of identification of connected persons and transactions

20. Normally there are inherent limitations and a degree of uncertainty associated with assertions regarding the identification of all connected persons and completeness of transactions with connected persons. The procedures identified in this Practice Note will provide a sufficient appropriate basis for the auditor to issue the form of letter contemplated in this Practice Note in the absence of any circumstance identified by the auditor that:
- (a) increases the risk of material misstatement beyond that which would ordinarily be expected; or
 - (b) indicates that a material misstatement of disclosed continuing connected transactions has occurred.

Where there is any indication that such circumstances exist, the auditor should perform modified, extended or additional procedures as are appropriate in the circumstances.

21. An engagement performed with reference to this Practice Note cannot be expected to detect all continuing connected transactions.
22. The auditor's letter would include a paragraph explaining the inherent limitations of the auditor's work in determining whether the information provided by the directors in respect of continuing connected transactions includes all continuing connected transactions. Instead, the auditor's work covers those continuing connected transactions that have been identified by the directors. In this regard, the auditor would obtain the directors' written representations as to the completeness of the continuing connected transactions identified by the listed issuer.
23. Notwithstanding the inherent limitations typically encountered by auditors as to the completeness and identification of continuing connected transactions and the fact that auditors are not required by this Practice Note to confirm such matters, if an auditor becomes aware of any specific circumstances arousing suspicion that continuing connected transactions have not been identified or have been omitted from disclosure, whether deliberately or otherwise, the auditor assesses the implications and considers appropriate actions that he should take.
24. The auditor should give consideration to the listed issuer's internal controls in place to identify additional connected persons or additional connected transactions arising during the period, for example, due to acquisitions of new subsidiaries during the period or changes to the counterparties of the continuing connected transactions.
25. Main Board Listing Rule 14A.10 / GEM Listing Rule 20.09 states that the Stock Exchange will not normally treat a PRC Governmental Body (see definition in Main Board Listing Rule 19A.04 / GEM Listing Rule 25.04) as a connected person. The Stock Exchange may request a listed issuer to explain its relationship with a PRC Governmental Body and why it should not be treated as a connected person. If the Stock Exchange decides to treat the PRC Government Body as a connected person, the listed issuer must comply with any additional requirements requested by the Stock Exchange. Therefore, where the listed issuer transacts with other PRC state-owned enterprises and the auditor has any concern as to whether the transactions should be regarded as continuing connected transactions, the auditor should confirm with the listed issuer the extent to which such transactions have been determined by the Stock Exchange to constitute continuing connected transactions. The auditor should also consider obtaining management representations in this regard.

Nature of the engagement to be performed

26. Following discussions between the Stock Exchange, staff at the SFC, and the HKICPA, to satisfy the requirements of the Listing Rules, it is considered appropriate for the auditor to conduct a limited assurance engagement on the continuing connected transactions identified by the listed issuer with reference to this Practice Note. A limited assurance engagement, in contrast to an audit, is not designed to obtain reasonable assurance that the continuing connected transactions disclosed in the listed issuer's annual report are free from material misstatement. A limited assurance engagement consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. When carrying out an engagement under this Practice Note, in addition to making inquiries and performing analytical procedures, the auditor will typically test a sample of transactions.
27. As explained in paragraph 22 of this Practice Note, the auditor's letter on continuing connected transactions is ring-fenced to cover solely those continuing connected transactions that have been identified by management. As also explained in paragraph 23 of this Practice Note, the auditor remains alert for circumstances that may indicate that some continuing connected transactions may have been omitted from disclosure. For example, the auditor considers the connected persons identified by management in light of those disclosed in the relevant previous announcements. Where there are apparent omissions, the auditor inquires as to the reasons and considers management's response and the implications on the contents of his letter.
28. A limited assurance engagement may bring significant matters affecting the disclosed continuing connected transactions to the auditor's attention, but it does not provide all of the evidence that would be required in an audit.

Terms of engagement

29. The auditor and the listed issuer should agree on the terms of engagement.
30. It is in the interests of both the auditor and the listed issuer that the auditor's role in respect of issuing a letter on continuing connected transactions is set out in writing. This may be achieved in a number of ways, for example, by including relevant terms and conditions in the audit engagement letter or by agreeing the terms and conditions in a separate engagement letter that deals specifically with the auditor's reporting on continuing connected transactions.
31. Matters that may be dealt with in the engagement letter include:
 - (a) the objective of the engagement, namely to report on continuing connected transactions disclosed in the listed issuer's annual report;
 - (b) the scope of the engagement;
 - (c) the directors' responsibility for ensuring the completeness and accuracy of disclosures of continuing connected transactions in the listed issuer's annual report and for the listed issuer's compliance with the Listing Rules in respect of continuing connected transactions and relevant laws and regulations;
 - (d) the directors' responsibility for establishing and maintaining effective internal controls relevant to the identification, recording, authorization and reporting of all connected persons and connected transactions, including all continuing connected transactions;
 - (e) the directors' responsibility for making all books and accounts and related information available to the auditor;
 - (f) the directors' agreement to provide written representations to the auditor in respect of continuing connected transactions that the auditor considers to be necessary;
 - (g) the auditor's responsibilities including reference that the auditor will conduct a limited assurance engagement in accordance with HKSAE 3000 and with reference to this Practice Note;

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- (h) the anticipated form and content of the auditor's letter to be issued, including the identity of the addressee of the letter and any restrictions on distribution and disclosure of the letter, as well as any other matters that the auditor believes appropriate to include in the engagement letter; and
- (i) a statement explaining any inherent limitations of the auditor's work (for example, with respect to completeness of continuing connected transactions, as explained in paragraphs 20 - 25 above).

An illustrative engagement letter is set out in Appendix 3 to this Practice Note.

Extent of testing and sampling

- 32. The auditor's understanding of the entity and its environment, including its internal controls, the results of the risk assessments relating to the continuing connected transactions and the auditor's consideration of materiality as it relates to the continuing connected transactions, affects the nature and extent of the inquiries made, as well as the nature and extent of analytical and other procedures.
- 33. For the purpose of addressing the Listing Rules' requirements, the auditor will typically perform tests of a sample of transactions in addition to making inquiries and applying, where relevant, analytical procedures. The auditor decides which means or combination of means, to be used for the determination of the number of items for testing and the selection of items for testing, based on his assessment of the risk of material misstatement in the context of the nature of the engagement and the matters to be addressed in his letter.
- 34. The extent of testing and the selection of items for testing should be solely determined by the auditor.

Materiality

- 35. Materiality should be considered by the auditor when determining the nature, timing and extent of his procedures; and evaluating the effect of misstatements. A matter in respect of continuing connected transactions is material if its omission or misstatement could reasonably be expected to influence the decisions of the users of the information disclosed. Materiality is considered in the context of quantitative factors such as relative magnitude and qualitative factors. This would include considering the nature and extent of the effect of these factors on the evaluation or measurement of the continuing connected transactions, and the interests of, for example, minority shareholders (whose interests the Main Board Listing Rules Chapter 14A / GEM Listing Rules Chapter 20 is intended to help protect). The assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the auditor's judgment.
- 36. For example, a misstatement in the value of continuing connected transactions may be small in terms of the amount. However, if adding the omitted amount to the amounts disclosed results in a breach of the annual cap permitted for the relevant continuing connected transactions, the omission may be material.
- 37. In evaluating whether, on the basis of the work undertaken, anything has come to his attention that causes him to believe that the matters in respect of which he is required to report have not been complied with, in all material respects, the auditor should assess whether the misstatements aggregated by him during the engagement are material, both individually and in aggregate.
- 38. The auditor should consider the concept of materiality in relation to the continuing connected transactions being reported upon. Reporting on continuing connected transactions provides a smaller base against which to measure materiality compared with the financial statements taken as a whole. Consequently, the auditor's procedures will ordinarily be more extensive than if the same disclosures of continuing connected transactions were to be reviewed in connection with a limited assurance report on the entire financial statements.

