

COE
Issued December 2005; revised June 2010

Effective on 30 June 2006 until 31 December 2010

Code of Ethics for Professional Accountants



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

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS**CONTENTS**

	Page
PREFACE.....	4
PART A: GENERAL APPLICATION OF THE CODE	
100 Introduction and Fundamental Principles	6
110 Integrity	11
120 Objectivity	12
130 Professional Competence and Due Care.....	13
140 Confidentiality	14
150 Professional Behaviour.....	16
PART B: PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE	
200 Introduction.....	18
210 Professional Appointment.....	23
220 Conflicts of Interest	26
230 Second Opinions	28
240 Fees and Other Types of Remuneration	29
250 Marketing Professional Services	31
260 Gifts and Hospitality.....	32
270 Custody of Client Assets	33
280 Objectivity – All Services	34
290 Independence – Assurance Engagements	35
PART C: PROFESSIONAL ACCOUNTANTS IN BUSINESS	
300 Introduction	76
310 Potential Conflicts	79
320 Preparation and Reporting of Information	80
330 Acting with Sufficient Expertise	81
340 Financial Interests	82
350 Inducements	84
PART D: ADDITIONAL ETHICAL REQUIREMENTS	
400 Introduction	87
410 Unlawful Acts or Defaults by Clients of Members	88
	<i>[previously Statement 1.204B]</i>
411 Unlawful Acts or Defaults by or on Behalf of a Member’s Employer	107
	<i>[previously Statement 1.290C]</i>

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

420	Use of Designations and Institute's Logo 113 <i>[previously Statement 1.213]</i>
430	Ethics in Tax Practice 115 <i>[previously Statement 1.210]</i>
431	Corporate Finance Advice 117 <i>[previously Statement 1.292]</i>
432	Integrity, Objectivity and Independence in Insolvency 128 <i>[previously Statement 1.203 (supp.)]</i>
440	Changes in a Professional Appointment 132 <i>[previously Statement 1.207]</i>
441	Change of Auditors of a Listed Issuer of the Stock Exchange of Hong Kong 140 <i>[previously Statement 1.207A]</i>
450	Practice Promotion 144 <i>[previously Statement 1.205]</i>
460	Clients' Monies 148 <i>[previously Statement 1.212]</i>
470	Financial and Accounting Responsibilities of Directors 150 <i>[previously Statement 1.290D]</i>
	DEFINITIONS 168
	EFFECTIVE DATE 172
	APPENDIX: Comparison with the IFAC Code of Ethics for Professional Accountants 173

PREFACE

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

1. Pursuant to section 18A of the Professional Accountants Ordinance, Council may, in relation to the practice of accountancy, issue or specify any statement of professional ethics required to be observed, maintained or otherwise applied by members of the Institute.
2. The Institute, as a member of the International Federation of Accountants (IFAC), is committed to the IFAC’s broad objective of developing and enhancing a coordinated worldwide accountancy profession with common standards. In working toward this objective, IFAC develops guidance on ethics for professional accountants. IFAC believes that issuing such guidance will improve the degree of uniformity of professional ethics throughout the world.
3. As an obligation of its membership, the Institute is obliged to support the work of IFAC by (a) informing its members of every pronouncement developed by IFAC, and (b) implementing those pronouncements, when and to the extent possible under local circumstances.
4. The Institute has determined to adopt the IFAC Code of Ethics for Professional Accountants as the ethical requirements for its members.
5. Where the Council of the Institute deems it necessary, it has included, and may develop further, additional ethical requirements on matters of relevance not covered by the IFAC Code of Ethics for Professional Accountants.
6. It is not practical to establish ethical requirements that apply to all situations and circumstances members of the Institute may encounter. Members of the Institute should therefore consider the ethical requirements as the basic principles they should follow in performing their work.
7. Council requires members of the Institute to comply with the Code of Ethics for Professional Accountants. Apparent failures by members of the Institute to comply with the Code of Ethics for Professional Accountants are liable to be enquired into by the appropriate committee established under the authority of the Institute, and disciplinary action may result. Disciplinary action may include an order that the name of the member be removed from the Institute’s membership register.
8. The Code of Ethics for Professional Accountants is likely to be taken into account when the work of members of the Institute is being considered in a court of law or in other contested situations.

PART A: GENERAL APPLICATION OF THE CODE

Section 100 Introduction and Fundamental Principles

Section 110 Integrity

Section 120 Objectivity

Section 130 Professional Competence and Due Care

Section 140 Confidentiality

Section 150 Professional Behaviour

Section 100

Introduction and Fundamental Principles

- 100.1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a **professional accountant's** responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest a professional accountant should observe and comply with the ethical requirements of this Code.
- 100.2 This Code is in four parts. Part A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework for applying those principles. The conceptual framework provides guidance on fundamental ethical principles. Professional accountants are required to apply this conceptual framework to identify threats to compliance with the fundamental principles, to evaluate their significance and, if such threats are other than **clearly insignificant*** to apply safeguards to eliminate them or reduce them to an acceptable level such that compliance with the fundamental principles is not compromised.
- 100.3 Parts B, C and D illustrate how the conceptual framework is to be applied in specific situations. They provide examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles and also provides examples of situations where safeguards are not available to address the threats and consequently the activity or relationship creating the threats should be avoided. Part B applies to **professional accountants in public practice***. Part C applies to **professional accountants in business***. Professional accountants in public practice may also find the guidance in Part C relevant to their particular circumstances. Part D sets out additional ethical requirements on specific areas.

Fundamental Principles

- 100.4 A professional accountant is required to comply with the following fundamental principles:
- (a) *Integrity*
- A professional accountant should be straightforward and honest in all professional and business relationships.
- (b) *Objectivity*
- A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.
- (c) *Professional Competence and Due Care*
- A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing **professional services***.

* See Definitions.

(d) *Confidentiality*

A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

(e) *Professional Behaviour*

A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Each of these fundamental principles is discussed in more detail in Sections 110 – 150.

Conceptual Framework Approach

- 100.5 The circumstances in which professional accountants operate may give rise to specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates such threats and specify the appropriate mitigating action. In addition, the nature of engagements and work assignments may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires a professional accountant to identify, evaluate and address threats to compliance with the fundamental principles, rather than merely comply with a set of specific rules which may be arbitrary, is, therefore, in the public interest. This Code provides a framework to assist a professional accountant to identify, evaluate and respond to threats to compliance with the fundamental principles. If identified threats are other than clearly insignificant, a professional accountant should, where appropriate, apply safeguards to eliminate the threats or reduce them to an acceptable level, such that compliance with the fundamental principles is not compromised.
- 100.6 A professional accountant has an obligation to evaluate any threats to compliance with the fundamental principles when the professional accountant knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles.
- 100.7 A professional accountant should take qualitative as well as quantitative factors into account when considering the significance of a threat. If a professional accountant cannot implement appropriate safeguards, the professional accountant should decline or discontinue the specific professional service involved, or where necessary resign from the client (in the case of a professional accountant in public practice) or the employing organization (in the case of a professional accountant in business).
- 100.8 A professional accountant may inadvertently violate a provision of this Code. Such an inadvertent violation, depending on the nature and significance of the matter, may not compromise compliance with the fundamental principles provided, once the violation is discovered, the violation is corrected promptly and any necessary safeguards are applied.
- 100.9 Parts B and C of this Code include examples that are intended to illustrate how the conceptual framework is to be applied. The examples are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant that may create threats to compliance with the

fundamental principles. Consequently, it is not sufficient for a professional accountant merely to comply with the examples presented; rather, the framework should be applied to the particular circumstances encountered by the professional accountant.

Threats and Safeguards

100.10 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

- (a) Self-interest threats, which may occur as a result of the financial or other interests of a professional accountant or of an immediate or **close family*** member;
- (b) Self-review threats, which may occur when a previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment;
- (c) Advocacy threats, which may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised;
- (d) Familiarity threats, which may occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others; and
- (e) Intimidation threats, which may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived.

Parts B and C of this Code, respectively, provide examples of circumstances that may create these categories of threats for professional accountants in public practice and professional accountants in business. Professional accountants in public practice may also find the guidance in Part C relevant to their particular circumstances.

100.11 Safeguards that may eliminate or reduce such threats to an acceptable level fall into two broad categories:

- (a) Safeguards created by the profession, legislation or regulation; and
- (b) Safeguards in the work environment.

100.12 Safeguards created by the profession, legislation or regulation include, but are not restricted to:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures.
- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

* See Definitions.

- 100.13 Parts B and C of this Code, respectively, discuss safeguards in the work environment for professional accountants in public practice and those in business.
- 100.14 Certain safeguards may increase the likelihood of identifying or deterring unethical behaviour. Such safeguards, which may be created by the accounting profession, legislation, regulation or an employing organization, include, but are not restricted to:
- Effective, well publicized complaints systems operated by the employing organization, the profession or a regulator, which enable colleagues, employers and members of the public to draw attention to unprofessional or unethical behaviour.
 - An explicitly stated duty to report breaches of ethical requirements.
- 100.15 The nature of the safeguards to be applied will vary depending on the circumstances. In exercising professional judgment, a professional accountant should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would conclude to be unacceptable.

Ethical Conflict Resolution

- 100.16 In evaluating compliance with the fundamental principles, a professional accountant may be required to resolve a conflict in the application of fundamental principles.
- 100.17 When initiating either a formal or informal conflict resolution process, a professional accountant should consider the following, either individually or together with others, as part of the resolution process:
- (a) Relevant facts;
 - (b) Ethical issues involved;
 - (c) Fundamental principles related to the matter in question;
 - (d) Established internal procedures; and
 - (e) Alternative courses of action.

Having considered these issues, a professional accountant should determine the appropriate course of action that is consistent with the fundamental principles identified. The professional accountant should also weigh the consequences of each possible course of action. If the matter remains unresolved, the professional accountant should consult with other appropriate persons within the **firm** or employing organization for help in obtaining resolution.

- 100.18 Where a matter involves a conflict with, or within, an organization, a professional accountant should also consider consulting with those charged with governance of the organization, such as the board of directors or the audit committee.
- 100.19 It may be in the best interests of the professional accountant to document the substance of the issue and details of any discussions held or decisions taken, concerning that issue.
- 100.20 If a significant conflict cannot be resolved, a professional accountant may wish to obtain professional advice from the relevant professional body or legal advisors,

* See Definitions.

and thereby obtain guidance on ethical issues without breaching confidentiality. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant should consider obtaining legal advice to determine whether there is a requirement to report.

- 100.21 If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant should, where possible, refuse to remain associated with the matter creating the conflict. The professional accountant may determine that, in the circumstances, it is appropriate to withdraw from the **engagement team*** or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

* See Definitions.

Section 110

Integrity

- 110.1 The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness.
- 110.2 A professional accountant should not be associated with reports, returns, communications or other information where they believe that the information:
- (a) Contains a materially false or misleading statement;
 - (b) Contains statements or information furnished recklessly; or
 - (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.
- 110.3 A professional accountant will not be considered to be in breach of paragraph 110.2 if the professional accountant provides a modified report in respect of a matter contained in paragraph 110.2.

Section 120

Objectivity

- 120.1 The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.
- 120.2 A professional accountant may be exposed to situations that may impair objectivity. It is impracticable to define and prescribe all such situations. Relationships that bias or unduly influence the professional judgment of the professional accountant should be avoided.

Section 130

Professional Competence and Due Care

- 130.1 The principle of professional competence and due care imposes the following obligations on professional accountants:
- (a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and
 - (b) To act diligently in accordance with applicable technical and professional standards when providing professional services.
- 130.2 Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. Professional competence may be divided into two separate phases:
- (a) Attainment of professional competence; and
 - (b) Maintenance of professional competence.
- 130.3 The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical professional and business developments. Continuing professional development develops and maintains the capabilities that enable a professional accountant to perform competently within the professional environments.
- 130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.
- 130.5 A professional accountant should take steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision.
- 130.6 Where appropriate, a professional accountant should make clients, employers or other users of the professional services aware of limitations inherent in the services to avoid the misinterpretation of an expression of opinion as an assertion of fact.

Section 140

Confidentiality

- 140.1 The principle of confidentiality imposes an obligation on professional accountants to refrain from:
- (a) Disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and
 - (b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.
- 140.2 A professional accountant should maintain confidentiality even in a social environment. The professional accountant should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a close or **immediate family*** member.
- 140.3 A professional accountant should also maintain confidentiality of information disclosed by a prospective client or employer.
- 140.4 A professional accountant should also consider the need to maintain confidentiality of information within the firm or employing organization.
- 140.5 A professional accountant should take all reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.
- 140.6 The need to comply with the principle of confidentiality continues even after the end of relationships between a professional accountant and a client or employer. When a professional accountant changes employment or acquires a new client, the professional accountant is entitled to use prior experience. The professional accountant should not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.
- 140.7 The following are circumstances where professional accountants are or may be required to disclose confidential information or when such disclosure may be appropriate:
- (a) Disclosure is permitted by law and is authorized by the client or the employer;
 - (b) Disclosure is required by law, for example:
 - (i) Production of documents or other provision of evidence in the course of legal proceedings; or
 - (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and
 - (c) There is a professional duty or right to disclose, when not prohibited by law:
 - (i) To comply with the quality review of a member body or professional body;

* See Definitions.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

- (ii) To respond to an inquiry or investigation by a member body or regulatory body;
- (iii) To protect the professional interests of a professional accountant in legal proceedings; or
- (iv) To comply with technical standards and ethics requirements.

140.8 In deciding whether to disclose confidential information, professional accountants should consider the following points:

- (a) Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the professional accountant;
- (b) Whether all the relevant information is known and substantiated, to the extent it is practicable; when the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment should be used in determining the type of disclosure to be made, if any; and
- (c) The type of communication that is expected and to whom it is addressed; in particular, professional accountants should be satisfied that the parties to whom the communication is addressed are appropriate recipients.

Additional requirements are set out in Section 410 "Unlawful Acts or Defaults by Clients of Members" and Section 411 "Unlawful Acts or Defaults by or on Behalf of a Member's Employer".

Section 150

Professional Behaviour

- 150.1 The principle of professional behaviour imposes an obligation on professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. This includes actions which a reasonable and informed third party, having knowledge of all relevant information, would conclude negatively affects the good reputation of the profession.
- 150.2 In marketing and promoting themselves and their work, professional accountants should not bring the profession into disrepute. Professional accountants should be honest and truthful and should not:
- (a) Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or
 - (b) Make disparaging references or unsubstantiated comparisons to the work of others.

Additional requirements are set out in Section 420 "Use of Designations and Institute's Logo".

PART B: PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

- Section 200 Introduction
- Section 210 Professional Appointment
- Section 220 Conflicts of Interest
- Section 230 Second Opinions
- Section 240 Fees and Other Types of Remuneration
- Section 250 Marketing Professional Services
- Section 260 Gifts and Hospitality
- Section 270 Custody of Client Assets
- Section 280 Objectivity – All Services
- Section 290 Independence – Assurance Engagements

Section 200

Introduction

- 200.1 This Part of the Code illustrates how the conceptual framework contained in Part A is to be applied by professional accountants in public practice. The examples in the following sections are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant in public practice that may create threats to compliance with the principles. Consequently, it is not sufficient for a professional accountant in public practice merely to comply with the examples presented; rather, the framework should be applied to the particular circumstances faced.
- 200.2 A professional accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the rendering of professional services.

Threats and Safeguards

- 200.3 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:
- (a) Self-interest;
 - (b) Self-review;
 - (c) Advocacy;
 - (d) Familiarity; and
 - (e) Intimidation.

These threats are discussed further in Part A of this Code.

The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to a **financial statement audit client**, a non-financial statement audit **assurance client** or a non-assurance client.

- 200.4 Examples of circumstances that may create self-interest threats for a professional accountant in public practice include, but are not limited to:
- A **financial interest**^{*} in a client or jointly holding a financial interest with a client.
 - Undue dependence on total fees from a client.
 - Having a close business relationship with a client.
 - Concern about the possibility of losing a client.
 - Potential employment with a client.
 - **Contingent fees**^{*} relating to an **assurance engagement**.^{*}
 - A loan to or from an assurance client or any of its directors or officers.

* See Definitions.

- 200.5 Examples of circumstances that may create self-review threats include, but are not limited to:
- The discovery of a significant error during a re-evaluation of the work of the professional accountant in public practice.
 - Reporting on the operation of financial systems after being involved in their design or implementation.
 - Having prepared the original data used to generate records that are the subject matter of the engagement.
 - A member of the **assurance team*** being, or having recently been, a **director or officer*** of that client.
 - A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement.
 - Performing a service for a client that directly affects the subject matter of the assurance engagement.
- 200.6 Examples of circumstances that may create advocacy threats include, but are not limited to:
- Promoting shares in a **listed entity*** when that entity is a financial statement audit client.
 - Acting as an advocate on behalf of an assurance client in litigation or disputes with third parties.
- 200.7 Examples of circumstances that may create familiarity threats include, but are not limited to:
- A member of the engagement team having a close or immediate family relationship with a director or officer of the client.
 - A member of the engagement team having a close or immediate family relationship with an employee of the client who is in a position to exert direct and significant influence over the subject matter of the engagement.
 - A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
 - Accepting gifts or preferential treatment from a client, unless the value is clearly insignificant.
 - Long association of senior personnel with the assurance client.
- 200.8 Examples of circumstances that may create intimidation threats include, but are not limited to:
- Being threatened with dismissal or replacement in relation to a client engagement.