39. If the auditor has identified a material misstatement, the auditor should communicate the misstatement to the appropriate level of management on a timely basis, and consider the need to report it to those charged with governance.
40. When undertaking his work, in some situations the auditor needs to evaluate the listed issuer's compliance with certain requirements that may not be expressed solely in numerical terms. For example, under Main Board Listing Rule 14A.56(2) / GEM Listing Rule 20.54(2) the auditor evaluates whether prices charged for goods or services delivered to connected persons are in accordance with the pricing policies of the listed issuer's group, and under Main Board Listing Rule 14A.56(3) / GEM Listing Rule 20.54(3), the auditor evaluates whether the continuing connected transactions were entered into in accordance with the relevant agreements. Evaluating compliance with requirements that are not expressed in numerical terms, involves assessing qualitative and often subjective aspects, and for any area of non-compliance, the auditor needs to consider whether it is material and if so, the impact of such non-compliance on his conclusions. Where the auditor identifies areas of non-compliance in respect of these types of terms, for example if say, certain aspects of the price charged were not in compliance with the pricing policies of the listed issuer's group, it may be useful for the auditor to quantify or estimate the financial impact that such non-compliance would have had on the value of the relevant transactions and then using that amount to evaluate whether the non-compliance is material individually or when aggregated with other misstatements, as described in paragraph 37 above.
41. The auditor's conclusions in his report are based on evaluating the matters in the context of what is material and whether anything has come to his attention that causes him to believe that the relevant requirements have not been complied with, in all material respects.

Interaction with the annual audit

42. During the course of the annual audit in accordance with HKSAs, the auditor is required to perform procedures in respect of related parties and transactions as set out in HKSA 550 "Related Parties". The definition of related party as set out in HKAS 24 and the definition of connected person in the Listing Rules are not the same. Nevertheless, many of the issues encountered when considering related party transactions during the course of the audit are broadly similar to those encountered in respect of continuing connected transactions. However, the respective reporting requirements for a listed issuer and its auditor in respect of continuing connected transactions under Main Board Listing Rules Chapter 14A / GEM Listing Rules Chapter 20 are different to those applicable for related party transactions in accordance with Hong Kong Financial Reporting Standards and the audit thereof under HKSAs.
43. The auditor should consider procedures performed and findings on related party transactions arising from his audit of the listed issuer's financial statements when designing, carrying out and evaluating the outcome of his procedures on the listed issuer's continuing connected transactions.

Risks of fraud and error

44. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:
 - (a) Omitting, advancing or delaying recognition of continuing connected transactions that have occurred during the reporting period;
 - (b) Concealing, or not disclosing, facts that could affect the identification of connected persons and the amounts of disclosed continuing connected transactions;
 - (c) Altering records and terms related to significant and unusual continuing connected transactions.

45. The responsibility for the prevention and detection of fraud rests with both those charged with governance of the listed issuer and with management. It is the responsibility of those charged with governance of the listed issuer to ensure, through oversight of management, that the listed issuer establishes and maintains internal controls relevant to continuing connected transactions to provide reasonable assurance with regard to reliability of the disclosure of continuing connected transactions, effectiveness and efficiency of operations of those internal controls and compliance with applicable laws and regulations.
46. Due to the inherent limitations of an engagement performed in accordance with HKSAE 3000 and with reference to this Practice Note, there is an unavoidable risk that some material misstatements of continuing connected transactions will not be detected by the auditor. This is the case even though the engagement is properly planned and performed in accordance with HKSAE 3000 and with reference to this Practice Note.
47. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. These may include, for example, failure by management to disclose to the auditor connected relationships or concealing the true identities of counterparties. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to rely on evidence when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

Skepticism

48. The auditor should plan and perform the engagement to issue his letter on continuing connected transactions with an attitude of professional skepticism, recognizing that circumstances may exist that cause the information to require a material adjustment for it to be prepared and disclosed, in all material respects, in accordance with the applicable requirements of the Listing Rules. An attitude of professional skepticism means that the auditor makes a critical assessment, with a questioning mind, of the validity of evidence obtained and is alert to evidence that contradicts or brings into question the reliability of documents or representations by management of the listed issuer.

Written representations

49. The auditor should obtain representations. Ordinarily a written representation letter should be obtained from the listed issuer's directors confirming that:
 - (a) the company has complied with the applicable reporting, approval and announcement requirements set out in the Listing Rules in respect of the continuing connected transactions;
 - (b) the company has appropriate internal controls over the identification, recording, authorization and reporting of all connected persons and connected transactions, including all continuing connected transactions;
 - (c) they are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud and error and have disclosed to the auditor the following:
 - their knowledge of fraud or suspected fraud affecting the entity involving management, employees who have significant roles in internal controls; or others where the fraud could have a material effect on the books of accounts, records and supporting documentation in respect of the entity's continuing connected transactions.

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- their knowledge of any allegations of fraud or suspected frauds, affecting the entity's books of accounts, records and supporting documentation in respect of the entity's continuing connected transactions communicated by employees, former employees or others.
 - the results of their assessment of the risk that the books of accounts, records and supporting documentation in respect of the entity's continuing connected transactions may be materially misstated as a result of fraud.
- (d) they have made available to the auditor all books of accounts, records and supporting documentation in respect of the entity's continuing connected transactions.
- (e) they have disclosed to the auditor the identity of the entity's connected persons and all the connected relationships and transactions of which they are aware;
- (f) the continuing connected transactions disclosed in the listed issuer's annual report are complete and accurate;
- (g) the continuing connected transactions have been entered into in compliance with the applicable requirements of the Listing Rules;
- (h) the continuing connected transactions have received the approval of the listed issuer's board of directors;
- (i) the continuing connected transactions are in accordance with the pricing policies of the listed issuer's group where the transactions involve the provision of goods or services by the listed issuer's group;
- (j) the relevant agreements governing the continuing connected transactions are in place and the continuing connected transactions have been entered into in accordance with the relevant agreements. No side agreement has been entered into in respect of any transaction, or if there are any side agreements, they have been made available to the auditor;
- (k) the continuing connected transactions have not exceeded the annual cap disclosed in previous announcements;
- (l) the INEDs have confirmed that the transactions have complied with the requirements of the Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53. Where the INEDs have not issued their confirmation prior to the auditor issuing his letter, the auditor should make inquiries as set out in paragraph 53 below; and
- (m) the directors believe the effects of those misstatements aggregated by the auditor during the engagement are immaterial, both individually and in the aggregate, and do not constitute non-compliance with the applicable requirements of the Listing Rules regarding continuing connected transactions. A summary of such misstatements should be included in or attached to the written representations.
50. The auditor may also request other representations where appropriate.
51. Representations by management cannot be a substitute for other evidence that the auditor could reasonably expect to be available. If a representation by management is contradicted by other evidence, the auditor should investigate the circumstances and, when necessary, reconsider the reliability of other representations made by management.
52. An example management representation letter in respect of reporting on continuing connected transactions is illustrated in Appendix 4 to this Practice Note.

53. Pursuant to Main Board Listing Rule 14A.57 / GEM Listing Rule 20.55, a copy of the auditor's letter on continuing connected transactions must be provided by the listed issuer to the Stock Exchange at least 10 business days before the bulk printing of the listed issuer's annual report. However, the INEDs' confirmation under Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53 is not subject to the same reporting deadline. Therefore, situations can arise where the auditor may be requested to issue his letter on continuing connected transactions before the INEDs have completed their review under the Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53. In instances where the INEDs' confirmation has not been issued before the auditor's letter on continuing connected transactions is issued, the auditor makes inquiries of the INEDs (directly or through management) as to whether there are any matters in respect of those representations set out in paragraph 49(l) of this Practice Note identified to date by the INEDs during the course of their review of continuing connected transactions, and considers the implications. In addition, management should be requested to inform the auditor of the issues, if any, identified by the INEDs upon completion of their review and issue of their confirmation so that the auditor may consider the implications of such issues on his letter.

Communication with those charged with governance

54. Ordinarily, the auditor initially discusses matters of governance interest with management, except where those matters relate to questions of management competence or integrity. These initial discussions with management are important in order to clarify facts and issues, and to give management an opportunity to provide further information. If management agrees to communicate a matter of governance interest with those charged with governance, the auditor may not need to repeat the communications, provided that the auditor is satisfied that such communications have effectively and appropriately been made.
55. In light of the INEDs' responsibility for reviewing the continuing connected transactions under Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53, the auditor should consider discussing with the listed issuer's INEDs (directly or through management) the outcome from the INEDs' review of continuing connected transactions. Whilst the scope of the INEDs' review of continuing connected transactions is not the same as the auditor's scope of work, any issues identified by the INEDs may impact on the auditor's risk assessments and procedures. Similarly, any issues noted by the auditor during the course of his work may be of relevance to the INEDs, although the auditor's engagement to issue a letter on continuing connected transactions under this Practice Note is not intended to provide any basis for the INEDs' review and confirmation under Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53. Where the auditor is requested to provide assistance to the INEDs in relation to the INEDs' obligations under Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53, such assistance constitutes a separate engagement.
56. The auditor should also consider discussing with the listed issuer's internal auditor, Audit Committee and any other committee that is responsible for managing and reviewing connected transactions, details of significant matters arising during the engagement performed with reference to this Practice Note.
57. Communicating significant matters arising during an engagement performed in accordance with HKSAE 3000 and with reference to this Practice Note helps the auditor to establish a common understanding with those charged with governance of the nature and resolution of those matters.
58. The auditor should inform those charged with governance of those misstatements aggregated by the auditor during the engagement that were determined by management to be immaterial, both individually and in the aggregate and that were determined by management not to constitute non-compliance with the applicable requirements of the Listing Rules regarding continuing connected transactions.
59. Where appropriate, the auditor may also wish to draw the INEDs' and Audit Committee's attention to the nature of his engagement, the inherent limitations of his work regarding completeness of continuing connected transactions in addition to any other significant matters.

60. The auditor is not required, when carrying out an engagement with reference to this Practice Note, to design procedures for the specific purpose of identifying matters of governance interest. However, during the course of the engagement, the auditor may note weaknesses or breakdowns in internal controls or other matters which he considers to be material and which he considers should be brought to the attention of those charged with governance. These may include, for example, fraud or material errors or non-compliance with laws and regulations. The auditor should also consider their impact on the engagement. Where appropriate, the auditor may provide recommendations for improvement. Examples of significant matters in respect of continuing connected transactions include:
- (a) non-disclosure (whether intentional or not) by management to the auditor of connected persons or significant connected transactions, which may alert those charged with governance to significant connected relationships and transactions of which they may not have been previously aware;
 - (b) the identification of significant connected transactions that have not been appropriately authorized and approved, which may give rise to suspected fraud;
 - (c) non-compliance with the applicable requirements of the Listing Rules regarding connected transactions of which the auditor has become aware.

Specific considerations

61. Under Main Board Listing Rule 14A.56 / GEM Listing Rule 20.54, the listed issuer must engage its auditor to report on continuing connected transaction every year. The auditor must provide a letter to the listed issuer's board of directors confirming whether anything has come to his/ her attention that causes him/ her to believe that the continuing connected transactions:
- (a) have not been approved by the listed issuer's board of directors;
 - (b) were not, in all material respects, in accordance with the pricing policies of the listed issuer's group if the transactions involve provision of goods or services by the listed issuer's group;
 - (c) were not entered into, in all material respects, in accordance with the relevant agreement governing the transactions; and
 - (d) have exceeded the cap.

Some of the foregoing provisions may be interpreted widely. The auditor's normal response and approach when issuing his letter on these matters in accordance with HKSAE 3000 and with reference to this Practice Note are set out below.

Reporting on approval by directors

62. Main Board Listing Rule 14A.56(1) / GEM Listing Rule 20.54(1) requires the auditor to report on whether the continuing connected transactions have been approved by the listed issuer's board of directors.
63. The auditor should obtain appropriate and sufficient evidence that the continuing connected transactions have been formally approved by the listed issuer's board of directors, for example, by inspecting minutes of meetings of the board of directors, or by obtaining written representations issued on behalf of the board or other suitable evidence of approval.

Reporting as to whether transactions complied with the pricing policies of the listed issuer's group

64. Where the listed issuer provides goods or services to a connected person, Main Board Listing Rule 14A.56(2) / GEM Listing Rule 20.54(2) requires the auditor to report on whether such continuing connected transactions are in accordance with the pricing policies of the listed issuer's group. This reporting requirement does not apply in respect of goods / services received by the listed issuer's group from connected persons.

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65. The auditor should make inquiries of management as to whether the continuing connected transactions have complied with the listed issuer's pricing policies. Where management confirms that some or all transactions have not complied with the listed issuer's pricing policies, the auditor should consider the impact on his work and letter. The auditor also considers whether the matter should be discussed with those charged with governance and whether the listed issuer should discuss the non-compliance with the Stock Exchange.
66. In addition to the inquiries described in paragraph 65 above, the auditor's other procedures when considering whether the relevant continuing connected transactions are in accordance with the listed issuer's pricing policies may vary according to the pricing terms of the relevant agreement. This will normally include testing a sample of transactions.
67. Ordinarily for the sample selected, the auditor evaluates (i) whether the price charged for each transaction agrees to the price set out in the relevant agreement and in turn, (ii) whether the price set out in the agreement has been determined in accordance with the listed issuer's pricing policies.
68. Where an agreement or pricing policy contains clear and quantitative pricing terms specifying a standard unit price or standard range of unit prices for the continuing connected transactions, the auditor may compare the price of a sample of transactions against the quantitative pricing terms stated in the agreement or the pricing policy to evaluate whether the actual price charged was in agreement with the pricing terms stated in the relevant document(s).
69. However, difficulties may arise where the relevant agreement and / or pricing policy contains a pricing term which is qualitative or judgmental (for example, if any reference to the price to be charged indicates reference to "market value", "reasonableness" or "arm's length"). There may be insufficient objective criteria for the auditor to evaluate compliance with a qualitative or judgmental pricing term particularly where the relevant goods or services are not of a standard or uniform nature.
70. Although information may be available to indicate how the price of a continuing connected transaction compares to that of a similar transaction with an independent third party, there are ordinarily practical difficulties that limit the auditor's ability to obtain information that all aspects of a connected transaction are equivalent to those undertaken by the listed issuer with an independent third party.
71. Where the pricing terms are not clearly set out in the agreements and / or pricing policy governing the selected continuing connected transactions, the auditor should request management to provide details of comparable transactions undertaken with non-connected persons and seek to establish whether the price charged is consistent with the price charged for comparable transactions as identified by management and in turn how the price charged complies with the relevant agreement and / or the listed issuer's pricing policy. The auditor then reports based on a comparison of the prices charged in respect of the relevant continuing connected transactions with such comparable transactions.
72. When evaluating compliance with the listed issuer's pricing policies, the auditor considers making inquiries of management to understand the factors that have been considered by management in developing and setting the prices, such as the size of purchase, credit term periods and settlement methods and to consider how the approach adopted for setting the prices for the selected continuing connected transactions is consistent with the listed issuer's pricing policies.
73. There may be situations where the pricing term in the relevant agreement or pricing policy is unclear or qualitative or judgmental. For these situations, the auditor may choose to set his expectation of an appropriate price or a range of prices based on the relevant information available in the market and to then compare the expected price against the actual price charged.