* See Definitions.

- Being threatened with litigation.
- Being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

200.9 A professional accountant in public practice may also find that specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats obviously cannot be categorized. In either professional or business relationships, a professional accountant in public practice should always be on the alert for such circumstances and threats.

200.10 Safeguards that may eliminate or reduce threats to an acceptable level fall into two broad categories:

- (a) Safeguards created by the profession, legislation or regulation; and
- (b) Safeguards in the work environment.

Examples of safeguards created by the profession, legislation or regulation are described in paragraph 100.12 of Part A of this Code.

200.11 In the work environment, the relevant safeguards will vary depending on the circumstances. Work environment safeguards comprise firm-wide safeguards and engagement specific safeguards. A professional accountant in public practice should exercise judgment to determine how to best deal with an identified threat. In exercising this judgment a professional accountant in public practice should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would reasonably conclude to be acceptable. This consideration will be affected by matters such as the significance of the threat, the nature of the engagement and the structure of the firm.

200.12 Firm-wide safeguards in the work environment may include:

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the identification of threats to compliance with the fundamental principles, the evaluation of the significance of these threats and the identification and the application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level.
- For firms that perform assurance engagements, documented **independence*** policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the evaluation and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level.
- Documented internal policies and procedures requiring compliance with the fundamental principles.

* See Definitions.

- Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
- Policies and procedures to prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement.
- Timely communication of a firm's policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures.
- Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system.
- Advising partners and professional staff of those assurance clients and related entities from which they must be independent.
- A disciplinary mechanism to promote compliance with policies and procedures.
- Published policies and procedures to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principles that concerns them.

200.13 Engagement-specific safeguards in the work environment may include:

- Involving an additional professional accountant to review the work done or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel.

200.14 Depending on the nature of the engagement, a professional accountant in public practice may also be able to rely on safeguards that the client has implemented. However it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.

200.15 Safeguards within the client's systems and procedures may include:

- When a client appoints a firm in public practice to perform an engagement, persons other than management ratify or approve the appointment.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that ensure objective choices in commissioning non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

Additional requirements are set out in Section 430 "Ethics in Tax Practice", Section 431 "Corporate Finance Advice" and Section 432 "Integrity, Objectivity and Independence in Insolvency".

Section 210

Professional Appointment

Client Acceptance

- 210.1 Before accepting a new client relationship, a professional accountant in public practice should consider whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behaviour may be created from, for example, questionable issues associated with the client (its owners, management and activities).
- 210.2 Client issues that, if known, could threaten compliance with the fundamental principles include, for example, client involvement in illegal activities (such as money laundering), dishonesty or questionable financial reporting practices.
- 210.3 The significance of any threats should be evaluated. If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
- 210.4 Appropriate safeguards may include obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities, or securing the client's commitment to improve corporate governance practices or internal controls.
- 210.5 Where it is not possible to reduce the threats to an acceptable level, a professional accountant in public practice should decline to enter into the client relationship.
- 210.6 Acceptance decisions should be periodically reviewed for recurring client engagements.

Engagement Acceptance

- 210.7 A professional accountant in public practice should agree to provide only those services that the professional accountant in public practice is competent to perform. Before accepting a specific client engagement, a professional accountant in public practice should consider whether acceptance would create any threats to compliance with the fundamental principles. For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.
- 210.8 A professional accountant in public practice should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:
- Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
 - Acquiring knowledge of relevant industries or subject matters.
 - Possessing or obtaining experience with relevant regulatory or reporting requirements.
 - Assigning sufficient staff with the necessary competencies.
 - Using experts where necessary.

- Agreeing on a realistic time frame for the performance of the engagement.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

210.9 When a professional accountant in public practice intends to rely on the advice or work of an expert, the professional accountant in public practice should evaluate whether such reliance is warranted. The professional accountant in public practice should consider factors such as reputation, expertise, resources available and applicable professional and ethical standards. Such information may be gained from prior association with the expert or from consulting others.

Changes in a Professional Appointment

210.10 A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, should determine whether there are any reasons, professional or other, for not accepting the engagement, such as circumstances that threaten compliance with the fundamental principles. For example, there may be a threat to professional competence and due care if a professional accountant in public practice accepts the engagement before knowing all the pertinent facts.

210.11 The significance of the threats should be evaluated. Depending on the nature of the engagement, this may require direct communication with the **existing accountant*** to establish the facts and circumstances behind the proposed change so that the professional accountant in public practice can decide whether it would be appropriate to accept the engagement. For example, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing accountant that may influence the decision as to whether to accept the appointment.

210.12 An existing accountant is bound by confidentiality. The extent to which the professional accountant in public practice can and should discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on:

- (a) Whether the client's permission to do so has been obtained; or
- (b) The legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction.

210.13 In the absence of specific instructions by the client, an existing accountant should not ordinarily volunteer information about the client's affairs. Circumstances where it may be appropriate to disclose confidential information are set out in Section 140 of Part A of this Code.

210.14 If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

* See Definitions.

- 210.15 Such safeguards may include:
- Discussing the client's affairs fully and freely with the existing accountant;
 - Asking the existing accountant to provide known information on any facts or circumstances, that, in the existing accountant's opinion, the proposed accountant should be aware of before deciding whether to accept the engagement;
 - When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing accountant will be requested so that inquiries may be made as to whether there are any professional or other reasons why the appointment should not be accepted.
- 210.16 A professional accountant in public practice will ordinarily need to obtain the client's permission, preferably in writing, to initiate discussion with an existing accountant. Once that permission is obtained, the existing accountant should comply with relevant legal and other regulations governing such requests. Where the existing accountant provides information, it should be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing accountant, the proposed accountant should try to obtain information about any possible threats by other means such as through inquiries of third parties or background investigations on senior management or those charged with governance of the client.
- 210.17 Where the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice should, unless there is satisfaction as to necessary facts by other means, decline the engagement.
- 210.18 A professional accountant in public practice may be asked to undertake work that is complementary or additional to the work of the existing accountant. Such circumstances may give rise to potential threats to professional competence and due care resulting from, for example, a lack of or incomplete information. Safeguards against such threats include notifying the existing accountant of the proposed work, which would give the existing accountant the opportunity to provide any relevant information needed for the proper conduct of the work.

Additional requirements are set out in Section 440 "Changes in a Professional Appointment" and Section 441 "Change of Auditors of a Listed Issuer of The Stock Exchange of Hong Kong".

Section 220

Conflicts of Interest

- 220.1 A professional accountant in public practice should take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may give rise to threats to compliance with the fundamental principles. For example, a threat to objectivity may be created when a professional accountant in public practice competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client. A threat to objectivity or confidentiality may also be created when a professional accountant in public practice performs services for clients whose interests are in conflict or the clients are in dispute with each other in relation to the matter or transaction in question.
- 220.2 A professional accountant in public practice should evaluate the significance of any threats. Evaluation includes considering, before accepting or continuing a client relationship or specific engagement, whether the professional accountant in public practice has any business interests, or relationships with the client or a third party that could give rise to threats. If threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
- 220.3 Depending upon the circumstances giving rise to the conflict, safeguards should ordinarily include the professional accountant in public practice:
- (a) Notifying the client of the firm's business interest or activities that may represent a conflict of interest, and obtaining their consent to act in such circumstances; or
 - (b) Notifying all known relevant parties that the professional accountant in public practice is acting for two or more parties in respect of a matter where their respective interests are in conflict, and obtaining their consent to so act; or
 - (c) Notifying the client that the professional accountant in public practice does not act exclusively for any one client in the provision of proposed services (for example, in a particular market sector or with respect to a specific service) and obtaining their consent to so act.
- 220.4 The following additional safeguards should also be considered:
- (a) The use of separate engagement teams; and
 - (b) Procedures to prevent access to information (e.g., strict physical separation of such teams, confidential and secure data filing); and
 - (c) Clear guidelines for members of the engagement team on issues of security and confidentiality; and
 - (d) The use of confidentiality agreements signed by employees and partners of the firm; and
 - (e) Regular review of the application of safeguards by a senior individual not involved with relevant client engagements.
- 220.5 Where a conflict of interest poses a threat to one or more of the fundamental principles, including objectivity, confidentiality or professional behaviour, that cannot be eliminated or reduced to an acceptable level through the application of safeguards, the professional accountant in public practice should conclude that it is not appropriate to accept a specific engagement or that resignation from one or more conflicting engagements is required.

- 220.6 Where a professional accountant in public practice has requested consent from a client to act for another party (which may or may not be an existing client) in respect of a matter where the respective interests are in conflict and that consent has been refused by the client, then they must not continue to act for one of the parties in the matter giving rise to the conflict of interest.

Section 230

Second Opinions

- 230.1 Situations where a professional accountant in public practice is asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client may give rise to threats to compliance with the fundamental principles. For example, there may be a threat to professional competence and due care in circumstances where the second opinion is not based on the same set of facts that were made available to the existing accountant, or is based on inadequate evidence. The significance of the threat will depend on the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment.
- 230.2 When asked to provide such an opinion, a professional accountant in public practice should evaluate the significance of the threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include seeking client permission to contact the existing accountant, describing the limitations surrounding any opinion in communications with the client and providing the existing accountant with a copy of the opinion.
- 230.3 If the company or entity seeking the opinion will not permit communication with the existing accountant, a professional accountant in public practice should consider whether, taking all the circumstances into account, it is appropriate to provide the opinion sought.

Section 240

Fees and Other Types of Remuneration

- 240.1 When entering into negotiations regarding professional services, a professional accountant in public practice may quote whatever fee deemed to be appropriate. The fact that one professional accountant in public practice may quote a fee lower than another is not in itself unethical. Nevertheless, there may be threats to compliance with the fundamental principles arising from the level of fees quoted. For example, a self-interest threat to professional competence and due care is created if the fee quoted is so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price.
- 240.2 The significance of such threats will depend on factors such as the level of fee quoted and the services to which it applies. In view of these potential threats, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Safeguards which may be adopted include:
- Making the client aware of the terms of the engagement and, in particular, the basis on which fees are charged and which services are covered by the quoted fee.
 - Assigning appropriate time and qualified staff to the task.
- 240.3 Contingent fees are widely used for certain types of non-assurance engagements.¹ They may, however, give rise to threats to compliance with the fundamental principles in certain circumstances. They may give rise to a self-interest threat to objectivity. The significance of such threats will depend on factors including:
- The nature of the engagement.
 - The range of possible fee amounts.
 - The basis for determining the fee.
 - Whether the outcome or result of the transaction is to be reviewed by an independent third party.
- 240.4 The significance of such threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level. Such safeguards may include:
- An advance written agreement with the client as to the basis of remuneration.
 - Disclosure to intended users of the work performed by the professional accountant in public practice and the basis of remuneration.
 - Quality control policies and procedures.
 - Review by an objective third party of the work performed by the professional accountant in public practice.

¹ Contingent fees for non-assurance services provided to assurance client are discussed in Section 290 of this part of the Code.

- 240.5 In certain circumstances, a professional accountant in public practice may receive a referral fee or commission relating to a client. For example, where the professional accountant in public practice does not provide the specific service required, a fee may be received for referring a continuing client to another professional accountant in public practice or other expert. A professional accountant in public practice may receive a commission from a third party (e.g., a software vendor) in connection with the sale of goods or services to a client. Accepting such a referral fee or commission may give rise to self-interest threats to objectivity and professional competence and due care.
- 240.6 A professional accountant in public practice may also pay a referral fee to obtain a client, for example, where the client continues as a client of another professional accountant in public practice but requires specialist services not offered by the existing accountant. The payment of such a referral fee may also create a self-interest threat to objectivity and professional competence and due care.
- 240.7 A professional accountant in public practice should not pay or receive a referral fee or commission, unless the professional accountant in public practice has established safeguards to eliminate the threats or reduce them to an acceptable level. Such safeguards may include:
- Disclosing to the client any arrangements to pay a referral fee to another professional accountant for the work referred.
 - Disclosing to the client any arrangements to receive a referral fee for referring the client to another professional accountant in public practice.
 - Obtaining advance agreement from the client for commission arrangements in connection with the sale by a third party of goods or services to the client.
- 240.8 A professional accountant in public practice may purchase all or part of another firm on the basis that payments will be made to individuals formerly owning the firm or to their heirs or estates. Such payments are not regarded as commissions or referral fees for the purpose of paragraph 240.5 – 240.7 above.

Section 250

Marketing Professional Services

250.1 When a professional accountant in public practice solicits new work through **advertising*** or other forms of marketing, there may be potential threats to compliance with the fundamental principles. For example, a self-interest threat to compliance with the principle of professional behaviour is created if services, achievements or products are marketed in a way that is inconsistent with that principle.

250.2 A professional accountant in public practice should not bring the profession into disrepute when marketing professional services. The professional accountant in public practice should be honest and truthful and should not:

- Make exaggerated claims for services offers, qualifications possessed or experience gained; or
- Make disparaging references to unsubstantiated comparisons to the work of another.

If the professional accountant in public practice is in doubt whether a proposed form of advertising or marketing is appropriate, the professional accountant in public practice should consult with the relevant professional body.

Additional requirements are set out in Section 450 "Practice Promotion".

* See Definitions.

Section 260

Gifts and Hospitality

- 260.1 A professional accountant in public practice, or an immediate or close family member, may be offered gifts and hospitality from a client. Such an offer ordinarily gives rise to threats to compliance with the fundamental principles. For example, self-interest threats to objectivity may be created if a gift from a client is accepted; intimidation threats to objectivity may result from the possibility of such offers being made public.
- 260.2 The significance of such threats will depend on the nature, value and intent behind the offer. Where gifts or hospitality which a reasonable and informed third party, having knowledge of all relevant information, would consider clearly insignificant are made a professional accountant in public practice may conclude that the offer is made in the normal course of business without the specific intent to influence decision making or to obtain information. In such cases, the professional accountant in public practice may generally conclude that there is no significant threat to compliance with the fundamental principles.
- 260.3 If evaluated threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice should not accept such an offer.

Section 270

Custody of Client Assets

- 270.1 A professional accountant in public practice should not assume custody of client monies or other assets unless permitted to do so by law and, if so, in compliance with any additional legal duties imposed on a professional accountant in public practice holding such assets.
- 270.2 The holding of client assets creates threats to compliance with the fundamental principles; for example, there is a self-interest threat to professional behaviour and may be a self interest threat to objectivity arising from holding client assets. To safeguard against such threats, a professional accountant in public practice entrusted with money (or other assets) belonging to others should:
- (a) Keep such assets separately from personal or firm assets;
 - (b) Use such assets only for the purpose for which they are intended;
 - (c) At all times, be ready to account for those assets, and any income, dividends or gains generated, to any persons entitled to such accounting; and
 - (d) Comply with all relevant laws and regulations relevant to the holding of and accounting for such assets.
- 270.3 In addition, professional accountants in public practice should be aware of threats to compliance with the fundamental principles through association with such assets, for example, if the assets were found to derive from illegal activities, such as money laundering. As part of client and engagement acceptance procedures for such services, professional accountants in public practice should make appropriate inquiries about the source of such assets and should consider their legal and regulatory obligations. They may also consider seeking legal advice.

Additional requirements are set out in Section 460 "Clients' Monies".

Section 280

Objectivity – All Services

- 280.1 A professional accountant in public practice should consider when providing any professional service whether there are threats to compliance with the fundamental principle of objectivity resulting from having interests in, or relationships with, a client or directors, officers or employees. For example, a familiarity threat to objectivity may be created from a family or close personal or business relationship.
- 280.2 A professional accountant in public practice who provides an assurance service is required to be independent of the assurance client. Independence of mind and in appearance is necessary to enable the professional accountant in public practice to express a conclusion, and be seen to express a conclusion, without bias, conflict of interest or undue influence of others. Section 290 provides specific guidance on independence requirements for professional accountants in public practice when performing an assurance engagement.
- 280.3 The existence of threats to objectivity when providing any professional service will depend upon the particular circumstances of the engagement and the nature of the work that the professional accountant in public practice is performing.
- 280.4 A professional accountant in public practice should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:
- Withdrawing from the engagement team.
 - Supervisory procedures.
 - Terminating the financial or business relationship giving rise to the threat.
 - Discussing the issue with higher levels of management within the firm.
 - Discussing the issue with those charged with governance of the client.

Section 290

Independence – Assurance Engagements

- 290.1 In the case of an assurance engagement it is in the public interest and, therefore, required by this Code of Ethics, that members of **assurance teams**,^{*} firms and, when applicable, **network firm**'s be independent of assurance clients.
- 290.2 Assurance engagements are designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria. The Hong Kong Framework for Assurance Engagements (the Assurance Framework) describes the elements and objectives of an assurance engagement, and identifies engagements to which Hong Kong Standards on Auditing (HKSAAs), Hong Kong Standards on Review Engagements (HKSREs) and Hong Kong Standards on Assurance Engagements (HKSAEs) apply. For a description of the elements and objectives of an assurance engagement reference should be made to the Assurance Framework.
- 290.3 As further explained in the Assurance Framework, in an assurance engagement the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
- 290.4 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term "subject matter information" is used to mean the outcome of the evaluation or measurement of subject matter. For example:
- The recognition, measurement, presentation and disclosure represented in the **financial statements**^{*} (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as Hong Kong Financial Reporting Standards, (criteria) to an entity's financial position, financial performance and cash flows (subject matter).
 - An assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO^{**} or CoCo^{***}, (criteria) to internal control, a process (subject matter).
- 290.5 Assurance engagements may be assertion-based or direct reporting. In either case they involve three separate parties: a public accountant in public practice, a responsible party and intended users.
- 290.6 In an assertion-based assurance engagement, which includes a **financial statement audit engagement**^{*}, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.