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74. If the actual price charged for the transaction is in line with the price estimated by the auditor or falls within the expected range of prices, the price would generally be taken as being in accordance with the listed issuer's pricing policies and the relevant agreement. If the actual price charged is different to the expected price or falls outside the expected range of prices, the auditor evaluates whether the difference can be accepted without further investigation. If not, the auditor carries out further investigation to evaluate whether the difference is due to:
- (a) differences in estimates made by the auditor, in which case the auditor reconsiders his expectation and whether it should be revised by taking into account management's explanation,
 - (b) error in the price charged, in which case the auditor quantifies and includes the error in a summary of misstatements and evaluates it as described in paragraph 37 of this Practice Note, or
 - (c) other reasons, in which case if management is unable to provide a reasonable and valid explanation for the difference or management's explanation cannot be corroborated, the auditor considers whether this may be indicative of fraud or error and / or whether further investigation and additional procedures are required.
75. The investigation carried out by the auditor ordinarily begins with inquiries of management, followed by corroboration of management's responses, for example, by comparing them with the auditor's understanding of the listed issuer and other evidence obtained during the course of the engagement; and consideration of the need to apply other procedures based on the results of such inquiries, if management is unable to provide an explanation or if the explanation is not considered adequate.
76. If the auditor is unable to reach a conclusion after conducting the work with reference to the guidance set out in paragraph 64 to 75 above, he should consider the impact on his letter and should discuss with the listed issuer's management and consider the guidance in paragraphs 97 and 99 below.
77. Under Main Board Listing Rule 14A.55(2) / GEM Listing Rule 20.53(2), it is the INEDs' responsibility (and not that of the auditor) to confirm that the continuing connected transactions were entered into on normal commercial terms or better. Whilst the auditor is not required to conclude or comment on whether or not the continuing connected transactions have been entered into on normal commercial terms or better, the auditor should consider discussing with the INEDs (directly or through management) to consider the INEDs' work and any issues that the INEDs identified during their annual review of continuing connected transactions.
78. The auditor's conclusions as to whether anything has come to his attention that causes him to believe that transactions involving the provision of goods or services were not in accordance with the pricing policies of the listed issuer's group, are drawn in the context of primarily evaluating matters in respect of prices charged and evaluating compliance with the pricing policies of the listed issuer's group in light of the guidance set out in paragraphs 64 to 77 above.

Reporting as to whether transactions were entered into in accordance with the relevant agreement

79. Main Board Listing Rule 14A.56(3) / GEM Listing Rule 20.54(3) requires an auditor's letter to report on whether the continuing connected transactions were entered into in accordance with the relevant agreement governing the transactions.
80. Main Board Listing Rule 14A.34 / GEM Listing Rule 20.32 requires that the listed issuer's group must enter into a written agreement for a connected transaction. Main Board Listing Rule 14A.51 / GEM Listing Rule 20.49 requires that the agreement for the continuing connected transaction must contain the basis for calculating the payments to be made. Main Board Listing Rule 14A.52 / GEM Listing Rule 20.50, requires that the period for the agreement must be fixed and reflect normal commercial terms or better and, except in special circumstances, must not exceed three years.

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81. Depending on the nature of the connected transaction, the relevant agreement governing the transaction may include many terms and conditions to be fulfilled by the parties to the agreement.
82. Some of these, in turn, may need to be fulfilled at different stages as specified in the agreement. It may be difficult for the auditor to assess whether all obligations and terms in the related agreement have been fulfilled. Furthermore, in the case of compliance with technical specifications set out in the relevant agreement that are applicable to a product or service, the auditor may not have sufficient expertise to evaluate whether the technical specifications have been adhered to or, if not, the significance of any non-compliance.
83. The auditor will ordinarily focus his work on confirming with management whether there is an agreement in place governing the continuing connected transactions and whether the actual price charged for the transaction was in line with the pricing terms set out in the agreement. Although paragraphs 64 to 78 deal with prices of goods and services in respect of continuing connected transactions provided by the listed issuer, similar guidance would typically apply when considering whether the price charged for goods and services received by the listed issuer was in accordance with the pricing terms set out in the relevant agreements. Where appropriate, the auditor may consider inquiring of personnel other than those responsible for financial and accounting matters in respect of any non-compliance with technical specifications set out in the relevant agreement, for example, with management responsible for production or engineering staff in the case of technical specifications.
84. The auditor should consider inspecting a sample of transactions to establish whether there is an agreement in place with the connected person with a fixed period and whether the acceptance of delivery of goods or services was supported by documentary evidence. When doing so, the auditor's objective is to obtain prima facie evidence in support of management's representation, but not for the purpose of confirming or reporting on compliance with all contractual matters. In respect of the transactions tested, the principal objective is to consider whether the transactions tested were covered by the agreement and that the relevant good/service envisaged by the agreement was exchanged at the agreed price.
85. For example, if the continuing connected transaction is to sell stainless steel components to the connected person, the auditor may not generally have the level of engineering or technical expertise to identify whether the particular product provided was fully compliant with technical requirements in the relevant agreement if the invoices indicated that "steel components" (rather than stainless steel components) were delivered.
86. For the purpose of an engagement under this Practice Note, it is generally regarded as a reasonable assumption that the right goods / services were delivered if the delivery is supported by a signed delivery note or other written acknowledgement of receipt of the goods / services being in accordance with the relevant agreement. Where such documentary evidence is not available, the auditor considers whether this may indicate non-compliance with the relevant agreement and where he considers necessary, discusses further with management and assesses the implications on the matters to be set out in his letter. However, the absence of documentary evidence does not necessarily mean that the auditor concludes that there has been any non-compliance.
87. In addition, for samples tested, the auditor compares the price of a sample of continuing connected transactions against the quantitative pricing term stated in the agreement to evaluate whether the actual price charged was in agreement with the pricing term stated in the agreement. In instances where the pricing term is qualitative or judgmental, guidance set out in paragraphs 68 to 71 and 73 to 75 relating to assessing whether the price charged was in accordance with the pricing terms set out in the relevant agreements would also apply.
88. The auditor should also confirm with management that no side agreements have been entered into in respect of the continuing connected transactions which have not been made available to the auditor.