* See Definitions.

** "Internal Control – Integrated Framework" The Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the US.

*** "Guidance on Assessing Control – The CoCo Principles" The Risk Management and Governance Board (previously known as the Criteria of Control Board (CoCo)), The Canadian Institute of Chartered Accountants.

290.7 In a direct reporting assurance engagement the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

290.8 Independence requires:

Independence of Mind

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

Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

290.9 The use of the word "independence" on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

290.10 Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires firms and members of assurance teams to identify, evaluate and address threats to independence, rather than merely comply with a set of specific rules which may be arbitrary, is, therefore, in the public interest.

A Conceptual Approach to Independence

290.11 Members of assurance teams, firms and network firms are required to apply the conceptual framework contained in Section 100 to the particular circumstances under consideration. In addition to identifying relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether relationships between individuals outside of the assurance team and the assurance client create threats to independence.

290.12 The examples presented in this section are intended to illustrate the application of the conceptual framework and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient for a member of an assurance team, a firm or a network firm merely to comply with the examples presented, rather they should apply the framework to the particular circumstances they face.

290.13 The nature of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level differ depending on the characteristics of the individual assurance engagement: whether it is a financial statement audit engagement or another type of assurance

engagement; and in the latter case, the purpose, subject matter information and intended users of the report. A firm should, therefore, evaluate the relevant circumstances, the nature of the assurance engagement and the threats to independence in deciding whether it is appropriate to accept or continue an engagement, as well as the nature of the safeguards required and whether a particular individual should be a member of the assurance team.

Assertion-based Assurance Engagements

Financial Statement Audit Engagements

290.14 Financial statement audit engagements are relevant to a wide range of potential users; consequently, in addition to independence of mind, independence in appearance is of particular significance. Accordingly, for financial statement audit clients, the members of the assurance team, the firm and network firms are required to be independent of the financial statement audit client. Such independence requirements include prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information (the financial statements). Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter (the financial position, financial performance and cash flows).

Other Assertion-based Assurance Engagements

290.15 In an assertion-based assurance engagement where the client is not a financial statement audit client, the members of the assurance team and the firm are required to be independent of the assurance client (the responsible party, which is responsible for the subject matter information and may be responsible for the subject matter). Such independence requirements include prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information. Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter of the engagement. Consideration should also be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.

290.16 In the majority of assertion-based assurance engagements, that are not financial statement audit engagements, the responsible party is responsible for the subject matter information and the subject matter. However, in some engagements the responsible party may not be responsible for the subject matter. For example, when a professional accountant in public practice is engaged to perform an assurance engagement regarding a report that an environmental consultant has prepared about a company's sustainability practices, for distribution to intended users, the environmental consultant is the responsible party for the subject matter information but the company is responsible for the subject matter (the sustainability practices).

290.17 In those assertion-based assurance engagements that are not financial statement audit engagements, where the responsible party is responsible for the subject matter information but not the subject matter the members of the assurance team and the firm are required to be independent of the party responsible for the subject matter information (the assurance client). In addition, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

Direct Reporting Assurance Engagements

- 290.18 In a direct reporting assurance engagement the members of the assurance team and the firm are required to be independent of the assurance client (the party responsible for the subject matter).

Restricted Use Reports

- 290.19 In the case of an assurance report in respect of a non-financial statement audit client expressly restricted for use by identified users, the users of the report are considered to be knowledgeable as to the purpose, subject matter information and limitations of the report through their participation in establishing the nature and scope of the firm's instructions to deliver the services, including the criteria against which the subject matter are to be evaluated or measured. This knowledge and the enhanced ability of the firm to communicate about safeguards with all users of the report increase the effectiveness of safeguards to independence in appearance. These circumstances may be taken into account by the firm in evaluating the threats to independence and considering the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level. At a minimum, it will be necessary to apply the provisions of this section in evaluating the independence of members of the assurance team and their immediate and close family. Further, if the firm had a material financial interest, whether direct or indirect, in the assurance client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Limited consideration of any threats created by network firm interests and relationships may be sufficient.

Multiple Responsible Parties

- 290.20 In some assurance engagements, whether assertion-based or direct reporting, that are not financial statement audit engagements, there might be several responsible parties. In such engagements, in determining whether it is necessary to apply the provisions in this section to each responsible party, the firm may take into account whether an interest or relationship between the firm, or a member of the assurance team, and a particular responsible party would create a threat to independence that is other than clearly insignificant in the context of the subject matter information. This will take into account factors such as:

- The materiality of the subject matter information (or the subject matter) for which the particular responsible party is responsible; and
- The degree of public interest associated with the engagement.

If the firm determines that the threat to independence created by any such interest or relationship with a particular responsible party would be clearly insignificant it may not be necessary to apply all of the provisions of this section to that responsible party.

Other Considerations

- 290.21 The threats and safeguards identified in this section are generally discussed in the context of interests or relationships between the firm, network firms, members of the assurance team and the assurance client. In the case of a financial statement audit client that is a listed entity, the firm and any network firms are required to consider the interests and relationships that involve that client's related entities. Ideally those entities and the interests and relationships should be identified in advance. For all other assurance clients, when the assurance team has reason to believe that a **related entity*** of such an assurance client is relevant to the

* See Definitions.

evaluation of the firm's independence of the client, the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards.

- 290.22 The evaluation of threats to independence and subsequent action should be supported by evidence obtained before accepting the engagement and while it is being performed. The obligation to make such an evaluation and take action arises when a firm, a network firm or a member of the assurance team knows, or could reasonably be expected to know, of circumstances or relationships that might compromise independence. There may be occasions when the firm, a network firm or an individual inadvertently violates this section. If such an inadvertent violation occurs, it would generally not compromise independence with respect to an assurance client provided the firm has appropriate quality control policies and procedures in place to promote independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied.
- 290.23 Throughout this section, reference is made to significant and clearly insignificant threats in the evaluation of independence. In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account. A matter should be considered clearly insignificant only if it is deemed to be both trivial and inconsequential.

Objective and Structure of This Section

- 290.24 The objective of this section is to assist firms and members of assurance teams in:
- (a) Identifying threats to independence;
 - (b) Evaluating whether these threats are clearly insignificant; and
 - (c) In cases when the threats are not clearly insignificant, identifying and applying appropriate safeguards to eliminate or reduce the threats to an acceptable level.

Consideration should always be given to what a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude to be unacceptable. In situations when no safeguards are available to reduce the threat to an acceptable level, the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement.

- 290.25 This section concludes with some examples of how this conceptual approach to independence is to be applied to specific circumstances and relationships. The examples discuss threats to independence that may be created by specific circumstances and relationships (paragraphs 290.100 onwards). Professional judgment is used to determine the appropriate safeguards to eliminate threats to independence or to reduce them to an acceptable level. In certain examples, the threats to independence are so significant the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement. In other examples, the threat can be eliminated or reduced to an acceptable level by the application of safeguards. The examples are not intended to be all-inclusive.
- 290.26 Certain examples in this section indicate how the framework is to be applied to a financial statements audit engagement for a listed entity.

- 290.27 When threats to independence that are not clearly insignificant are identified, and the firm decides to accept or continue the assurance engagement, the decision should be documented. The documentation should include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.
- 290.28 The evaluation of the significance of any threats to independence and the safeguards necessary to reduce any threats to an acceptable level, takes into account the public interest. Certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. Examples of such entities may include listed companies, credit institutions, insurance companies, and pension funds. Because of the strong public interest in the financial statements of listed entities, certain paragraphs in this section deal with additional matters that are relevant to the financial statement audit of listed entities. Consideration should be given to the application of the framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.
- 290.29 Audit committees can have an important corporate governance role when they are independent of client management and can assist the Board of Directors in satisfying themselves that a firm is independent in carrying out its audit role. There should be regular communications between the firm and the audit committee (or other governance body if there is no audit committee) of listed entities regarding relationships and other matters that might, in the firm's opinion, reasonably be thought to bear on independence.
- 290.30 Firms should establish policies and procedures relating to independence communications with audit committees, or others charged with governance of the client. In the case of the financial statement audit of listed entities, the firm should communicate orally and in writing at least annually, all relationships and other matters between the firm, network firms and the financial statement audit client that in the firm's professional judgment may reasonably be thought to bear on independence. Matters to be communicated will vary in each circumstance and should be decided by the firm, but should generally address the relevant matters set out in this section.

Engagement Period

- 290.31 The members of the assurance team and the firm should be independent of the assurance client during the period of the assurance engagement. The period of the engagement starts when the assurance team begins to perform assurance services and ends when the assurance report is issued, except when the assurance engagement is of a recurring nature. If the assurance engagement is expected to recur, the period of the assurance engagement ends with the notification by either party that the professional relationship has terminated or the issuance of the final assurance report, whichever is later.
- 290.32 In the case of a financial statement audit engagement, the engagement period includes the period covered by the financial statements reported on by the firm. When an entity becomes a financial statement audit client during or after the period covered by the financial statements that the firm will report on, the firm should consider whether any threats to independence may be created by:
- Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to the acceptance of the financial statement audit engagement; or

- Previous services provided to the audit client.

Similarly, in the case of an assurance engagement that is not a financial statement audit engagement, the firm should consider whether any financial or business relationships or previous services may create threats to independence.

290.33 If a non-assurance service was provided to the financial statement audit client during or after the period covered by the financial statements but before the commencement of professional services in connection with the financial statement audit and the service would be prohibited during the period of the audit engagement, consideration should be given to the threats to independence, if any, arising from the service. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards may include:

- Discussing independence issues related to the provision of the non-assurance service with those charged with governance of the client, such as the audit committee;
- Obtaining the client's acknowledgement of responsibility for the results of the non-assurance service;
- Precluding personnel who provided the non-assurance service from participating in the financial statement audit engagement; and
- Engaging another firm to review the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

290.34 [Not used]

APPLICATION OF FRAMEWORK TO SPECIFIC SITUATIONS**CONTENTS**

	Paragraph
Introduction	290.100
Financial Interests	290.104
Provisions Applicable to All Assurance Clients	290.106
Provisions Applicable to Financial Statement Audit Clients	290.113
Provisions Applicable to Non-Financial Statement Audit Assurance Clients	290.122
Loans and Guarantees	290.126
Close Business Relationships with Assurance Clients	290.132
Family and Personal Relationships	290.135
Employment with Assurance Clients	290.143
Recent Service with Assurance Clients	290.146
Serving as an Officer or Director on the Board of Assurance Clients	290.149
Long Association of Senior Personnel with Assurance Clients	
General Provisions	290.153
Financial Statement Audit Clients that are Listed Entities	290.154
Provision of Non-assurance Services to Assurance Clients	290.158
Preparing Accounting Records and Financial Statements	290.166
General Provisions	290.169
Financial Statement Audit Clients that are Not Listed Entities	290.170
Financial Statement Audit Clients that are Listed Entities	290.171
Emergency Situations	290.173
Valuation Services	290.174
Provision of Taxation Services to Financial Statement Audit Clients	290.180
Provision of Internal Audit Services to Financial Statement Audit Clients	290.181
Provision of IT Systems Services to Financial Statement Audit Clients	290.187
Temporary Staff Assignments to Financial Statement Audit Clients	290.192
Provision of Litigation Support Services to Financial Statement Audit Clients	290.193
Provision of Legal Services to Financial Statement Audit Clients	290.196
Recruiting Senior Management	290.203
Corporate Finance and Similar Activities	290.204

Fees and Pricing	
Fees - Relative Size	290.206
Fees - Overdue	290.208
Pricing	290.209
Contingent Fees	290.210
Gifts and Hospitality.....	290.213
Actual or Threatened Litigation	290.214

SECTION 290 INTERPRETATION

Application of Section 290 to assurance engagements that are not financial statement audit engagements.....	2005-01
----------------------------------------------------------------------------------------------------------------	---------

Introduction

- 290.100 The following examples describe specific circumstances and relationships that may create threats to independence. The examples describe the potential threats created and the safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level in each circumstance. The examples are not all inclusive. In practice, the firm, network firms and the members of the assurance team will be required to assess the implications of similar, but different, circumstances and relationships and to determine whether safeguards, including the safeguards in paragraphs 200.12 through 200.15 can be applied to satisfactorily address the threats to independence.
- 290.101 Some of the examples deal with financial statement audit clients while others deal with assurance engagements for clients that are not financial statement audit clients. The examples illustrate how safeguards should be applied to fulfill the requirement for the members of the assurance team, the firm and network firms to be independent of a financial statement audit client, and for the members of the assurance team and the firm to be independent of an assurance client that is not a financial statement audit client. The examples do not include assurance reports to a non-financial statement audit client expressly restricted for use by identified users. As stated in paragraph 290.19 for such engagements, members of the assurance team and their immediate and close family are required to be independent of the assurance client. Further, the firm should not have a material financial interest, direct or indirect, in the assurance client.
- 290.102 The examples illustrate how the framework applies to financial statement audit clients and other assurance clients. The examples should be read in conjunction with paragraphs 290.20 which explain that, in the majority of assurance engagements, there is one responsible party and that responsible party comprises the assurance client. However, in some assurance engagements there are two responsible parties. In such circumstances, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.
- 290.103 Interpretation 2005-01 to this section provides further guidance on the application of the independence requirements contained in this section to assurance engagements that are not financial statement audit engagements.

Financial Interests

- 290.104 A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, the materiality of the financial interest and the type of financial interest (direct or indirect).
- 290.105 When evaluating the type of financial interest, consideration should be given to the fact that financial interests range from those where the individual has no control over the investment vehicle or the financial interest held (e.g., a mutual fund, unit trust or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g., as a trustee) or is able to influence investment decisions. In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or its investment strategy. When control exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise such control the financial interest should be considered indirect.

Provisions Applicable to All Assurance Clients

290.106 If a member of the assurance team, or their immediate family member, has a **direct financial interest**^{*}, or a material **indirect financial interest**^{*}, in the assurance client, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:

- (a) Dispose of the direct financial interest prior to the individual becoming a member of the assurance team;
- (b) Dispose of the indirect financial interest in total or dispose of a sufficient amount of it so that the remaining interest is no longer material prior to the individual becoming a member of the assurance team; or
- (c) Remove the member of the assurance team from the assurance engagement.

290.107 If a member of the assurance team, or their immediate family member receives, by way of, for example, an inheritance, gift or, as a result of a merger, a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat would be created. The following safeguards should be applied to eliminate the threat or reduce it to an acceptable level:

- (a) Disposing of the financial interest at the earliest practical date; or
- (b) Removing the member of the assurance team from the assurance engagement.

During the period prior to disposal of the financial interest or the removal of the individual from the assurance team, consideration should be given to whether additional safeguards are necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant to review the work done, or otherwise advise as necessary.

290.108 When a member of the assurance team knows that his or her close family member has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat may be created. In evaluating the significance of any threat, consideration should be given to the nature of the relationship between the member of the assurance team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be considered and applied as necessary. Such safeguards might include:

- The close family member disposing of all or a sufficient portion of the financial interest at the earliest practical date;
- Discussing the matter with those charged with governance, such as the audit committee;
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team with the close family relationship or otherwise advise as necessary; or

* See Definitions.

- Removing the individual from the assurance engagement.

290.109 When a firm or a member of the assurance team holds as a trustee a direct financial interest or a material indirect financial interest in the assurance client, the self-interest threat created by the possible influence of the trust over the assurance client would be so significant that the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:

- Dispose of the direct financial interest held by the trust;
- Dispose of the indirect financial interest held by the trust in total or dispose of a sufficient amount of it so that the remaining interest is no longer material;
- Step down as the trustee; or
- Remove the member of the assurance team from the assurance engagement.

290.110 Consideration should be given to whether a self-interest threat may be created by the financial interests of individuals outside of the assurance team and their immediate and close family members. Such individuals would include:

- Partners, and their immediate family members, who are not members of the assurance team;
- Partners and managerial employees who provide non-assurance services to the assurance client; and
- Individuals who have a close personal relationship with a member of the assurance team.

Whether the interests held by such individuals may create a self-interest threat will depend upon factors such as:

- The firm's organizational, operating and reporting structure; and
- The nature of the relationship between the individual and the member of the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Where appropriate, policies to restrict people from holding such interests;
- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done or otherwise advise as necessary.

290.111 An inadvertent violation of this section as it relates to a financial interest in an assurance client would not impair the independence of the firm, the network firm or a member of the assurance team when:

- (a) The firm, and the network firm, have established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;

- (b) The firm, and the network firm, promptly notify the professional that the financial interest should be disposed of; and
- (c) The disposal occurs at the earliest practical date after identification of the issue, or the professional is removed from the assurance team.