89. The auditor's conclusions in his report are primarily based on evaluating whether anything has come to his attention that causes him to believe that there was not an agreement in place governing the transactions and that the prices charged were not, in all material respects, in accordance with the pricing terms set out in the relevant agreements governing such transactions, in light of the guidance set out in paragraphs 79 to 88 above.

Reporting on whether transactions are within the annual cap ("cap")

90. Main Board Listing Rule 14A.56(4) / GEM Listing Rule 20.54(4) requires the auditor to report on whether the continuing connected transactions have not exceeded the cap.
91. The auditor should make inquiries of management to confirm that the continuing connected transactions have not exceeded the relevant cap(s).
92. In addition, the auditor should compare the aggregate amounts of the continuing connected transactions to the respective cap. When doing so, the auditor should confirm with management the relevant previous announcements to confirm the amount of the cap.
93. The auditor should compare the different types of continuing connected transactions disclosed in the relevant previous announcements to those disclosed in the annual report. Where there are apparent omissions from disclosure, the auditor should make inquiries of management and satisfy himself as to the reasons for any apparent omissions (for example, it could be the case that the listed issuer did not subsequently enter into transactions that were originally contemplated).

Reporting

General aspects

94. The auditor should evaluate the results of his procedures in order to form the conclusions in his letter.
95. The auditor's letter is addressed to the listed issuer's board of directors and includes conclusions on the basis of the work undertaken in accordance with HKSAE 3000 and with reference to this Practice Note.
96. The auditor should consider the impact of any matters identified on his work and letter. For example, the auditor should consider whether any matters would preclude the auditor from issuing his letter or whether he may need to modify or qualify any conclusions.
97. The auditor should also consider whether the matter(s) should be discussed with management and / or those charged with governance, and whether the listed issuer should discuss such with the Stock Exchange. For example, the following matters should be considered:
- (a) where the actual price charged of some or all continuing connected transactions was not in agreement with the pricing terms stated in the relevant agreement or the pricing policy of the listed issuer;
 - (b) where the actual price charged of some or all continuing connected transactions was not consistent with the price charged for comparable transactions as identified by management; or
 - (c) where the approach adopted by the listed issuer for setting prices for some or all continuing connected transactions was inconsistent with the approach adopted for other transactions.
98. An example unmodified auditor's letter on continuing connected transactions is set out in Appendix 2 to this Practice Note. However circumstances may arise where the auditor believes that a modified or qualified conclusion is appropriate. This Practice Note does not preclude the auditor from issuing a modified or qualified conclusion.

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99. Under the Main Board Listing Rule 14A.59 / GEM Listing Rule 20.57, a listed issuer must promptly notify the Stock Exchange and publish an announcement if the INEDs and / or the auditor cannot confirm the matters required under the Main Board Listing Rules 14A.55 and / or 14A.56 or GEM Listing Rules 20.53 and / or 20.54. In this respect, reference to the auditor not being able to confirm the matters set out in the Main Board Listing Rule 14A.56 / GEM Listing Rule 20.54 should be evaluated as to whether the auditor would not be able to issue an unmodified letter as envisaged in this Practice Note. The responsibility for determining whether any announcement is required rests solely with the listed issuer's directors. Where a directors' meeting of the listed issuer to approve the management representation letter in respect of the auditor's letter is required to be held, but is scheduled to take place less than 10 business days prior to the bulk printing of the listed issuer's annual report, the auditor may not be able to issue his letter in final form to enable the listed issuer to provide a copy to the Stock Exchange within the Stock Exchange's timeframe. In these circumstances, the listed issuer should consider communicating the potential delay and its best estimate of the expected delivery date of the auditor's letter to the Stock Exchange in writing.
100. The auditor should note that the listed issuer is required to provide a copy of the auditor's letter in respect of continuing connected transactions to the Stock Exchange pursuant to the Listing Rules. In the auditor's letter, the auditor should give his express consent to the letter being supplied to the Stock Exchange.
101. Once the auditor's letter is issued, the auditor has no further direct responsibility to update or actively seek information on events occurring subsequent to the date of the letter. The listed issuer should be requested to inform the auditor of any event occurring subsequent to the date of the auditor's letter that may impact on the letter, prior to the issuance of the listed issuer's annual report. For example, in instances where the INEDs' confirmation has not been issued before the auditor's letter on continuing connected transactions is issued, management should be requested to inform the auditor of the issues, if any, identified by the INEDs upon completion of their review and issue of their confirmation, so that the auditor may consider the implications of such issues on his letter.

References to auditor's letter in the annual report

102. The Main Board Listing Rule 14A.71(6)(b) / GEM Listing Rule 20.69(6)(b) requires that the listed issuer's board of directors must state in the annual report whether its auditor has confirmed the matters set out in the Main Board Listing Rule 14A.56 / GEM Listing Rule 20.54. In this respect, given the nature of the engagement and for better clarity as to the work performed with reference to this Practice Note, generally a suitable disclosure in this respect would be for the listed issuer to include appropriate references in the annual report to the work performed by the auditor. In instances where the auditor's letter is proposed to be modified or qualified, the auditor should remind the listed issuer's directors of their obligations under Main Board Listing Rule 14A.59 / GEM Listing Rule 20.57 to promptly notify the Stock Exchange and to issue an announcement concerning the modification or qualification. Details of the modification or qualification should be disclosed in the annual report. An illustrative example of such a disclosure in instances where the auditor's letter issued does not contain any modification or qualification is set out below.

"The Company's auditor was engaged to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The auditor has issued his unqualified letter containing his findings and conclusions in respect of the continuing connected transactions disclosed by the Group in page [] of the Annual Report in accordance with [Main Board Listing Rule 14A.56][GEM Listing Rule 20.54]. A copy of the auditor's letter has been provided by the Company to The Stock Exchange of Hong Kong Limited."

103. The Main Board Listing Rules 14A.49 / GEM Listing Rules 20.47 require the listed issuer to disclose its connected transactions conducted during the financial year in its annual report and refer to the Main Board Listing Rule 14A.71 and 14A.72 / GEM Listing Rule 20.69 and 20.70 for the content requirements. The auditor should consider whether the disclosures in the annual report are consistent with the information and findings in respect of the continuing connected transactions on which the auditor reports.
104. Whilst any disclosures in the annual report are solely the responsibility of the listed issuer's directors, where the auditor considers that any inappropriate references have been made in respect of his work or conclusions or any incorrect disclosures have been made in respect of the continuing connected transactions, he should discuss with management and if he feels it necessary, with those charged with governance. The auditor's response will depend on the nature of any issue and his view on the extent to which he considers that any reference to him or his work are inappropriate.

Documentation

105. The auditor should prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's conclusions and to provide evidence that the engagement was performed in accordance with HKSAE 3000 and with reference to this Practice Note. The documentation enables an experienced auditor having no previous connection with the engagement to understand the nature, timing and extent of the inquiries made, and analytical and other procedures applied, information obtained, and any significant matters considered during the performance of the engagement, including the disposition of such matters.

Effective date

106. This Practice Note is effective upon issue.

Appendix 1

Summary of relevant Main Board Listing Rules and GEM Listing Rules

Below is a summary of Main Board Listing Rules and GEM Listing Rules that we have referred to in the body of this Practice Note and that are effective from 1 July 2014. This summary is broadly replicated from the Main Board Listing Rules. Although GEM Listing Rules are broadly aligned to Main Board Listing Rules, there may be slight differences between them which should be clear from the summary below.

In all cases, auditors should refer to Chapters 14A and 19A of Main Board Listing Rules / Chapters 20 and 25 of GEM Listing Rules for the original rules in respect of connected transactions, and which The Stock Exchange of Hong Kong Limited may update from time to time.

Main Board
Listing Rule /
GEM Listing
Rule

PRC Governmental Body

14A.10 /
20.09 The Exchange will not normally treat a PRC Governmental Body as a connected person. The Exchange may request a listed issuer to explain its relationship with a PRC Governmental Body and why it should not be treated as a connected person. If the Exchange decides to treat the PRC Governmental Body as a connected person, the listed issuer must comply with any additional requirements requested by the Exchange.

REQUIREMENTS FOR CONNECTED TRANSACTIONS

.....

Written agreement

14A.34 /
20.32 The listed issuer's group must enter into a written agreement for a connected transaction.

.....

Annual reporting

14A.49 /
20.47 The listed issuer must disclose its connected transactions conducted during the financial year in its annual report. See Main Board Listing Rules 14A.71 and 14A.72 / GEM Listing Rules 20.69 and 20.70 for the content requirements.

Requirements for continuing connected transactions

.....

Terms of an agreement

14A.51 /
20.49 A written agreement for a continuing connected transaction must contain the basis for calculating the payments to be made. Examples include sharing of costs incurred by the parties, unit prices for goods or services provided, annual rental for leasing a property, or management fees based on a percentage of the total construction cost.

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14A.52 /
20.50 The period for the agreement must be fixed and reflect normal commercial terms or better. It must not exceed three years except in special circumstances where the nature of the transaction requires a longer period. In this case, the listed issuer must appoint an independent financial adviser to explain why the agreement requires a longer period and to confirm that it is normal business practice for agreements of this type to be of such duration.

.....

Annual review by independent non-executive directors and auditors

14A.55 /
20.53 The listed issuer's independent non-executive directors must review the continuing connected transactions every year and confirm in the annual report whether the transactions have been entered into:

- (1) in the ordinary and usual course of business of the listed issuer's group;
- (2) on normal commercial terms or better; and
- (3) according to the agreement governing them on terms that are fair and reasonable and in the interests of the listed issuer's shareholders as a whole.

14A.56 /
20.54 The listed issuer must engage its auditors to report on the continuing connected transaction every year. The auditors must provide a letter to the listed issuer's board of directors confirming whether anything has come to their attention that causes them to believe that the continuing connected transactions:

- (1) have not been approved by the listed issuer's board of directors;
- (2) were not, in all material respects, in accordance with the pricing policies of the listed issuer's group if the transactions involve the provision of goods or services by the listed issuer's group;
- (3) were not entered into, in all material respects, in accordance with the relevant agreement governing the transactions; and
- (4) have exceeded the cap.

14A.57 /
20.55 The listed issuer must provide a copy of the auditors' letter to the Exchange at least 10 business days before the bulk printing of its annual report.

14A.58 /
20.56 The listed issuer must allow, and ensure that the counterparties to the continuing connected transactions allow, the auditors sufficient access to their records for the purpose of reporting on the transactions.

14A.59 /
20.57 The listed issuer must promptly notify the Exchange and publish an announcement if the independent non-executive directors and/or the auditors cannot confirm the matters as required. The Exchange may require the listed issuer to re-comply with the announcement and shareholders' approval requirements and may impose additional conditions.

.....

CONTENT REQUIREMENTS

.....

Annual reports

- 14A.71 /
20.69
- The listed issuer's annual report must contain the following information on the connected transactions conducted in that financial year (including continuing connected transactions under agreements signed in previous years):
- (1) the transaction date;
 - (2) the parties to the transaction and a description of their connected relationship;
 - (3) a brief description of the transaction and its purpose;
 - (4) the total consideration and terms;
 - (5) the nature of the connected person's interest in the transaction; and
 - (6) for continuing connected transactions,
 - (a) a confirmation from the listed issuer's independent non-executive directors on the matters set out in Main Board Listing Rule 14A.55 / GEM Listing Rule 20.53; and
 - (b) a statement from the listed issuer's board of directors whether the auditors have confirmed the matters set out in Main Board Listing Rule 14A.56 / GEM Listing Rule 20.54.
- 14A.72 /
20.70
- When the listed issuer discloses in its annual report information of any related party transaction under the accounting standards for preparing its financial statements, it must specify whether the transaction is a connected transaction under this Chapter and whether it has complied with the requirements in this Chapter.

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Main Board
Listing Rule
19A.04

The following terms, save where the context otherwise requires, have the following meanings:—

.....

"PRC Governmental Body"
(中國政府機關)

for purposes of Main Board Listing Rules 19A.14 and 19A.19, includes (but not limited to)

- (a) PRC Central Government, including the State Council of the PRC (中國國務院), State Ministries and Commissions (國家部委), Bureaus and Administrations directly under the State Council (國務院直屬機構), State Council Offices and Institutions (國務院辦事機構及直屬國務院事業單位), Bureaus supervised by State Ministries and Commissions (國家部委代管局);
- (b) PRC Provincial-level Governments, including Provincial Governments (省政府), Municipalities directly under the Central Government (直轄市) and Autonomous Regions (自治區), together with their respective administrative arms, agencies and institutions.
- (c) PRC local governments immediately under the PRC Provincial-level Governments, including prefectures (區), municipalities (市) and counties (縣), together with their respective administrative arms, agencies and institutions.

Note: For clarity, entities under the PRC Government that are engaging in commercial business or operating another commercial entity will be excluded from this definition.

.....

"PRC issuer"
[This term is also defined in GEM Listing Rule 1.01 with the same meaning]

an issuer which is duly incorporated in the PRC as a joint stock limited company (股份有限公司)

.....

GEM Listing Rule 25.04 In this Chapter

.....

(2) the term "PRC Governmental Body" means:—

- (a) PRC Central Government, including the State Council of the PRC (中國國務院), State Ministries and Commissions (國家部委), Bureaus and Administrations directly under the State Council (國務院直屬機構), State Council Offices and Institutions (國務院辦事機構及直屬國務院事業單位), Bureaus supervised by State Ministries and Commissions (國家部委代管局);
- (b) PRC Provincial-level Governments, including Provincial Governments (省政府), Municipalities directly under the Central Government (直轄市) and Autonomous Regions (自治區), together with their respective administrative arms, agencies and institutions; or
- (c) PRC Local Governments immediately under the PRC Provincial-level Governments, including prefectures (區), municipalities (市) and counties (縣), together with their respective administrative arms, agencies and institutions that is not engaging in commercial business or operating another commercial entity.

Note: For clarity, entities under the PRC Government that are engaging in commercial business or operating another commercial entity will be excluded from this definition.

Appendix 2

Example Independent Auditor's Letter on Continuing Connected Transactions

To the Board of Directors of XYZ Limited ("the Company")

In accordance with our agreed terms of engagement dated [date], we have carried out procedures on the attached list¹ of continuing connected transactions entered into by the Company and its subsidiaries (collectively referred to as "the Group") for the year ended [date] and which the directors have advised us are to be disclosed in the Company's annual report for the year ended [date] ("the disclosed continuing connected transactions").