290.112 When an inadvertent violation of this section relating to a financial interest in an assurance client has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:

- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
- Excluding the individual from any substantive decision-making concerning the assurance engagement.

Provisions Applicable to Financial Statement Audit Clients

290.113 If a firm, or a network firm, has a direct financial interest in a financial statement audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.

290.114 If a firm, or a network firm, has a material indirect financial interest in a financial statement audit client of the firm a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.115 If a firm, or a network firm, has a material financial interest in an entity that has a controlling interest in a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.116 If the retirement benefit plan of a firm, or network firm, has a financial interest in a financial statement audit client the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement. If the retirement benefit plan of a firm, or network firm, has a material indirect financial interest in an audit client a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the retirement benefit plan of a firm, or network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.117 If other partners, including partners who do not perform assurance engagements, or their immediate family, in the **office**^{*} in which the **engagement partner**^{*} practices in connection with the financial statement audit hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an

* See Definitions.

acceptable level. Accordingly, such partners or their immediate family should not hold any such financial interests in such an audit client.

- 290.118 The office in which the engagement partner practices in connection with the financial statement audit is not necessarily the office to which that partner is assigned. Accordingly, when the engagement partner is located in a different office from that of the other members of the assurance team, judgment should be used to determine in which office the partner practices in connection with that audit.
- 290.119 If other partners and managerial employees who provide non-assurance services to the financial statement audit client, except those whose involvement is clearly insignificant, or their immediate family, hold a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such personnel or their immediate family should not hold any such financial interests in such an audit client.
- 290.120 A financial interest in a financial statement audit client that is held by an immediate family member of (a) a partner located in the office in which the engagement partner practices in connection with the audit, or (b) a partner or managerial employee who provides non-assurance services to the audit client is not considered to create an unacceptable threat provided it is received as a result of their employment rights (e.g., pension rights or share options) and, where necessary, appropriate safeguards are applied to reduce any threat to independence to an acceptable level.
- 290.121 A self-interest threat may be created if the firm, or the network firm, or a member of the assurance team has an interest in an entity and a financial statement audit client, or a director, officer or controlling owner thereof also has an investment in that entity. Independence is not compromised with respect to the audit client if the respective interests of the firm, the network firm, or member of the assurance team, and the audit client, or director, officer or controlling owner thereof are both immaterial and the audit client cannot exercise significant influence over the entity. If an interest is material, to either the firm, the network firm or the audit client, and the audit client can exercise significant influence over the entity, no safeguards are available to reduce the threat to an acceptable level and the firm, or the network firm, should either dispose of the interest or decline the audit engagement. Any member of the assurance team with such a material interest should either:
- (a) Dispose of the interest;
 - (b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material; or
 - (c) Withdraw from the audit.

Provisions Applicable to Non-Financial Statement Audit Assurance Clients

- 290.122 If a firm has a direct financial interest in an assurance client that is not a financial statement audit client the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.
- 290.123 If a firm has a material indirect financial interest in an assurance client that is not a financial statement audit client a self-interest threat is also created. The only action appropriate to permit the firm to perform the engagement would be for the firm to either dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

- 290.124 If a firm has a material financial interest in an entity that has a controlling interest in an assurance client that is not a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only action appropriate to permit the firm to perform the engagement would be for the firm either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- 290.125 When a restricted use report for an assurance engagement that is not a financial statement audit engagement is issued, exceptions to the provisions in paragraphs 290.106 through 290.110 and 290.122 through 290.124 are set out in 290.19.

Loans and Guarantees

- 290.126 A loan, or a guarantee of a loan, to the firm from an assurance client that is a bank or a similar institution, would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements and the loan is immaterial to both the firm and the assurance client. If the loan is material to the assurance client or the firm it may be possible, through the application of safeguards, to reduce the self-interest threat created to an acceptable level. Such safeguards might include involving an additional professional accountant from outside the firm, or network firm, to review the work performed.
- 290.127 A loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.
- 290.128 Similarly, deposits made by, or brokerage accounts of, a firm or a member of the assurance team with an assurance client that is a bank, broker or similar institution would not create a threat to independence provided the deposit or account is held under normal commercial terms.
- 290.129 If the firm, or a member of the assurance team, makes a loan to an assurance client, that is not a bank or similar institution, or guarantees such an assurance client's borrowing, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.
- 290.130 Similarly, if the firm or a member of the assurance team accepts a loan from, or has borrowing guaranteed by, an assurance client that is not a bank or similar institution, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.
- 290.131 The examples in paragraphs 290.126 through 290.130 relate to loans and guarantees between the firm and an assurance client. In the case of a financial statement audit engagement, the provisions should be applied to the firm, all network firms and the audit client.

Close Business Relationships With Assurance Clients

- 290.132 A close business relationship between a firm or a member of the assurance team and the assurance client or its management, or between the firm, a network firm and a financial statement audit client, will involve a commercial or common financial interest and may create self-interest and intimidation threats. The following are examples of such relationships:

- Having a material financial interest in a joint venture with the assurance client or a controlling owner, director, officer or other individual who performs senior managerial functions for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the assurance client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the assurance client's products or services, or the assurance client acts as the distributor or marketer of the products or services of the firm.

In the case of a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm, the network firm and the audit client, no safeguards could reduce the threat to an acceptable level. In the case of an assurance client that is not a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm and the assurance client, no safeguards could reduce the threat to an acceptable level. Consequently, in both these circumstances the only possible courses of action are to:

- (a) Terminate the business relationship;
- (b) Reduce the magnitude of the relationship so that the financial interest is immaterial and the relationship is clearly insignificant; or
- (c) Refuse to perform the assurance engagement.

Unless any such financial interest is immaterial and the relationship is clearly insignificant to the member of the assurance team, the only appropriate safeguard would be to remove the individual from the assurance team.

290.133 In the case of a financial statement audit client, business relationships involving an interest held by the firm, a network firm or a member of the assurance team or their immediate family in a closely held entity when the audit client or a director or officer of the audit client, or any group thereof, also has an interest in that entity, do not create threats to independence provided:

- (a) The relationship is clearly insignificant to the firm, the network firm and the audit client;
- (b) The interest held is immaterial to the investor, or group of investors; and
- (c) The interest does not give the investor, or group of investors, the ability to control the closely held entity.

290.134 The purchase of goods and services from an assurance client by the firm (or from a financial statement audit client by a network firm) or a member of the assurance team would not generally create a threat to independence providing the transaction is in the normal course of business and on an arm's length basis. However, such transactions may be of a nature or magnitude so as to create a self-interest threat. If the threat created is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Eliminating or reducing the magnitude of the transaction;
- Removing the individual from the assurance team; or

- Discussing the issue with those charged with governance, such as the audit committee.

Family and Personal Relationships

290.135 Family and personal relationships between a member of the assurance team and a director, an officer or certain employees, depending on their role, of the assurance client, may create self-interest, familiarity or intimidation threats. It is impracticable to attempt to describe in detail the significance of the threats that such relationships may create. The significance will depend upon a number of factors including the individual's responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client. Consequently, there is a wide spectrum of circumstances that will need to be evaluated and safeguards to be applied to reduce the threat to an acceptable level.

290.136 When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level. If application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. For example, in the case of an audit of financial statements, if the spouse of a member of the assurance team is an employee in a position to exert direct and significant influence over the preparation of the audit client's accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing the individual from the assurance team.

290.137 When an immediate family member of a member the assurance team is an employee in a position to exert direct and significant influence over the subject matter of the engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the immediate family member holds with the client; and
- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the immediate family member; or
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

290.138 When a close family member of a member of the assurance team is a director, an officer, or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the close family member holds with the client; and
- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the close family member; or
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

290.139 In addition, self-interest, familiarity or intimidation threats may be created when a person who is other than an immediate or close family member of a member of the assurance team has a close relationship with the member of the assurance team and is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore, members of the assurance team are responsible for identifying any such persons and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual within the assurance client.

290.140 Consideration should be given to whether self-interest, familiarity or intimidation threats may be created by a personal or family relationship between a partner or employee of the firm who is not a member of the assurance team and a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore partners and employees of the firm are responsible for identifying any such relationships and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the firm professional with the assurance team, the position held within the firm, and the role of the individual within the assurance client.

290.141 An inadvertent violation of this section as it relates to family and personal relationships would not impair the independence of a firm or a member of the assurance team when:

- (a) The firm has established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create threats to independence;
- (b) Either the responsibilities of the assurance team are re-structured so that the professional does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if this is not possible, the firm promptly removes the professional from the assurance engagement; and
- (c) Additional care is given to reviewing the work of the professional.

290.142 When an inadvertent violation of this section relating to family and personal relationships has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:

- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
- Excluding the individual from any substantive decision-making concerning the assurance engagement.

Employment with Assurance Clients

290.143 A firm or a member of the assurance team's independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats particularly when significant connections remain between the individual and his or her former firm. Similarly, a member of the assurance team's independence may be threatened when an individual participates in the assurance engagement knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.

290.144 If a member of the assurance team, partner or former partner of the firm has joined the assurance client, the significance of the self-interest, familiarity or intimidation threats created will depend upon the following factors:

- (a) The position the individual has taken at the assurance client.
- (b) The amount of any involvement the individual will have with the assurance team.
- (c) The length of time that has passed since the individual was a member of the assurance team or firm.
- (d) The former position of the individual within the assurance team or firm.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Considering the appropriateness or necessity of modifying the assurance plan for the assurance engagement;
- Assigning an assurance team to the subsequent assurance engagement that is of sufficient experience in relation to the individual who has joined the assurance client;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary; or
- Quality control review of the assurance engagement.

In all cases, all of the following safeguards are necessary to reduce the threat to an acceptable level:

- (a) The individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed pre-determined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm's independence.
- (b) The individual does not continue to participate or appear to participate in the firm's business or professional activities.

290.145 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future. This threat can be reduced to an acceptable level by the application of all of the following safeguards:

- (a) Policies and procedures to require the individual to notify the firm when entering serious employment negotiations with the assurance client.
- (b) Removal of the individual from the assurance engagement.

In addition, consideration should be given to performing an independent review of any significant judgments made by that individual while on the engagement.

Recent Service with Assurance Clients

290.146 To have a former officer, director or employee of the assurance client serve as a member of the assurance team may create self-interest, self-review and familiarity threats. This would be particularly true when a member of the assurance team has to report on, for example, subject matter information he or she had prepared or elements of the financial statements he or she had valued while with the assurance client.

290.147 If, during the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, the threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, such individuals should not be assigned to the assurance team.

290.148 If, prior to the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, this may create self-interest, self-review and familiarity threats. For example, such threats would be created if a decision made or work performed by the individual in the prior period, while employed by the assurance client, is to be evaluated in the current period as part of the current assurance engagement. The significance of the threats will depend upon factors such as:

- The position the individual held with the assurance client;
- The length of time that has passed since the individual left the assurance client; and
- The role the individual plays on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Involving an additional professional accountant to review the work done by the individual as part of the assurance team or otherwise advise as necessary; or
- Discussing the issue with those charged with governance, such as the audit committee.

Serving as an Officer or Director on the Board of Assurance Clients

- 290.149 If a partner or employee of the firm serves as an officer or as a director on the board of an assurance client the self-review and self-interest threats created would be so significant no safeguard could reduce the threats to an acceptable level. In the case of a financial statement audit engagement, if a partner or employee of a network firm were to serve as an officer or as a director on the board of the audit client the threats created would be so significant no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.
- 290.150 The position of Company Secretary has different implications in different jurisdictions. The duties may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.
- 290.151 If a partner or employee of the firm or a network firm serves as Company Secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant, no safeguard could reduce the threat to an acceptable level unless the duties and functions undertaken are limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns, and are permitted by law.
- 290.152 Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.

Long Association of Senior Personnel With Assurance Clients

General Provisions

- 290.153 Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The significance of the threat will depend upon factors such as:
- The length of time that the individual has been a member of the assurance team;
 - The role of the individual on the assurance team;
 - The structure of the firm; and
 - The nature of the assurance engagement.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied to reduce the threat to an acceptable level. Such safeguards might include:

- Rotating the senior personnel off the assurance team;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done by the senior personnel or otherwise advise as necessary; or
- Independent internal quality reviews.

Financial Statement Audit Clients that are Listed Entities

290.154 Using the same engagement partner or the same individual responsible for the **engagement quality control review*** on a financial statement audit over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the financial statement audit of a listed entity and safeguards should be applied in such situations to reduce such threat to an acceptable level. Accordingly in respect of the financial statement audit of listed entities:

- (a) The engagement partner and the individual responsible for the engagement quality control review should be rotated after serving in either capacity, or a combination thereof, for a pre-defined period, normally no more than seven years; and
- (b) Such an individual rotating after a pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.

290.155 When a financial statement audit client becomes a listed entity the length of time the engagement partner or the individual responsible for the engagement quality control review has served the audit client in that capacity should be considered in determining when the individual should be rotated.

290.156 [Not used]

290.157 [Not used]

Provision of Non-assurance Services to Assurance Clients

290.158 Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these firms, which have a good understanding of the business, bring their knowledge and skill to bear in other areas. Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client's business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client's business, the better the assurance team will understand the assurance client's procedures and controls, and the business and financial risks that it faces. The provision of non-assurance services may, however, create threats to the independence of the firm, a network firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.

* See Definitions.

290.159 The following activities would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the assurance engagement would reduce the threats to an acceptable level:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client, or having the authority to do so.
- Determining which recommendation of the firm should be implemented.
- Reporting, in a management role, to those charged with governance.

290.160 The examples set out in paragraphs 290.166 through 290.205 are addressed in the context of the provision of non-assurance services to an assurance client. The potential threats to independence will most frequently arise when a non-assurance service is provided to a financial statement audit client. The financial statements of an entity provide financial information about a broad range of transactions and events that have affected the entity. The subject matter information of other assurance services, however, may be limited in nature. Threats to independence, however, may also arise when a firm provides a non-assurance service related to the subject matter information, of a non-financial statement audit assurance engagement. In such cases, consideration should be given to the significance of the firm's involvement with the subject matter information, of the engagement, whether any self-review threats are created and whether any threats to independence could be reduced to an acceptable level by application of safeguards, or whether the engagement should be declined. When the non-assurance service is not related to the subject matter information, of the non-financial statement audit assurance engagement, the threats to independence will generally be clearly insignificant.

290.161 The following activities may also create self-review or self-interest threats:

- Having custody of an assurance client's assets.
- Supervising assurance client employees in the performance of their normal recurring activities.
- Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Making arrangements so that personnel providing such services do not participate in the assurance engagement;
- Involving an additional professional accountant to advise on the potential impact of the activities on the independence of the firm and the assurance team; or
- Other relevant safeguards set out in national regulations.

290.162 New developments in business, the evolution of financial markets, rapid changes in information technology, and the consequences for management and control, make it impossible to draw up an all-inclusive list of all situations when providing non-

assurance services to an assurance client might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level. In general, however, a firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level.

290.163 The following safeguards may be particularly relevant in reducing to an acceptable level threats created by the provision of non-assurance services to assurance clients:

- Policies and procedures to prohibit professional staff from making management decisions for the assurance client, or assuming responsibility for such decisions.
- Discussing independence issues related to the provision of non-assurance services with those charged with governance, such as the audit committee.
- Policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm.
- Involving an additional professional accountant to advise on the potential impact of the non-assurance engagement on the independence of the member of the assurance team and the firm.
- Involving an additional professional accountant outside of the firm to provide assurance on a discrete aspect of the assurance engagement.
- Obtaining the assurance client's acknowledgement of responsibility for the results of the work performed by the firm.
- Disclosing to those charged with governance, such as the audit committee, the nature and extent of fees charged.
- Making arrangements so that personnel providing non-assurance services do not participate in the assurance engagement.

290.164 Before the firm accepts an engagement to provide a non-assurance service to an assurance client, consideration should be given to whether the provision of such a service would create a threat to independence. In situations when a threat created is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level.

290.165 The provision of certain non-assurance services to financial statement audit clients may create threats to independence so significant that no safeguard could eliminate the threat or reduce it to an acceptable level.

Preparing Accounting Records and Financial Statements

290.166 Assisting a financial statement audit client in matters such as preparing accounting records or financial statements may create a self-review threat when the financial statements are subsequently audited by the firm.

290.167 It is the responsibility of financial statement audit client management to ensure that accounting records are kept and financial statements are prepared, although they may request the firm to provide assistance. If firm, or network firm, personnel providing such assistance make management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards.

Consequently, personnel should not make such decisions. Examples of such managerial decisions include:

- Determining or changing journal entries, or the classifications for accounts or transaction or other accounting records without obtaining the approval of the financial statement audit client;
- Authorizing or approving transactions; and
- Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.

290.168 The audit process involves extensive dialogue between the firm and management of the financial statement audit client. During this process, management requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for financial statement audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm's independence. Similarly, the financial statement audit process may involve assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as Hong Kong Financial Reporting Standards), drafting disclosure items, proposing adjusting journal entries and providing assistance and advice in the preparation of local statutory accounts of subsidiary entities. These services are considered to be a normal part of the audit process and do not, under normal circumstances, threaten independence so long as the responsibilities for the preparation of accounting records and financial statements rest with the audit client and the firm only assumes an advisory role.