Directors' responsibilities

The Directors of the Company are responsible for the completeness and accuracy of disclosures of continuing connected transactions and the Company's compliance with the [Main Board Listing Rules][GEM Listing Rules] issued by The Stock Exchange of Hong Kong Limited in respect of such transactions. This responsibility includes designing, implementing and maintaining internal controls relevant to the identification, recording, authorization and reporting of all continuing connected transactions.

Auditor's responsibilities

It is our responsibility to express a conclusion, based on our work, on the disclosed continuing connected transactions and to report our conclusion to you².

Basis of conclusion

We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants.

Our work consisted of making inquiries, primarily of persons responsible for financial and accounting matters, applying analytical and other review procedures and testing transactions on a sample basis where we considered appropriate. Our work was substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion on the disclosed continuing connected transactions.

Furthermore, due to the nature of connected persons and transactions, it was not practicable for us to determine whether the disclosed continuing connected transactions and the books and records of the Group include all continuing connected transactions. It was impracticable for us to quantify the potential impact of this on the disclosures of continuing connected transactions in the Company's annual report. Accordingly, our report relates solely to the continuing connected transactions that have been disclosed to us and in the books and records of the Group made available to us.

¹ This could either be a list of the continuing connected transactions disclosed in the listed issuer's annual report or an extract from the listed issuer's annual report that contains the relevant disclosures. Where the letter refers to the listed issuer's annual report, as the letter is to be issued at least 10 business days prior to bulk printing of the annual report, ordinarily the annual report will be in draft form when the auditor issues his letter.

² Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the letter in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Conclusion

Based on the foregoing, in respect of the disclosed continuing connected transactions:

- a. nothing has come to our attention that causes us to believe that the disclosed continuing connected transactions have not been approved by the Company's board of directors.
- b. for transactions involving the provision of goods or services by the Group, nothing has come to our attention that causes us to believe that the transactions were not, in all material respects, in accordance with the pricing policies of the Group.
- c. nothing has come to our attention that causes us to believe that the transactions were not entered into, in all material respects, in accordance with the relevant agreements governing such transactions.
- d. with respect to the aggregate amount of [each of] the continuing connected transactions set out in the attached list of continuing connected transactions, nothing has come to our attention that causes us to believe that the disclosed continuing connected transactions have exceeded the annual cap as set by the Company.

Restrictions on the use of this letter

This letter is intended solely for the purpose of assisting you in respect of your obligations under the [Main Board Listing Rule 14A.56][GEM Listing Rule 20.54] with respect of continuing connected transactions. This letter is not intended to be, and should not be, used for any other purpose and we expressly disclaim any liability or duty to any other party in this respect including The Stock Exchange of Hong Kong Limited.

This letter should not be distributed to any other parties save that we agree that a copy of this letter may be provided by the Company to The Stock Exchange of Hong Kong Limited without further comment from us.

XYZ & Co.
Certified Public Accountants (Practising) [or Certified Public Accountants]
[Address]
Date

Appendix 3

Example Engagement Letter

The following letter is to be used as a guide and will need to be adapted according to individual requirements and circumstances.

Auditors would seek their own advice as to the form of contract they wish to adopt and whether to include or attach other contractual terms of business. In addition, if auditors wish to include statements in the engagement letter limiting their liability and / or indemnifying them against third party claims in respect of the engagement, they would take legal advice concerning the wording of such statements and how they are communicated.

To the Board of Directors of [Name of the listed issuer] ("the Company")

We are providing this letter to confirm our understanding of the terms and objectives of our engagement to report on the continuing connected transactions of the Company and its subsidiaries ("the Group") to be disclosed in the Company's annual report ("Transactions"). The purpose of our engagement is to provide assistance to you in respect of the requirements set out in Chapter [14A][20] of the Rules Governing the Listing of Securities on [the Growth Enterprise Market of] The Stock Exchange of Hong Kong Limited ("the Listing Rules").

1. Objective of our work

- 1.1 The objective of our work is to provide us with a basis for reporting whether anything has come to our attention that causes us to believe that:
- (a) the Transactions have not been approved by the Company's board of directors.
 - (b) for those Transactions that involve provision of goods or services by the Group, the Transactions were not, in all material respects, in accordance with the pricing policies of the Group.
 - (c) the Transactions were not entered into, in all material respects, in accordance with the relevant agreements governing such transactions.
 - (d) the Transactions have exceeded the annual cap as set by the Company.

2. Directors' responsibilities

- 2.1 The responsibility for ensuring the completeness and accuracy of disclosures of continuing connected transactions in the Company's annual report and for the Company's compliance with the Listing Rules with respect to continuing connected transactions and relevant laws and regulations rests solely with the Company and yourselves. This responsibility includes ensuring that the [Company][Group] has appropriate internal controls in place over the identification, recording, authorization and reporting of all connected persons and connected transactions; and has designed, implemented and maintained internal control to prevent and detect fraud and error. In addition, you will disclose to us the results of your assessment of the risk that the books of accounts, records and supporting documentation in respect of the [Company's][Group's] continuing connected transactions may be materially misstated as a result of fraud and your knowledge of fraud or suspected fraud and any allegations of fraud or suspected frauds affecting the [Company's][Group's] books of accounts, records and supporting documentation in respect of the [Company's][Group's] continuing connected transactions.
- 2.2 For the purposes of our work, you will make available to us, as and when required, all of the [Company's][Group's] books of account and all other relevant records and related information that we consider necessary. In addition, you will disclose to us the identity of the Company's connected persons and all the connected relationships and transactions of which you are aware.

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- 2.3 We draw your attention to paragraph [55][53] of Chapter [14A][20] to the Listing Rules, which requires the Company's independent non-executive directors ("INEDs") to review and confirm in the annual report that the Transactions have been entered into:
- (a) in the ordinary and usual course of business of the Group;
 - (b) on normal commercial terms or better; and
 - (c) according to the agreement governing them on terms that are fair and reasonable and in the interests of the Company's shareholders as a whole.

The INEDs also have the responsibility to determine the scope and extent of its review so as to discharge its duty under the Listing Rules. Our engagement should not be taken as a substitute or basis for the INEDs' review.

- 2.4 We may require receipt of written representations from the Company's board of directors, INEDs or other members of management in connection with certain matters relating to the Transactions before we issue our letter reporting on the matters set out in paragraph 1.1 above. In connection with representations and the supply of information to us generally, you are responsible for the accuracy and completeness of any information or documentation provided to us.
- 2.5 Once we have issued our letter, we have no further direct responsibility to update or actively seek information on events occurring subsequent to the date of our letter. You will inform us of any event occurring subsequent to the date of our letter that may impact on our letter, prior to the issuance of the Company's annual report.

3. Auditor's responsibilities

- 3.1 Our responsibility is to express a conclusion, based on our work to be performed, on the disclosed continuing connected transactions and to report our conclusion to you.

4. Scope and limitations of our work

- 4.1 Our work will be carried out in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our work will consist of making inquiries, primarily of persons responsible for financial and accounting matters, applying analytical and other review procedures and testing transactions on a sample basis where we consider appropriate. Our work is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently will not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we will not express an audit opinion on the Transactions.
- 4.2 In addition, due to the nature of connected transactions, we will not be in a position to confirm the completeness of the Transactions or whether the Transactions are in accordance with normal commercial terms or in compliance with relevant laws and regulations.