General Provisions

290.169 The examples in paragraphs 290.170 through 290.173 indicate that self-review threats may be created if the firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter information of an audit engagement of the firm. This notion may be equally applicable in situations when the subject matter information of the assurance engagement is not financial statements. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this prospective financial information. Consequently, the firm should evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.

Financial Statements Audit Clients that are Not Listed Entities

290.170 The firm, or a network firm, may provide a financial statement audit client that is not a listed entity with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Recording transactions for which the audit client has determined or approved the appropriate account classification;
- Posting coded transactions to the audit client's general ledger;

- Preparing financial statements based on information in the trial balance; and
- Posting the audit client approved entries to the trial balance.

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Making arrangements so such services are not performed by a member of the assurance team;
- Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;
- Requiring the source data for the accounting entries to be originated by the audit client;
- Requiring the underlying assumptions to be originated and approved by the audit client; or
- Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements.

Financial Statement Audit Clients that are Listed Entities

290.171 The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of a financial statement audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to a listed entity that is a financial statement audit client.

290.172 The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of a financial statement audit client that is a listed entity would not be seen as impairing independence with respect to the audit client provided that the following conditions are met:

- (a) The services do not involve the exercise of judgment.
- (b) The divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client, or the services provided are collectively immaterial to the division or subsidiary.
- (c) The fees to the firm, or network firm, from such services are collectively clearly insignificant.

If such services are provided, all of the following safeguards should be applied:

- (a) The firm, or network firm, should not assume any managerial role nor make any managerial decisions.
- (b) The audit client should accept responsibility for the results of the work.

- (c) Personnel providing the services should not participate in the audit.

Emergency Situations

290.173 The provision of accounting and bookkeeping services to financial statement audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:

- (a) The firm, or network firm, does not assume any managerial role or make any managerial decisions;
- (b) The audit client accepts responsibility for the results of the work; and
- (c) Personnel providing the services are not members of the assurance team.

Valuation Services

290.174 A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.

290.175 A self-review threat may be created when a firm or network firm performs a valuation for a financial statement audit client that is to be incorporated into the client's financial statements.

290.176 If the valuation service involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided or, alternatively, the only course of action would be to withdraw from the financial statement audit engagement.

290.177 Performing valuation services for a financial statement audit client that are neither separately, nor in the aggregate, material to the financial statements, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:

- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary;
- Confirming with the audit client their understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;
- Obtaining the audit client's acknowledgement of responsibility for the results of the work performed by the firm; and
- Making arrangements so that personnel providing such services do not participate in the audit engagement.

In determining whether the above safeguards would be effective, consideration should be given to the following matters:

- (a) The extent of the audit client's knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment.

- (b) The degree to which established methodologies and professional guidelines are applied when performing a particular valuation service.
 - (c) For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item concerned.
 - (d) The reliability and extent of the underlying data.
 - (e) The degree of dependence on future events of a nature which could create significant volatility inherent in the amounts involved.
 - (f) The extent and clarity of the disclosures in the financial statements.
- 290.178 When a firm, or a network firm, performs a valuation service for a financial statement audit client for the purposes of making a filing or return to a tax authority, computing an amount of tax due by the client, or for the purpose of tax planning, this would not create a significant threat to independence because such valuations are generally subject to external review, for example by a tax authority.
- 290.179 When the firm performs a valuation that forms part of the subject matter information of an assurance engagement that is not a financial statement audit engagement, the firm should consider any self-review threats. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

Provision of Taxation Services to Financial Statement Audit Clients

- 290.180 In many jurisdictions, the firm may be asked to provide taxation services to a financial statement audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Before the firm accepts an engagement to provide taxation service to an audit client, consideration should be given to whether the provision of such a service would create threats to independence. In situations when a threat created is other than clearly insignificant, the taxation engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level. The provision of certain taxation services to an audit client may create threats to independence so significant that no safeguard other than the prohibition of such services could eliminate the threats or reduce the threats to an acceptable level.

Provision of Internal Audit Services to Financial Statement Audit Clients

- 290.181 A self-review threat may be created when a firm, or network firm, provides internal audit services to a financial statement audit client. Internal audit services may comprise an extension of the firm's audit service beyond requirements of generally accepted auditing standards, assistance in the performance of a client's internal audit activities or outsourcing of the activities. In evaluating any threats to independence, the nature of the service will need to be considered. For this purpose, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.
- 290.182 Services involving an extension of the procedures required to conduct a financial statement audit in accordance with Hong Kong Standards on Auditing would not be considered to impair independence with respect to the audit client provided that the firm's or network firm's personnel do not act or appear to act in a capacity equivalent to a member of audit client management.

- 290.183 When the firm, or a network firm, provides assistance in the performance of a financial statement audit client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by client management and the internal audit activities themselves.
- 290.184 Performing a significant portion of the financial statement audit client's internal audit activities may create a self-review threat and a firm, or network firm, should consider the threats and proceed with caution before taking on such activities. Appropriate safeguards should be put in place and the firm, or network firm, should, in particular, ensure that the audit client acknowledges its responsibilities for establishing, maintaining and monitoring the system of internal controls.
- 290.185 Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:
- (a) The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls;
 - (b) The audit client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
 - (c) The audit client, the audit committee or supervisory body approves the scope, risk and frequency of internal audit work;
 - (d) The audit client is responsible for evaluating and determining which recommendations of the firm should be implemented;
 - (e) The audit client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining and acting on reports from the firm; and
 - (f) The findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.
- 290.186 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.

Provision of IT Systems Services to Financial Statement Audit Clients

- 290.187 The provision of services by a firm or network firm to a financial statement audit client that involve the design and implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may create a self-review threat.
- 290.188 The self-review threat is likely to be too significant to allow the provision of such services to a financial statement audit client unless appropriate safeguards are put in place ensuring that:
- (a) The audit client acknowledges its responsibility for establishing and monitoring a system of internal controls;
 - (b) The audit client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;

- (c) The audit client makes all management decisions with respect to the design and implementation process;
 - (d) The audit client evaluates the adequacy and results of the design and implementation of the system; and
 - (e) The audit client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.
- 290.189 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.
- 290.190 The provision of services by a firm, or network firm, to a financial statement audit client which involve either the design or the implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may also create a self-review threat. The significance of the threat, if any, should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.
- 290.191 The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are not considered to create a threat to independence provided that firm or network firm personnel do not perform management functions.

Temporary Staff Assignments to Financial Statement Audit Clients

- 290.192 The lending of staff by a firm, or network firm, to a financial statement audit client may create a self-review threat when the individual is in a position to influence the preparation of a client's accounts or financial statements. In practice, such assistance may be given (particularly in emergency situations) but only on the understanding that the firm's or network firm's personnel will not be involved in:
- (a) Making management decisions;
 - (b) Approving or signing agreements or other similar documents; or
 - (c) Exercising discretionary authority to commit the client.

Each situation should be carefully analyzed to identify whether any threats are created and whether appropriate safeguards should be implemented. Safeguards that should be applied in all circumstances to reduce any threats to an acceptable level include:

- The staff providing the assistance should not be given audit responsibility for any function or activity that they performed or supervised during their temporary staff assignment; and
- The audit client should acknowledge its responsibility for directing and supervising the activities of firm, or network firm, personnel.

Provision of Litigation Support Services to Financial Statement Audit Clients

- 290.193 Litigation support services may include activities such as acting as an expert witness, calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute, and assistance with document management and retrieval in relation to a dispute or litigation.

290.194 A self-review threat may be created when the litigation support services provided to a financial statement audit client include the estimation of the possible outcome and thereby affects the amounts or disclosures to be reflected in the financial statements. The significance of any threat created will depend upon factors such as:

- The materiality of the amounts involved;
- The degree of subjectivity inherent in the matter concerned; and
- The nature of the engagement.

The firm, or network firm, should evaluate the significance of any threat created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to perform the service; or
- The involvement of others, such as independent experts.

290.195 If the role undertaken by the firm or network firm involved making managerial decisions on behalf of the financial statement audit client, the threats created could not be reduced to an acceptable level by the application of any safeguard. Therefore, the firm or network firm should not perform this type of service for an audit client.

Provision of Legal Services to Financial Statement Audit Clients

290.196 Legal services are defined as any services for which the person providing the services must either be admitted to practice before the Courts of the jurisdiction in which such services are to be provided, or have the required legal training to practice law. Legal services encompass a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition advice and support and the provision of assistance to clients' internal legal departments. The provision of legal services by a firm, or network firm, to an entity that is a financial statement audit client may create both self-review and advocacy threats.

290.197 Threats to independence need to be considered depending on the nature of the service to be provided, whether the service provider is separate from the assurance team and the materiality of any matter in relation to the entities' financial statements. The safeguards set out in paragraph 290.163 may be appropriate in reducing any threats to independence to an acceptable level. In circumstances when the threat to independence cannot be reduced to an acceptable level the only available action is to decline to provide such services or withdraw from the financial statement audit engagement.

290.198 The provision of legal services to a financial statement audit client which involve matters that would not be expected to have a material effect on the financial statements are not considered to create an unacceptable threat to independence.

290.199 There is a distinction between advocacy and advice. Legal services to support a financial statement audit client in the execution of a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an

acceptable level. Such a service would not generally impair independence, provided that:

- (a) Members of the assurance team are not involved in providing the service; and
- (b) In relation to the advice provided, the audit client makes the ultimate decision or, in relation to the transactions, the service involves the execution of what has been decided by the audit client.

290.200 Acting for a financial statement audit client in the resolution of a dispute or litigation in such circumstances when the amounts involved are material in relation to the financial statements of the audit client would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the firm should not perform this type of service for a financial statement audit client.

290.201 When a firm is asked to act in an advocacy role for a financial statement audit client in the resolution of a dispute or litigation in circumstances when the amounts involved are not material to the financial statements of the audit client, the firm should evaluate the significance of any advocacy and self-review threats created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client; or
- Using professionals who are not members of the assurance team to perform the service.

290.202 The appointment of a partner or an employee of the firm or network firm as General Counsel for legal affairs to a financial statement audit client would create self-review and advocacy threats that are so significant no safeguards could reduce the threats to an acceptable level. The position of General Counsel is generally a senior management position with broad responsibility for the legal affairs of a company and consequently, no member of the firm or network firm should accept such an appointment for a financial statement audit client.

Recruiting Senior Management

290.203 The recruitment of senior management for an assurance client, such as those in a position to affect the subject matter information of the assurance engagement, may create current or future self-interest, familiarity and intimidation threats. The significance of the threat will depend upon factors such as:

- The role of the person to be recruited; and
- The nature of the assistance sought.

The firm could generally provide such services as reviewing the professional qualifications of a number of applicants and provide advice on their suitability for the post. In addition, the firm could generally produce a short-list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.

The significance of the threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. In all cases, the firm should

not make management decisions and the decision as to whom to hire should be left to the client.

Corporate Finance and Similar Activities

290.204 The provision of corporate finance services, advice or assistance to an assurance client may create advocacy and self-review threats. In the case of certain corporate finance services, the independence threats created would be so significant no safeguards could be applied to reduce the threats to an acceptable level. For example, promoting, dealing in, or underwriting of an assurance client's shares is not compatible with providing assurance services. Moreover, committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the client would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level. In the case of a financial statement audit client the provision of those corporate finance services referred to above by a firm or a network firm would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level.

290.205 Other corporate finance services may create advocacy or self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Examples of such services include assisting a client in developing corporate strategies, assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria, and providing structuring advice and assisting a client in analyzing the accounting effects of proposed transactions. Safeguards that should be considered include:

- Policies and procedures to prohibit individuals assisting the assurance client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to provide the services; and
- Ensuring the firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client.

Fees and Pricing

Fees – Relative Size

290.206 When the total fees generated by an assurance client represent a large proportion of a firm's total fees, the dependence on that client or client group and concern about the possibility of losing the client may create a self-interest threat. The significance of the threat will depend upon factors such as:

- The structure of the firm; and
- Whether the firm is well established or newly created.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the extent and nature of fees charged with the audit committee, or others charged with governance;
- Taking steps to reduce dependency on the client;
- External quality control reviews; and

- Consulting a third party, such as a professional regulatory body or another professional accountant.

290.207 A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner. The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Policies and procedures to monitor and implement quality control of assurance engagements; and
- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary.

Fees – Overdue

290.208 A self-interest threat may be created if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issue of the assurance report for the following year. Generally the payment of such fees should be required before the report is issued. The following safeguards may be applicable:

- Discussing the level of outstanding fees with the audit committee, or others charged with governance.
- Involving an additional professional accountant who did not take part in the assurance engagement to provide advice or review the work performed.

The firm should also consider whether the overdue fees might be regarded as being equivalent to a loan to the client and whether, because of the significance of the overdue fees, it is appropriate for the firm to be re-appointed.

Pricing

290.209 When a firm obtains an assurance engagement at a significantly lower fee level than that charged by the predecessor firm, or quoted by other firms, the self-interest threat created will not be reduced to an acceptable level unless:

- (a) The firm is able to demonstrate that appropriate time and qualified staff are assigned to the task; and
- (b) All applicable assurance standards, guidelines and quality control procedures are being complied with.

Contingent Fees

290.210 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them.

290.211 A contingent fee charged by a firm in respect of an assurance engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by the application of any safeguard. Accordingly, a firm should not enter into any fee arrangement for an assurance engagement under which the amount of the fee is contingent on the result of the assurance work or on items that are the subject matter information of the assurance engagement.

290.212 A contingent fee charged by a firm in respect of a non-assurance service provided to an assurance client may also create self-interest and advocacy threats. If the amount of the fee for a non-assurance engagement was agreed to, or contemplated, during an assurance engagement and was contingent on the result of that assurance engagement, the threats could not be reduced to an acceptable level by the application of any safeguard. Accordingly, the only acceptable action is not to accept such arrangements. For other types of contingent fee arrangements, the significance of the threats created will depend on factors such as:

- The range of possible fee amounts;
- The degree of variability;
- The basis on which the fee is to be determined;
- Whether the outcome or result of the transaction is to be reviewed by an independent third party; and
- The effect of the event or transaction on the assurance engagement.

The significance of the threats should be evaluated and, if the threats are other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threats to an acceptable level. Such safeguards might include:

- Disclosing to the audit committee, or others charged with governance, the extent and nature of fees charged;
- Review or determination of the final fee by an unrelated third party; or
- Quality and control policies and procedures.

Gifts and Hospitality

290.213 Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats. When a firm or a member of the assurance team accepts gifts or hospitality, unless the value is clearly insignificant, the threats to independence cannot be reduced to an acceptable level by the application of any safeguard. Consequently, a firm or a member of the assurance team should not accept such gifts or hospitality.

Actual or Threatened Litigation

290.214 When litigation takes place, or appears likely, between the firm or a member of the assurance team and the assurance client, a self-interest or intimidation threat may be created. The relationship between client management and the members of the assurance team must be characterized by complete candor and full disclosure regarding all aspects of a client's business operations. The firm and the client's management may be placed in adversarial positions by litigation, affecting management's willingness to make complete disclosures and the firm may face a self-interest threat. The significance of the threat created will depend upon such factors as:

- The materiality of the litigation;
- The nature of the assurance engagement; and
- Whether the litigation relates to a prior assurance engagement.

Once the significance of the threat has been evaluated the following safeguards should be applied, if necessary, to reduce the threats to an acceptable level:

- (a) Disclosing to the audit committee, or others charged with governance, the extent and nature of the litigation;
- (b) If the litigation involves a member of the assurance team, removing that individual from the assurance team; or
- (c) Involving an additional professional accountant in the firm who was not a member of the assurance team to review the work done or otherwise advise as necessary.

If such safeguards do not reduce the threat to an appropriate level, the only appropriate action is to withdraw from, or refuse to accept, the assurance engagement.

Section 290 Interpretation

This interpretation is directed towards the application of the Code of Ethics for Professional Accountants to the topics of the specific queries received. Those subject to the regulations of other authoritative bodies, such as the US Securities and Exchange Commission, may wish to consult with them for their positions on these matters.

Interpretation 2005-01

Application of Section 290 to assurance engagements that are not financial statement audit engagements

This interpretation provides guidance on the application of the independence requirements contained in Section 290 to assurance engagements that are not financial statement audit engagements.

This interpretation focuses on the application issues that are particular to assurance engagements that are not financial statement audit engagements. There are other matters noted in Section 290 that are relevant in the consideration of independence requirements for all assurance engagements. For example, paragraph 290.15 states that consideration should be given to any threats the firm has reason to believe may be created by network firms interests and relationships. Similarly, paragraph 290.21 states that for assurance clients, that are other than listed entity financial statement audit clients, when the assurance team has reason to believe that a related entity of such an assurance client is relevant to the evaluation of the firm's independence of the client, the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards. These matters are not specifically addressed in this interpretation.

As explained in the Hong Kong Framework for Assurance Engagements, in an assurance engagement, the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

Assertion-based Assurance Engagements

In an assertion-based assurance engagement, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.

In an assertion-based assurance engagement independence is required from the responsible party, which is responsible for the subject matter information and may be responsible for the subject matter.

In those assertion-based assurance engagements where the responsible party is responsible for the subject matter information but not the subject matter, independence is required from the responsible party. In addition, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

Direct Reporting Assurance Engagements

In a direct reporting assurance engagement, the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

In a direct reporting assurance engagement independence is required from the responsible party, which is responsible for the subject matter.

Multiple Responsible Parties

In both assertion-based assurance engagements and direct reporting assurance engagements there may be several responsible parties. For example, a public accountant in public practice may be asked to provide assurance on the monthly circulation statistics of a number of independently owned newspapers. The assignment could be an assertion based assurance engagement where each newspaper measures its circulation and the statistics are presented in an assertion that is available to the intended users. Alternatively, the assignment could be a direct reporting assurance engagement, where there is no assertion and there may or may not be a written representation from the newspapers.

In such engagements, when determining whether it is necessary to apply the provisions in Section 290 to each responsible party, the firm may take into account whether an interest or relationship between the firm, or a member of the assurance team, and a particular responsible party would create a threat to independence that is other than clearly insignificant in the context of the subject matter information. This will take into account:

- The materiality of the subject matter information (or the subject matter) for which the particular responsible party is responsible; and
- The degree of public interest that is associated with the engagement.

If the firm determines that the threat to independence created by any such relationships with a particular responsible party would be clearly insignificant it may not be necessary to apply all of the provisions of this section to that responsible party.

The following example has been developed to demonstrate the application of Section 290. It is assumed that the client is not also a financial statement audit client of the firm, or a network firm.

A firm is engaged to provide assurance on the total proven oil reserves of 10 independent companies. Each company has conducted geographical and engineering surveys to determine their reserves (subject matter). There are established criteria to determine when a reserve may be considered to be proven which the professional accountant in public practice determines to be suitable criteria for the engagement.

The proven reserves for each company as at December 31, 20X0 were as follows:

	Proven oil reserves thousands barrels
Company 1	5,200
Company 2	725
Company 3	3,260
Company 4	15,000
Company 5	6,700
Company 6	39,126
Company 7	345
Company 8	175
Company 9	24,135
Company 10	9,635
Total	104,301

The engagement could be structured in differing ways:

Assertion based engagements

A1 Each company measures its reserves and provides an assertion to the firm and to intended users.

A2 An entity other than the companies measures the reserves and provides an assertion to the firm and to intended users.

Direct reporting engagements

D1 Each company measures the reserves and provides the firm with a written representation that measures its reserves against the established criteria for measuring proven reserves. The representation is not available to the intended users.

D2 The firm directly measures the reserves of some of the companies.

Application of approach

A1 Each company measures its reserves and provides an assertion to the firm and to intended users.

There are several responsible parties in this engagement (companies 1-10). When determining whether it is necessary to apply the independence provisions to all of the companies, the firm may take into account whether an interest or relationship with a particular company would create a threat to independence that is other than clearly insignificant. This will take into account factors such as:

- The materiality of the company's proven reserves in relation to the total reserves to be reported on; and
- The degree of public interest associated with the engagement. (paragraph 290.20).

For example Company 8 accounts for 0.16% of the total reserves, therefore a business relationship or interest with the Company 8 would create less of a threat than a similar relationship with Company 6, which accounts for approximately 37.5% of the reserves.

Having determined those companies to which the independence requirements apply, the assurance team and the firm are required to be independent of those responsible parties which would be considered to be the assurance client (paragraph 290.20).

A2 An entity other than the companies measures the reserves and provides an assertion to the firm and to intended users.

The firm would be required to be independent of the entity that measures the reserves and provides an assertion to the firm and to intended users (paragraph 290.17). That entity is not responsible for the subject matter and so consideration should be given to any threats the firm has reason to believe may be created by interests/relationships with the party responsible for the subject matter (paragraph 290.17). There are several parties responsible for subject matter in this engagement (companies 1-10). As discussed in example A1 above, the firm may take into account whether an interest or relationship with a particular company would create a threat to independence that is other than clearly insignificant.

D1 Each company provides the firm with a representation that measures its reserves against the established criteria for measuring proven reserves. The representation is not available to the intended users.

There are several responsible parties in this engagement (companies 1-10). When determining whether it is necessary to apply the independence provisions to all of the companies, the firm may take into account whether an interest or relationship with a particular company would create a threat to independence that is other than clearly insignificant. This will take into account factors such as:

- The materiality of the company's proven reserves in relation to the total reserves to be reported on; and
- The degree of public interest associated with the engagement (paragraph 290.20).

For example Company 8 accounts for 0.16% of the reserves, therefore a business relationship or interest with the Company 8 would create less of a threat than a similar relationship with Company 6 that accounts for approximately 37.5% of the reserves.

Having determined those companies to which the independence requirements apply, the assurance team and the firm are required to be independent of those responsible parties which would be considered to be the assurance client (paragraph 290.20).

D2 The firm directly measures the reserves of some of the companies

The application is the same as in example D1.

PART C: PROFESSIONAL ACCOUNTANTS IN BUSINESS

- Section 300 Introduction
- Section 310 Potential Conflicts
- Section 320 Preparation and Reporting of Information
- Section 330 Acting with Sufficient Expertise
- Section 340 Financial Interests
- Section 350 Inducements

Section 300

Introduction

- 300.1 This Part of the Code illustrates how the conceptual framework contained in Part A is to be applied by professional accountants in business.
- 300.2 Investors, creditors, employers and other sectors of the business community, as well as governments and the public at large, all may rely on the work of professional accountants in business. Professional accountants in business may be solely or jointly responsible for the preparation and reporting of financial and other information, which both their employing organizations and third parties may rely on. They may also be responsible for providing effective financial management and competent advice on a variety of business-related matters.
- 300.3 A professional accountant in business may be a salaried employee, a partner, director (whether executive or non-executive), an owner manager, a volunteer or another working for one or more employing organization. The legal form of the relationship with the employing organization, if any, has no bearing on the ethical responsibilities incumbent on the professional accountant in business.
- 300.4 A professional accountant in business has a responsibility to further the legitimate aims of their employing organization. This Code does not seek to hinder a professional accountant in business from properly fulfilling that responsibility, but considers circumstances in which conflicts may be created with the absolute duty to comply with the fundamental principles.
- 300.5 A professional accountant in business often holds a senior position within an organization. The more senior the position, the greater will be the ability and opportunity to influence events, practices and attitudes. A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization that emphasizes the importance that senior management places on ethical behaviour.
- 300.6 The examples presented in the following sections are intended to illustrate how the conceptual framework is to be applied and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant in business that may create threats to compliance with the principles. Consequently, it is not sufficient for a professional accountant in business merely to comply with the examples; rather, the framework should be applied to the particular circumstances faced.

Threats and Safeguards

- 300.7 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:
- (a) Self-interest;
 - (b) Self-review;
 - (c) Advocacy;
 - (d) Familiarity; and
 - (e) Intimidation.

These threats are discussed further in Part A of this Code.

- 300.8 Examples of circumstances that may create self-interest threats for a professional accountant in business include, but are not limited to:
- Financial interests, loans or guarantees.
 - Incentive compensation arrangements.
 - Inappropriate personal use of corporate assets.
 - Concern over employment security.
 - Commercial pressure from outside the employing organization.
- 300.9 Circumstances that may create self-review threats include, but are not limited to, business decisions or data being subject to review and justification by the same professional accountant in business responsible for making those decisions or preparing that data.
- 300.10 When furthering the legitimate goals and objectives of their employing organizations professional accountants in business may promote the organization's position, provided any statements made are neither false nor misleading. Such actions generally would not create an advocacy threat.
- 300.11 Examples of circumstances that may create familiarity threats include, but are not limited to:
- A professional accountant in business in a position to influence financial or non-financial reporting or business decisions having an immediate or close family member who is in a position to benefit from that influence.
 - Long association with business contacts influencing business decisions.
 - Acceptance of a gift or preferential treatment, unless the value is clearly insignificant.
- 300.12 Examples of circumstances that may create intimidation threats include, but are not limited to:
- Threat of dismissal or replacement of the professional accountant in business or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported.
 - A dominant personality attempting to influence the decision making process, for example with regard to the awarding of contracts or the application of an accounting principle.
- 300.13 Professional accountants in business may also find that specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats obviously cannot be categorized. In all professional and business relationships, professional accountants in business should always be on the alert for such circumstances and threats.

- 300.14 Safeguards that may eliminate or reduce to an acceptable level the threats faced by professional accountants in business fall into two broad categories:
- (a) Safeguards created by the profession, legislation or regulation; and
 - (b) Safeguards in the work environment.
- 300.15 Examples of safeguards created by the profession, legislation or regulation are detailed in paragraph 100.12 of Part A of this Code.
- 300.16 Safeguards in the work environment include, but are not restricted to:
- The employing organization's systems of corporate oversight or other oversight structures.
 - The employing organization's ethics and conduct programs.
 - Recruitment procedures in the employing organization emphasizing the importance of employing high caliber competent staff.
 - Strong internal controls.
 - Appropriate disciplinary processes.
 - Leadership that stresses the importance of ethical behaviour and the expectation that employees will act in an ethical manner.
 - Policies and procedures to implement and monitor the quality of employee performance.
 - Timely communication of the employing organization's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures.
 - Policies and procedures to empower and encourage employees to communicate to senior levels within the employing organization any ethical issues that concern them without fear of retribution.
 - Consultation with another appropriate professional accountant.
- 300.17 In circumstances where a professional accountant in business believes that unethical behaviour or actions by others will continue to occur within the employing organization, the professional accountant in business should consider seeking legal advice. In those extreme situations where all available safeguards have been exhausted and it is not possible to reduce the threat to an acceptable level, a professional accountant in business may conclude that it is appropriate to resign from the employing organization.

Section 310

Potential Conflicts

- 310.1 A professional accountant in business has a professional obligation to comply with the fundamental principles. There may be times, however, when their responsibilities to an employing organization and the professional obligations to comply with the fundamental principles are in conflict. Ordinarily, a professional accountant in business should support the legitimate and ethical objectives established by the employer and the rules and procedures drawn up in support of those objectives. Nevertheless, where compliance with the fundamental principles is threatened, a professional accountant in business must consider a response to the circumstances.
- 310.2 As a consequence of responsibilities to an employing organization, a professional accountant in business may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A professional accountant in business may face pressure to:
- Act contrary to law or regulation.
 - Act contrary to technical or professional standards.
 - Facilitate unethical or illegal earnings management strategies.
 - Lie to, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:
 - The auditors of the employing organization; or
 - Regulators.
 - Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with, for example:
 - The financial statements;
 - Tax compliance;
 - Legal compliance; or
 - Reports required by securities regulators.
- 310.3. The significance of threats arising from such pressures, such as intimidation threats, should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:
- Obtaining advice where appropriate from within the employing organization, an independent professional advisor or a relevant professional body.
 - The existence of a formal dispute resolution process within the employing organization.
 - Seeking legal advice.

Section 320

Preparation and Reporting of Information

- 320.1 Professional accountants in business are often involved in the preparation and reporting of information that may either be made public or used by others inside or outside the employing organization. Such information may include financial or management information, for example, forecasts and budgets, financial statements, management discussion and analysis, and the management letter of representation provided to the auditors as part of an audit of financial statements. A professional accountant in business should prepare or present such information fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context.
- 320.2 A professional accountant in business who has responsibility for the preparation or approval of the general purpose financial statements of an employing organization should ensure that those financial statements are presented in accordance with the applicable financial reporting standards.
- 320.3 A professional accountant in business should maintain information for which the professional accountant in business is responsible in a manner that:
- (a) Describes clearly the true nature of business transactions, assets or liabilities;
 - (b) Classifies and records information in a timely and proper manner; and
 - (c) Represents the facts accurately and completely in all material respects.
- 320.4 Threats to compliance with the fundamental principles, for example self-interest or intimidation threats to objectivity or professional competence and due care, may be created where a professional accountant in business may be pressured (either externally or by the possibility of personal gain) to become associated with misleading information or to become associated with misleading information through the actions of others.
- 320.5 The significance of such threats will depend on factors such as the source of the pressure and the degree to which the information is, or may be, misleading. The significance of the threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include consultation with superiors within the employing organization, for example, the audit committee or other body responsible for governance, or with a relevant professional body.
- 320.6 Where it is not possible to reduce the threat to an acceptable level, a professional accountant in business should refuse to remain associated with information they consider is or may be misleading. Should the professional accountant in business be aware that the issuance of misleading information is either significant or persistent, the professional accountant in business should consider informing appropriate authorities in line with the guidance in Section 140. The professional accountant in business may also wish to seek legal advice or resign.

Section 330

Acting with Sufficient Expertise

- 330.1 The fundamental principle of professional competence and due care requires that a professional accountant in business should only undertake significant tasks for which the professional accountant in business has, or can obtain, sufficient specific training or experience. A professional accountant in business should not intentionally mislead an employer as to the level of expertise or experience possessed, nor should a professional accountant in business fail to seek appropriate expert advice and assistance when required.
- 330.2 Circumstances that threaten the ability of a professional accountant in business to perform duties with the appropriate degree of professional competence and due care include:
- Insufficient time for properly performing or completing the relevant duties.
 - Incomplete, restricted or otherwise inadequate information for performing the duties properly.
 - Insufficient experience, training and/or education.
 - Inadequate resources for the proper performance of the duties.
- 330.3 The significance of such threats will depend on factors such as the extent to which the professional accountant in business is working with others, relative seniority in the business and the level of supervision and review applied to the work. The significance of the threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Safeguards that may be considered include:
- Obtaining additional advice or training.
 - Ensuring that there is adequate time available for performing the relevant duties.
 - Obtaining assistance from someone with the necessary expertise.
 - Consulting, where appropriate, with:
 - Superiors within the employing organization;
 - Independent experts; or
 - A relevant professional body.
- 330.4 Where threats cannot be eliminated or reduced to an acceptable level, professional accountants in business should consider whether to refuse to perform the duties in question. If the professional accountant in business determines that refusal is appropriate the reasons for doing so should be clearly communicated.

Additional requirements are set out in Section 470 "Financial and Accounting Responsibilities of Directors".

Section 340

Financial Interests

340.1 Professional accountants in business may have financial interests, or may know of financial interests of immediate or close family members, that could, in certain circumstances, give rise to threats to compliance with the fundamental principles. For example, self-interest threats to objectivity or confidentiality may be created through the existence of the motive and opportunity to manipulate price sensitive information in order to gain financially. Examples of circumstances that may create self-interest threats include, but are not limited to situations where the professional accountant in business or an immediate or close family member:

- Holds a direct or indirect financial interest in the employing organization and the value of that financial interest could be directly affected by decisions made by the professional accountant in business;
- Is eligible for a profit related bonus and the value of that bonus could be directly affected by decisions made by the professional accountant in business;
- Holds, directly or indirectly, share options in the employing organization, the value of which could be directly affected by decisions made by the professional accountant in business;
- Holds, directly or indirectly, share options in the employing organization which are, or will soon be, eligible for conversion; or
- May qualify for share options in the employing organization or performance related bonuses if certain targets are achieved.

340.2 In evaluating the significance of such a threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, professional accountants in business must examine the nature of the financial interest. This includes an evaluation of the significance of the financial interest and whether it is direct or indirect. Clearly, what constitutes a significant or valuable stake in an organization will vary from individual to individual, depending on personal circumstances.

340.3 If threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level. Such safeguards may include:

- Policies and procedures for a committee independent of management to determine the level or form of remuneration of senior management.
- Disclosure of all relevant interests, and of any plans to trade in relevant shares to those charged with the governance of the employing organization, in accordance with any internal policies.
- Consultation, where appropriate, with superiors within the employing organization.
- Consultation, where appropriate, with those charged with the governance of the employing organization or relevant professional bodies.
- Internal and external audit procedures.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

- Up-to-date education on ethical issues and the legal restrictions and other regulations around potential insider trading.

340.4 A professional accountant in business should neither manipulate information nor use confidential information for personal gain.

Section 350

Inducements

Receiving Offers

- 350.1 A professional accountant in business or an immediate or close family member may be offered an inducement. Inducements may take various forms, including gifts, hospitality, preferential treatment and inappropriate appeals to friendship or loyalty.
- 350.2 Offers of inducements may create threats to compliance with the fundamental principles. When a professional accountant in business or an immediate or close family member is offered an inducement, the situation should be carefully considered. Self-interest threats to objectivity or confidentiality are created where an inducement is made in an attempt to unduly influence actions or decisions, encourage illegal or dishonest behaviour or obtain confidential information. Intimidation threats to objectivity or confidentiality are created if such an inducement is accepted and it is followed by threats to make that offer public and damage the reputation of either the professional accountant in business or an immediate or close family member.
- 350.3 The significance of such threats will depend on the nature, value and intent behind the offer. If a reasonable and informed third party, having knowledge of all relevant information, would consider the inducement insignificant and not intended to encourage unethical behaviour, then a professional accountant in business may conclude that the offer is made in the normal course business and may generally conclude that there is no significant threat to compliance with the fundamental principles.
- 350.4 If evaluated threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in business should not accept the inducement. As the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement but, sometimes, merely from the fact of the offer having been made, additional safeguards should be adopted. A professional accountant in business should assess the risk associated with all such offers and consider whether the following actions should be taken:
- (a) Where such offers have been made, immediately inform higher levels of management or those charged with governance of the employing organization;
 - (b) Inform third parties of the offer – for example, a professional body or the employer of the individual who made the offer; a professional accountant in business should, however, consider seeking legal advice before taking such a step; and
 - (c) Advise immediate or close family members of relevant threats and safeguards where they are potentially in positions that might result in offers of inducements, for example as a result of their employment situation; and
 - (d) Inform higher levels of management or those charged with governance of the employing organization where immediate or close family members are employed by competitors or potential suppliers of that organization.

Making Offers

- 350.5 A professional accountant in business may be in a situation where the professional accountant in business is expected to, or is under other pressure to, offer inducements to subordinate the judgment of another individual or organization, influence a decision-making process or obtain confidential information.
- 350.6 Such pressure may come from within the employing organization, for example, from a colleague or superior. It may also come from an external individual or organization suggesting actions or business decisions that would be advantageous to the employing organization possibly influencing the professional accountant in business improperly.
- 350.7 A professional accountant in business should not offer an inducement to improperly influence professional judgment of a third party.
- 350.8 Where the pressure to offer an unethical inducement comes from within the employing organization, the professional accountant should follow the principles and guidance regarding ethical conflict resolution set out in Part A of this Code.

PART D: ADDITIONAL ETHICAL REQUIREMENTS

- Section 400 Introduction
- Section 410 Unlawful Acts or Defaults by Clients of Members
[previously Statement 1.204B]
- Section 411 Unlawful Acts or Defaults by or on Behalf of a Member's Employer
[previously Statement 1.290C]
- Section 420 Use of Designations and Institute's Logo
[previously Statement 1.213]
- Section 430 Ethics in Tax Practice
[previously Statement 1.210]
- Section 431 Corporate Finance Advice
[previously Statement 1.292]
- Section 432 Integrity, Objectivity and Independence in Insolvency
[previously Statement 1.203 (supp.)]
- Section 440 Changes in a Professional Appointment
[previously Statement 1.207]
- Section 441 Change of Auditors of a Listed Issuer of the Stock Exchange of Hong Kong
[previously Statement 1.207A]
- Section 450 Practice Promotion
[previously Statement 1.205]
- Section 460 Clients' Monies
[previously Statement 1.212]
- Section 470 Financial and Accounting Responsibilities of Directors
[previously Statement 1.290D]

Section 400

Introduction

- 400.1 This Part of the Code sets out the additional ethical requirements on specific areas. Where the Council of the Institute deems it necessary, it has included, and may develop further, additional ethical requirements on matters of relevance not covered by the IFAC Code of Ethics for Professional Accountants. The existing additional ethical requirements are primarily derived from local legal or regulatory requirements.
- 400.2 The sections under this Part are to be read in the context of the fundamental principles of professional ethics for professional accountants and the conceptual framework for applying those principles which are set out in Parts A to C. Consequently, it is not sufficient for a professional accountant merely to comply with the additional ethical requirements under this Part; rather, the entire Code should be applied to the particular circumstances faced.
- 400.3 The sections under this Part originate from Professional Ethics Statements that were in existence prior to the issuance of the Code. They have not yet been conformed to all the requirements under Parts A to C which are adopted from the IFAC Code of Ethics for Professional Accountants. The Institute plans to review and update where necessary all the sections under this Part. The references to the previous Professional Ethics Statements are inserted in the relevant sections for easy reference.
- 400.4 Until the sections under this Part are updated, where members encounter situations where a requirement under this Part is:
- (a) more stringent than a provision in Part A, B or C, the requirement under this Part should prevail; or
 - (b) in conflict with or less stringent than a provision in Part A, B or C, the relevant provision in Part A, B or C should be followed.

Section 410 [previously Statement 1.204B]

Unlawful Acts or Defaults by Clients of Members

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

Occasions sometimes arise where a member, in carrying out his professional duties, acquires knowledge indicating that a client or an officer or employee of the client may have been guilty of some default or unlawful act. This may put him in a difficult situation of conflicting duties, aggravated sometimes by allegations that he himself is implicated in some way in those unlawful acts, or has some legal responsibility arising from those acts. This section gives guidance to members concerning these areas of difficulty. However, it is for general guidance only and in any particular case reference should also be made to any relevant legislation. Although various examples are given of the duties of members, they are examples only. These areas of difficulty involve not only questions of professional conduct but also important legal considerations.

Every case depends upon its own circumstances and if a member is in the slightest doubt as to his correct course of action he should seek independent legal or other professional advice.

This section of guidance has been settled in consultation with counsel.

General Principles

Introduction

410.1 In recent years there has been a steady growth internationally in the number of criminal offences committed, or suspected by the authorities to have been committed, in the business environment. It is not practicable to set out all the offences which members may encounter in the course of their work but the principal statutory and common law offences concerned are:

- (a) theft, obtaining by deception, false accounting;
- (b) fraud, forgery and offences in relation to companies including frauds on creditors and shareholders;
- (c) corruption offences;
- (d) conspiracy, soliciting or inciting to commit crime;
- (e) offences in relation to taxation;
- (f) involvement in arrangements relating to the proceeds of drug trafficking.

410.2 The Guidelines which follow are intended to assist members in the discharge of their professional responsibilities when, in one way or another, their clients or officers or employees of their clients come under suspicion by the authorities (whether justified or not) of having committed some criminal offences, or members themselves have information that their clients have in one way or another become so implicated. The guidance given in the Guidelines is not intended to be exhaustive. There will arise from time to time situations of conflicting duties not covered by these Guidelines. Members should therefore use their own judgement in all cases and would be well advised to consult a solicitor if in doubt.

- 410.3 A practising member, acting in any professional capacity, has access to much information of a private nature. It is essential that he should normally treat such information as available to him for the purpose only of carrying out the professional duties for which he has been engaged. To divulge information about a client's affairs would normally be a breach of professional confidence. However, the duty of confidentiality is not absolute. Where, for example, members acquire information in the course of an audit showing that defaults and unlawful acts have taken place, members may be duty-bound to make such disclosures and statements in their reports as would ensure that their functions and duties as auditors are properly discharged. Likewise members may have duties to make reports as auditors under the Banking Ordinance 1986 or to make disclosures to the relevant authorities under the Drug Trafficking (Recovery of Proceeds) Ordinance both of which require the disclosure of confidential information.

Relations Between a Member and His Client

Disclosure of Information by His Client to a Member

- 410.4 Where a member is engaged to prepare or audit accounts of a client or to deal with taxation or any other work relating to that client he should always make it clear to the client that he can only do so on the basis of full disclosure of all information relevant to the work in question. If the client will not agree, the member should not act for him.
- 410.5 If the client fails to provide such information or explanation as the member may require, the member has a clear professional obligation to indicate this fact in any report and may consider that he can no longer act.
- 410.6 It is an offence under the Companies Ordinance for an officer of a company knowingly or recklessly to make a statement to the auditors of the company (whether orally or in writing) conveying any information or explanation which the auditors may require which is misleading, false or deceptive in a material particular.
- 410.7 A member may, in the course of acting for one client, acquire information which he is aware discredits the information supplied to the member by a second client. In such a case the member may not reveal to the second client any information obtained as a result of his dealings with the first client. To do so without permission would be a breach of the duty of confidentiality owed to the first client. In practice it will probably not be possible to obtain the first client's permission to disclose information to the second client without a breach of confidentiality in respect of the second client's affairs. The member must first do his best to make sure that the information that he has acquired is valid. Thereafter, the member should use every endeavour to obtain from within the records of the second client evidence to substantiate independently the information acquired from the first client. In the absence of any such evidence the member should, in appropriate cases, consider seeking the second client's consent to obtaining direct confirmation of the information concerned. If the member is seeking confirmation in connection with his work as auditor of the second client and consent is refused he should consider qualifying his report or resigning, and, where relevant, making an appropriate statement under section 140A(2)(b) of the Companies Ordinance without revealing the name of the first client. In other cases where consent is refused the member should consider ceasing to act.

Disclosure of Defaults or Unlawful Acts

- 410.8 It is an implied term of a member's contract with his client that the member will not, as a general rule, disclose to other persons information about his client's affairs acquired during and as a result of their professional relationship, against his client's wishes. Therefore where a member becomes aware that a client has committed a

default or unlawful act, the member should in principle keep the matter between himself and his client.

- 410.9 The relationship between client and member is a highly confidential one, in which candour on the part of the client is of great importance, and it is in the public interest that, in general, that confidence should be maintained. The very fact that, relying on the confidential relationship which exists, clients are frank with members probably prevents a large number of offences being committed because a client, on discussing his intentions and proposed action with the member, will have the dangers pointed out to him; if he acts on the member's advice, he will refrain from putting his proposal into action.
- 410.10 However, the confidentiality, whether arising from contract - paragraph 410.8 above - or as a matter of public interest - paragraph 410.9 above - is by no means absolute. There will be circumstances where a member is (1) *required* to disclose to others knowledge of defaults or criminal acts acquired in the course of such confidential relationship and (2) *free* to make such disclosure (refer paragraph 410.3 above).

Obligation to Disclose

- 410.11 A member must disclose information if compelled by process of law, for example under a court order or under the compulsion of a statute, in particular sections 13 and 14(1)(d) of the Prevention of Bribery Ordinance, section 51(4)(a) of the Inland Revenue Ordinance and sections 20, 21 and 25 of the Drug Trafficking (Recovery of Proceeds) Ordinance.
- 410.12 The only exception to the above rule - paragraph 410.11 - might be where, in the course of giving the information, the member might incriminate himself in relation to crimes that he might himself have committed. In such circumstances he might be entitled to the benefit of the ordinary privilege against self-incrimination. If such a situation should arise, members are strongly advised to seek legal representation. However it should be noted that a person cannot refuse to reply to a section 14(1)(d) Notice on the grounds of self-incrimination because any reply to the Notice cannot be used as evidence against the maker.
- 410.13 Where a member is approached by the police, the Inland Revenue Department, the ICAC or other authority in the course of making enquiries concerning the affairs of a client or former client, the member should act with caution. He should first ascertain whether or not the person requesting information has a statutory right to demand it. Generally speaking, a member will not be acting contrary to law if he refuses to impart information to persons who have no statutory right to demand it; on the other hand, he might well be acting in breach of his duty of confidence to his client if he volunteers the information. It should be emphasized that, broadly speaking, members are under no general duty to "co-operate" with the authorities by "assisting" in their investigations - unless so expressly authorised by their clients or required to do so by law. Accordingly, if thus approached, the member should state that he is not in a position to discuss his client's affairs. In these circumstances it is advisable for members to seek legal advice to clarify the legal aspects of their positions.
- 410.14 If a notice is served on a client requiring production of documents which are in the possession of the member but are the property of the client the member should read the notice carefully to see if he is under compulsion of law to produce the documents. If he is, then the question of the client's permission is not relevant and the member must comply with the notice. If there is doubt in the matter - where, for example, the notice does not sufficiently identify the documents or class of documents to be produced - then the member should not produce the document unconditionally. One way of resolving a dispute of this nature is to have the documents put separately and sealed, pending the taking of legal advice. Generally

speaking, unless the notice is addressed to the member, the member should assume that he is under no legal requirement to produce the documents to anyone except his client, and that he would be acting contrary to his fiduciary duties to his client to do so.

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

410.16 A member should not normally appear in court as a witness in a case against a client or former client, unless he is served with a subpoena or other lawful summons to do so. He cannot lawfully refuse to produce in court any documents in his ownership or possession which the court may direct him to produce. If the persons in charge of the prosecution have indicated that they will call upon him to produce certain documents in court, the member should have the documents with him, but the power to order the production in court rests with the court.

Freedom to Disclose

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

410.18 A member may disclose to the appropriate authorities information concerning his client where the member's own interests require disclosure of that information. Under such circumstances there is no contractual bar to disclosure of information concerning a client. Examples of circumstances where a member is free to disclose include the following:

- (a) where it might enable the member to defend himself against a criminal charge or to clear himself of suspicion; or
- (b) to resist an action for negligence brought against him by his client or some third person; or
- (c) to enable the member to defend himself against disciplinary proceedings or criticism of him which is the subject of enquiry under the disciplinary rules of the Hong Kong Institute of Certified Public Accountants (the "Institute"); or
- (d) to enable the member to sue for his fees.

Members' Own Relations with Authorities

Criminal Offences

410.19 A member himself commits a criminal offence:

- (a) if he incites a client or anyone else to commit a criminal offence; or
- (b) if he helps or encourages a client or anyone else in the planning or execution of a criminal offence; or
- (c) if he agrees with a client or anyone else to pervert or obstruct the course of justice by concealing, destroying or fabricating evidence or by misleading the police by statements which he knows to be untrue.

- 410.20 Further, section 90 of the Criminal Procedure Ordinance makes it a criminal offence for anyone to do any act with intent to impede the apprehension or prosecution of another person, knowing that the other person has committed a serious offence.
- 410.21 Section 91 of the Criminal Procedure Ordinance makes it a criminal offence for anyone, knowing that a serious offence has been committed by another person, and knowing (or believing) that he has information that might be of material assistance in securing the prosecution or conviction of that person, accepts any consideration for not disclosing such information.
- 410.22 With regard to paragraphs 410.20 and 410.21 above, offences under the Inland Revenue Ordinance involving the evasion (or attempted evasion) of tax assessable under the Ordinance may constitute a “serious offence” as referred to in those two paragraphs above.

Taxation Matters

Introduction

- 410.23 Fraudulent evasion and attempted evasion of taxes are criminal offences.
- 410.24 The making of false statements (whether written or not) relating to tax with intent to defraud the Revenue or delivery of false documents with that intent are likewise criminal offences.
- 410.25 Tax avoidance is not an offence and should be distinguished from evasion. Avoidance consists of the arrangement of a taxpayer’s affairs within the law so as to minimise the incidence of tax. In advising on methods of minimizing tax, members must obviously have regard to the dominant objectives of the client’s transactions, particularly having regard to the provisions of sections 61 and 61A of the Inland Revenue Ordinance.

Penalty Proceedings and Mitigation

- 410.26 The statutes imposing taxes and duties usually define a number of offences for which money penalties recoverable in penalty proceedings are prescribed. Penalty proceedings are not criminal proceedings, and the recovery of a penalty against a taxpayer does not normally prejudice the institution of criminal proceedings against him; although in the case of proceedings instituted under section 82A of the Inland Revenue Ordinance to recover additional tax, the taxpayer is protected from criminal proceedings under section 80(2) or 82(1) in respect of the same facts.

Property Tax, Salaries Tax, Profits Tax and Interest Tax

- 410.27 At the date of publication of this section the taxes with which members are most likely to be concerned are property tax, salaries tax, profits tax and interest tax. The position as regards these taxes is considered in more detail in paragraphs 410.28 to 410.47 below.

Taxation Frauds and Negligence Involving Accounts

- (a) ***Presumption as to returns statements and forms submitted by one person on behalf of another***

- 410.28 The attention of members is drawn to subsection (5) of section 51 of the Inland Revenue Ordinance which provides that any returns or statements submitted by or on behalf of any person shall be deemed to have been submitted by him or by his authority unless he proves the contrary. In view of this provision, and in order to minimise the risk of misunderstanding between the client and the accountant,

members are recommended to ensure that they are acting under an appropriate authority when submitting accounts to the Inland Revenue Department in connection with the ascertainment of a client's liability to property tax, profits tax or interest tax and to take steps to ensure that the client has signed or otherwise approved the accounts.

(b) ***Past accounts later found to be defective***

- 410.29 A member's duty of confidence to his client can be qualified by the client's own conduct. If a client has withheld information from or otherwise deceived a member, with the result that accounts prepared or reported upon by him or returns or computations based thereon were defective, and the member has submitted or is aware that the client has submitted those accounts or documents to the Inland Revenue Department, it would be improper for the member to allow the Inland Revenue Department to continue to rely upon them. He should advise his client to make a complete disclosure to the Inland Revenue Department. (For the circumstances in which disclosure may be justified see paragraphs 410.8 to 410.18 above).
- 410.30 Having advised his client to make such disclosure without delay, the member should, for his own protection, ensure that a record of his advice to his client is kept, so as to rebut any possible charge of conspiracy with or of aiding and abetting his client under section 80(4) or of assisting his client to evade tax under section 82(1) of the Inland Revenue Ordinance.
- 410.31 If the client refuses to act in accordance with the member's advice to make an immediate disclosure, the member should inform his client that he can no longer act for him in tax matters and that it will be necessary for the member to inform the Inland Revenue Department that, since he prepared or reported upon the accounts concerned or the returns or computations based thereon, he has acquired information which indicates that those accounts or documents cannot be relied upon and that he has ceased to act for the client in tax matters. The member should then so inform the Inland Revenue Department, but he is under no legal duty to furnish details of the reasons why the accounts are defective and normally it would be improper for him to do so without first obtaining the client's consent. (For the circumstances in which he could do so see paragraphs 410.8 to 410.18 above). Although members are normally under no legal duty to furnish such information to the Inland Revenue Department, attention is drawn to sections 51(4) and 51B of the Inland Revenue Ordinance. Under these sections the Inland Revenue Department may require members to furnish such relevant information as may be required, and may obtain search warrants for the purpose of obtaining such information. Should such action be taken by the Inland Revenue Department, the member would be under no obligation to obtain the client's consent before releasing such information.

(c) ***Accounts currently being prepared or audited***

- 410.32 A member may acquire knowledge of matters which do not affect past accounts but would result in the Inland Revenue Department being defrauded if not properly dealt with in accounts which the member is currently engaged in preparing or auditing. If the client fails to provide such information as the member may require or refuses to agree to the accounts being drawn up in the manner which the member considers necessary, then the member clearly has a professional obligation to include such qualifications in his report on the accounts as will indicate the respects in which they are defective. A member must always bear in mind that "Any person who wilfully with intent to evade or to assist any other person to evade tax makes any false statement; signs any statement or return without reasonable grounds for believing the same to be true; or falsifies or authorises the falsification of any books of account or records shall be guilty of a misdemeanour." (section 82 of the Inland Revenue Ordinance).

- 410.33 If the client dispenses with the member's services or if the member resigns before he has completed his work and reported on the accounts, no further legal duty rests on the member and he has no responsibility towards the Inland Revenue Department and no authority to give information. It would normally be improper for him to do so unless the Inland Revenue Department invokes section 51(4) or 51B of the Inland Revenue Ordinance. (For the circumstances in which he could do so see paragraphs 410.8 to 410.18 above).
- 410.34 Where, however, the member's services are not dispensed with, his position in relation to the Inland Revenue Department after he has completed his professional duties as accountant or auditor is as follows:
- (a) the member should not without the client's authority send the accounts to the Inland Revenue Department (see paragraph 410.28).
 - (b) if the member is not requested to undertake the taxation work (that is to say, to act on the client's behalf in dealing with the Inland Revenue Department) he has no direct responsibility towards the Inland Revenue Department and no authority to give any information. In the event of his receiving any enquiry from the Inland Revenue Department he should normally do no more than state that he is not dealing with taxation matters and that all enquiries should be addressed to the client. If the enquiry indicates that accounts bearing the member's name have been submitted he should normally state that he cannot add to his report thereon. The position is the same whether or not the member has acted for the client in taxation matters in previous years. The Inland Revenue Department may however invoke section 51(4) or 51B of the Inland Revenue Ordinance to obtain relevant information from members. (For a discussion of the circumstances in which he may do this see paragraphs 410.8 to 410.18 above).
 - (c) on the other hand, if the client requests the member to undertake the taxation work he should always make it clear to the client that he can do so only on the basis of full disclosure of all relevant information. If the client will not agree, the member should state that he cannot act for him in taxation matters and in that case the position regarding any enquiries the member may receive from the Inland Revenue Department is the same as in b above.
- 410.35 Where the member has not been requested, or has declined, to act in taxation matters (items (b) and (c) of the preceding paragraph), he could lawfully continue in the future to act as accountant or auditor, including appropriate qualifications when necessary in his reports on the accounts, but not taking any part in taxation matters. In the circumstances envisaged, however, it seems likely that either the member or the client would not wish to continue the professional association between them.
- (d) ***Past accounts of a new client***
- 410.36 A member who is engaged in preparing or auditing accounts for a new client may acquire knowledge indicating that accounts submitted to the Inland Revenue Department for previous years were defective. In these circumstances:
- (a) the member should advise his client to make a complete disclosure to the Inland Revenue Department;
 - (b) the member has no responsibility for the past accounts but if the nature of the defects in them is such as to affect the correctness of the accounts which the member is engaged in preparing or auditing he should inform his client that an appropriate adjustment will need to be made and shown separately in those accounts; and if the client refuses to agree to such an adjustment the member should include appropriate qualifications in his report on the accounts. Paragraphs 410.33 to 410.35 would then apply.

Taxation Frauds and Negligence not Involving Accounts

- 410.37 Paragraphs 410.28 to 410.36 above relate to taxation frauds and negligence through the medium of defective accounts. A member may, however, acquire knowledge indicating that a client has been guilty of taxation frauds or negligence by means which do not affect the client's accounts, for example, the submission of incorrect returns of private income. The member should advise his client to make a complete disclosure to the Inland Revenue Department. If the client refuses to do so, the member's position will depend upon whether or not the matter is within the scope of the duties he has undertaken for the client:
- (a) if it relates to taxation matters on which the member has not acted for the client (for example, omission of private income where the member has dealt only with the tax computations of business profits and not with the client's tax returns), the member has no further duty and it would normally be improper for him to make any disclosure to the Inland Revenue Department. (For the circumstances in which disclosure may be justified see paragraphs 410.8 to 410.18 above). He could lawfully continue to act for the client as hitherto. He may prefer to terminate the association.
 - (b) if it relates to taxation matters on which the member has acted for the client, then the member should inform the client that he can no longer act for him and that it will be necessary for the member to inform the Inland Revenue Department that he must dissociate himself from the returns (or other information involved) for the years in question and that he has ceased to act for the client on taxation matters. The member should then so inform the Inland Revenue Department, but he is under no duty to give further details and it would normally be improper for him to do so without first obtaining the consent of the client. (For the circumstances in which he could do so see paragraphs 410.8 to 410.18 above).

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

General Professional Duty to Give Guidance

- 410.38 The advice given in preceding paragraphs is in no way intended to assist a member to shield a client from the consequences of having defrauded the Crown of tax, or of having been negligent in regard to tax matters. A member should regard himself as having a professional obligation to urge upon a client, in the client's own interests, the importance of making a full disclosure and authorising the member to proceed, where necessary, with "back duty" negotiations.
- 410.39 Circumstances vary and it is not always that a client fully appreciates the seriousness of his offence or the consequences that may ensue: in particular he may not realise that if there is no disclosure and the Inland Revenue Department later discovers a fraud there is considerably greater likelihood of a criminal prosecution (with the possibility of imprisonment on conviction) than where a suitable monetary settlement is offered on the client's own disclosure.
- 410.40 The client may also not realise that if a member is obliged to cease to act for him and notifies the Inland Revenue Department to that effect in the manner advised in preceding paragraphs (after which the member would have no further dealings with the Inland Revenue Department in relation to the client) this may well result in the Inland Revenue Department commencing enquiries which lead to discovery of fraud.

- 410.41 All these are matters which the member should regard as his professional duty to impress upon the client. If nevertheless his advice is not accepted, it is important that the member's subsequent conduct should, from both the legal and professional standpoints, be correct and such as to safeguard his own position and reputation. It is to this position that the whole of this section is directed.

Statutory Provisions Relating to Disclosure of Information

- 410.42 Under section 51(4) of the Inland Revenue Ordinance an assessor of the Inland Revenue Department has power to serve a notice requiring any person on whom the notice is served to make available for inspection any documents which may be relevant for the purposes of obtaining full information on any matter which may affect any liability, responsibility, or obligation of any person under the Inland Revenue Ordinance. A member on whom such a notice is served has a statutory duty to comply with the notice. No question of confidentiality to the client could arise if the notice sufficiently identifies the documents or class of documents for which production for inspection is required.

- 410.43 It is, however, not unusual for assessors as a matter of practical convenience to ask a client, or the member acting for him, for information which the assessor may have no statutory right to demand but which could be called for by the Assistant Commissioners or by the Commissioner of Inland Revenue under the statutory provisions referred to above. A client need not comply with an assessor's request where it exceeds the rights which could be exercised by the assessor. The client may, however, prefer to comply (and it may be in his best interests to do so) rather than wait for the formal exercise of powers under section 51B.

- 410.44 As indicated in paragraphs 410.31 and 410.37b above, a member should inform the Inland Revenue Department when he subsequently learns that accounts prepared by him, or returns or computations based thereon, are defective and cannot be relied upon, and where such is the fact, that he has ceased to act for the client in taxation matters. Subject thereto, a member normally ought not to take any independent action that may bring the affairs of a client under the scrutiny of the Investigation Section of the Inland Revenue Department without first obtaining the consent of the client. This point can be of considerable importance where a member has taken over the practice of another accountant. He may receive a request from the Inland Revenue Department for his co-operation by way of providing information relating to his clients, the object being to enable the Department to make a general review to decide whether there are any clients whose affairs appear to need further investigation. The professional relationship between a member and his client is normally such as to debar a member from co-operating in this way with the Department and his proper course in such circumstances is so to inform the Department. (For a discussion of the circumstances in which a member would be justified in an action see paragraphs 410.8 to 410.18 above).

Members' Working Papers

- 410.45 As indicated in the Institute's Statement 1.301 "Books and Papers - Ownership, Disclosure and Lien", a member's working papers are his own property and not that of his client. However, working papers do fall within the powers given to the various commissioners under the sections referred to in paragraphs 410.42 and 410.43 above and they may have to be produced as relevant evidence in connection with sections 51(4)(a) and 51B(1)(i) and in terms of section 51B(1) subsections (i) and (iii) the powers relating to search warrants were specifically extended to allow the Commissioner or authorised officer to make copies of accounts etc. relating to a client but not belonging to the person being investigated (see subsection (iii)). In contrast to the above, correspondence with the Inland Revenue Department and tax computations are the property of the client as the member is acting as agent for his client in his dealing with the Inland Revenue Department. Accordingly, he would

seldom be justified in acceding to a request for the surrender of such papers without the client's consent. (For the circumstances in which he could accede to the request see paragraphs 410.8 to 410.18 above).

410.46 The Institute's Council understands from discussion with the Inland Revenue Department that in back duty cases "working papers" are regarded by the Inland Revenue Department as including:

- (a) analyses of banking accounts;
- (b) schedules supporting the statements submitted with the report;
- (c) correspondence such as with bankers and stockbrokers;
- (d) correspondence with the client and with solicitors; and
- (e) notes of questions and answers between the client and the accountant.

410.47 The Council wishes to emphasise that it is entirely for the member to decide whether to make his working papers available to the Inland Revenue Department. He should not normally do so without the consent of his client (for the circumstances in which he could do so see paragraphs 410.8 to 410.18 above) but the client is not in a position to instruct him to do so. Even if the client's consent is obtained, it would not place the member under any obligation to the Inland Revenue Department as it could in no way affect his right to maintain the privacy of his own property. Subject to these fundamental considerations, the opinion of the Council on the items listed in the preceding paragraph is as follows:

- (a) with regard to the analyses, schedules and correspondence referred to in paragraph 410.46 (a), (b) and (c), the Council would see no objection to the production of relevant working papers to the Inland Revenue Department in appropriate cases if they are likely to be significant as factual evidence supporting the accountant's report and the statements submitted therewith;
- (b) the correspondence and notes referred to in paragraph 410.46 (d) and (e) may well be of a highly confidential nature. They should not be produced to the Inland Revenue Department unless the accountant considers there are exceptional circumstances, in which event he should if possible obtain his client's authority covering the specific documents which it is desired to produce and before doing so should advise his client to seek legal advice if there is any doubt as to the wisdom of giving such authority. If his client will not give his authority the accountant will seldom be justified in producing the papers to the Inland Revenue Department. (For the circumstances in which he may do so see paragraphs 410.8 to 410.18 above).

Other Taxes and Duties

410.48 Taxes and duties other than property, salaries, profits and interest taxes with which members or their clients may be concerned include at the date of publication of this section:

- (a) Stamp, Estate, Betting, Entertainment and Hotel Accommodation Duties.
- (b) Business Registration Fees.

The general considerations regarding taxation frauds and negligence mentioned in paragraphs 410.23 to 410.26 above broadly apply to the above mentioned fees and duties: and where a practising member is acting as an agent for a client for the purpose of any of them similar considerations to those set out in paragraphs 410.29 to 410.41 above arise. With regard to requirements to disclose information or to

produce documents, reference should be made in each case to the relevant statutory provisions, which vary in their terms as between one tax or duty and another.

Special Areas

Special Points in Connection with Companies

410.49 In considering the advice given in this section it is important to bear in mind that in the case of a company governed by the Companies Ordinance the auditor's client is the company and not the directors. Where, however, the directors have so acted as to result in the company defrauding the Revenue or committing other offences, references in this section to the "client" should be regarded in the first instance as referring to the directors of the company: for example, where it is necessary for the member to advise a client to make a full disclosure to the Revenue the advice should be given to the directors.

Qualifications in the Auditor's Report

410.50 If it becomes necessary for the member to include qualifications in his report on the accounts, the qualifications should be in such terms as will indicate clearly the respects in which he has been unable to satisfy himself on the matters on which he is required to satisfy himself or to express an opinion, even though the result will be to disclose, to the shareholders and others who may see the accounts, the fact that offences have been committed.

410.51 Members are advised not to attempt to avoid the awkward responsibility of qualifying the report on the accounts by refusing to report and by resigning. A member has a contractual duty to the shareholders to report to them on the accounts, and should make every effort to discharge this duty. The member's proper course of action is to report upon the accounts. He should then consider whether to accept reappointment at the next General Meeting when his term of office expires. In any case, the member will not be able to avoid bringing to the attention of shareholders circumstances which may indicate that offences have been committed by resigning his office. Section 140A(2) of the Companies Ordinance requires him to include in his notice of resignation a statement of any circumstances connected with his resignation which he considers should be brought to the notice of members or creditors of the company, or else a statement to the effect that there are no such circumstances. His resignation will be treated as ineffective unless he complies with this obligation. Members should refer to Section 440 "Changes in a Professional Appointment" for further guidance.

410.52 In deciding whether to accept an audit appointment or reappointment as auditor, a member should consider whether limitations on the scope of his work are likely to be imposed by the client such that the member may be frustrated in performing his functions as an auditor. Such limitations may result from a client's conduct, such as the directors' refusal to provide access to books and records, or to give the required information and explanations, or where the directors prevent a particular procedure considered necessary by the auditor from being carried out. When the envisaged limitation is so significant that the member believes that the need to issue a qualification of opinion exists, or when the limitation infringes on his statutory duties as the auditor, the member would normally not accept appointment or reappointment as auditor.

Transmission of Report to Shareholders

410.53 An auditor's duty is normally performed when he sends his report to the secretary or directors of the company for onward transmission to the shareholders of the company. But if he knows that his report has not been sent to the shareholders or if

he has good reason to believe that his report, when sent to the secretary or directors, will not be sent to the shareholders, it may be necessary for him to take such steps as are practicable to communicate the contents of his report direct to the shareholders. As soon as the possibility of making such a communication arises, therefore, he should seek legal advice about his duty to the shareholders in the particular circumstances of the case, as to the method of any communication his duty requires and as to the terms in which the communication should be made.

Past Accounts

410.54 In relation to past accounts on which the auditor has reported and now finds to be defective he should consider the positions of the Inland Revenue Department, the shareholders and third parties other than the Inland Revenue Department.

- (a) The Inland Revenue Department. The auditor should follow the procedure set out in paragraphs 410.29 to 410.31 above whether it is the directors or the directors and the shareholders who refuse to comply with the auditor's advice and whether or not the auditor is removed from office by means of a general meeting specially called for that purpose.
- (b) Shareholders. The auditor should consider whether it is necessary that the shareholders be informed of the falsity of the past accounts. If it is necessary, he should do so either by exercising his right to speak at a general meeting on any part of the business which concerns him or by adjusting the next accounts or, if he feels that matters cannot properly be left for so long, by requesting the directors to issue a suitable statement to the shareholders. If they refuse to do so, or do not do so to his satisfaction, the auditor may have to take such steps as are practicable to notify the shareholders himself. As soon as the possibility of making such a communication arises, therefore, he should seek legal advice about his duty to the shareholders in the particular circumstances of the case, as to the method of any communications his duty requires and as to the terms in which the communication should be made.
- (c) Third parties. The auditor ought not to allow anyone to continue to rely upon accounts on which he has reported, but now finds to be false, if there is any possibility of the third party acting to his detriment through reliance on the false accounts. An auditor might be held to be guilty of fraud (though the point is not covered by any authority) or held to be civilly liable in negligence (see the ICAEW statement "Accountants' Liability to Third Parties - The Hedley Byrne Decision") if he knew that the accounts had been submitted to a third party as an inducement to the third party to act thereon and he failed to inform the third party on discovering the falsity of the accounts before the third party had acted to his detriment. And in the case of a listed company an auditor would need in some circumstances to consider whether he should inform the relevant Stock Exchanges of what he had discovered. Before making any such communication, therefore, he should seek legal advice about his duty and rights in the particular circumstances of the case, as to the method of any communication he decides to make and as to the terms in which the communication should be made.

Removal of the Auditor

410.55 The distinction between the directors and the shareholders will sometimes have little or no relevance, either because the directors hold a controlling interest or because all the shareholders are directors. When in these circumstances the directors fail to comply with the auditor's advice they are likely to wish to prevent the auditor from completing his audit and making a report containing qualifications. They could achieve this by calling a general meeting at which the sole business would be the removal of the auditor, no accounts being placed before the meeting. If this procedure is followed, the auditor may wish to exercise his right under section

141(7) of the Companies Ordinance to attend the meeting and be heard. If he has been acting for the company in relation to taxation matters, and he receives any enquiries from the Revenue he should confine his reply to a statement that he has been removed from office at general meeting called specially for that purpose and that the enquiries should accordingly be addressed to the company.

Companies in Liquidation

- 410.56 Although the appointment of an auditor of a company is made by the shareholders in general meeting his appointment is by the company as a legal entity and his duty of confidence is to the company as distinct from the individual shareholders. If the company goes into liquidation the company's rights remain vested in the company as an entity and it is therefore still the company to which the auditor has a duty of confidence. The liquidator is the person through whom the company's rights are exercised, enforced, or defended and