5. Reporting, distribution and disclosure

- 5.1 Our letter will be addressed to the board of directors and will be for your information only.
- 5.2 We will agree that a copy of the letter once issued may be provided to The Stock Exchange of Hong Kong Limited without further comment from us and that appropriate reference to our work in respect of the Transactions may be made in the Company's annual report. Such disclosure should appropriately reflect the nature of the work undertaken and the outcome of that work. We would be pleased to discuss those disclosures with you during the course of our engagement, although the responsibility for the appropriateness of disclosures in the Company's annual report rests solely with the Company.
- 5.3 Our letter shall not be copied, referred to or disclosed in whole or in part, other than as set out in this letter, and we expressly disclaim any liability to any party, including The Stock Exchange of Hong Kong Limited, other than the Company in respect of our work under this engagement.
- 5.4 Save as set out above, you shall not distribute our letter or make other references to us or our work or letter in this respect without our prior written consent, which shall not be unreasonably withheld.
- 5.5 We shall also report to you any material weaknesses in the Group's procedures that come to our attention in relation to this engagement and to which we think attention should be drawn. We shall exercise our professional judgment to determine the significance of any matter to be communicated and shall decide the appropriate means of communication. You should appreciate that our work should not be relied upon to identify all weaknesses, fraud or error that may exist.

6. Other matters

- 6.1 [We estimate that the fee for the work will be HK\$[*amount*], plus outlays which will be charged on an actual basis.][Our fee for the work has been incorporated in our audit fee which has been agreed with you separately.]
- 6.2 This letter shall be subject to and governed by Hong Kong law and all disputes arising from or under this engagement letter shall be subject to the exclusive jurisdiction of the Hong Kong courts.
- 6.3 This letter sets out the entire agreement and understanding between us and you in connection with the services to be delivered by us under this letter and supersedes all previous arrangements and understandings between us and you which shall cease to have any further force or effect.
- 6.4 This letter is effective in respect of reporting on continuing connected transactions in respect of the Company's annual report for the year [ending][ended] [*date*] and future years during our tenure as the Company's auditors or unless this letter is terminated by you or us, or amended or superseded by agreement in writing between you and us. Either party may terminate this engagement contract or suspend its operation by giving 30 days' prior notice in writing to the other at any time.

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6.5 We should be grateful if you would confirm in writing your agreement to the terms of this letter by signing and returning the attached copy, or let us know if they are not in accordance with your understanding of our terms of appointment.

Yours faithfully

[Enclosures]

I have read and understood the terms and conditions of this letter and I agree to and accept them.

Signed

Date:

Duly authorized, for and on behalf of the Board of
[name of listed issuer]

Appendix 4

Example Representation Letter

The following letter is not intended to be a standard letter. Representations by management will vary from one entity to another and from one period to the next.

(letterhead of the listed issuer)

Date

To [Name of auditors]

Dear Sirs

This representation is provided in connection with the work you performed for the purpose of reporting on the continuing connected transactions of [Name of the listed issuer] ("the Company") and its subsidiaries ("the Group") for the year ended [date] ("the Continuing Connected Transactions") in accordance with the engagement letter dated [date of engagement letter].

We confirm, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves, the following representations given to you in respect of the above engagement:

1. We acknowledge that the work you performed was substantially less in scope than an audit and that, accordingly, you do not express an audit opinion on the Continuing Connected Transactions.
2. We acknowledge that we are responsible for ensuring, and confirm, that all continuing connected transactions entered into by the Group were in compliance with the applicable requirements as set out in Chapter [14A][20] of the Rules Governing the Listing of Securities on [the Growth Enterprise Market of] The Stock Exchange of Hong Kong Limited ("the Listing Rules").
3. We are responsible for, and confirm, the completeness and accuracy of the continuing connected transactions to be disclosed in the annual report and which are as set out in the attached Appendix.
4. We confirm that the Company has complied with the applicable reporting, approval and announcement requirements set out in the Listing Rules in respect of the continuing connected transactions.
5. We are responsible for ensuring, and confirm, that the [Company][Group] has appropriate internal controls over the identification, recording, authorization and reporting of all connected persons and connected transactions, including all continuing connected transactions.
6. We confirm that we are responsible for the design, implementation and maintenance of internal control to prevent and detect fraud and error and confirm the following:
 - we have disclosed our knowledge of fraud or suspected fraud affecting the [Company][Group] involving management, employees who have significant roles in internal control; or others where the fraud could have a material effect on the books of accounts, records and supporting documentation in respect of the [Company's][Group's] continuing connected transactions.

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- we have disclosed our knowledge of any allegations of fraud or suspected frauds, affecting the [Company's][Group's] books of accounts, records and supporting documentation in respect of the Group's continuing connected transactions communicated by employees, former employees or others.
 - we believe that the risk that the books of accounts, records and supporting documentation in respect of the [Company's][Group's] continuing connected transactions may be materially misstated as a result of fraud is not significant, based on the results of our assessment³.
7. We confirm that we have made available to you all books of accounts, records and supporting documentation in respect of the Group's continuing connected transactions.
8. We confirm that we have disclosed to you the identity of the Company's connected persons and all the connected relationships and transactions of which we are aware.
9. We confirm that:
- the Continuing Connected Transactions have been approved by the Company's Board of Directors;
 - the prices charged for the Continuing Connected Transactions were in accordance with the pricing policies of the Group;
 - there is a written agreement in place governing each of the Continuing Connected Transactions and the transactions have been entered into in accordance with such agreements. No side agreement has been entered into in respect of any transaction[, or if side agreements have been entered into, they have been made available to you]; [and]
 - the aggregate annual values of the Continuing Connected Transactions have not exceeded the annual cap of [relevant amount(s)] disclosed in previous announcement(s) dated [relevant date(s)] made by the Company in respect of [each of] the Continuing Connected Transaction(s)[.];[.]
10. We confirm that the Company's independent non-executive directors have reviewed the Continuing Connected Transactions and confirm that ⁴:
- the Continuing Connected Transactions have been entered into in the ordinary and usual course of business of the Group;
 - the Continuing Connected Transactions have been entered into on normal commercial terms or better; and
 - the Continuing Connected Transactions have been entered into according to the relevant agreement governing each of the Continuing Connected Transactions on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

³ In instances where management concluded that the risk of that the books of accounts, records and supporting documentation in respect of the [Company's][Group's] continuing connected transactions may be materially misstated as a result of fraud is not insignificant based on the results of their assessment, the wording may need to be adapted where appropriate.

⁴ In instances where the INEDs' confirmation has not been issued before the representation letter on continuing connected transactions is issued, management should be requested to confirm that no issues have arisen to date (or alternatively that all such issues have been communicated to the auditor) and that management undertakes to inform the auditor of any issues arising between the date of the representation letter and the date of issuance by the INEDs of the INEDs' confirmation.

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11. We have considered the summary of misstatements attached to this letter and believe the effects of those misstatements aggregated by you during the engagement are immaterial, both individually and in the aggregate, and we consider that those misstatements do not constitute non-compliance with the applicable requirements of the Listing Rules regarding Continuing Connected Transactions.
12. [Set out further additional representations to address specific circumstances of the client.]

Yours faithfully

By Order of the Board

Name:
Position:

Name:
Position: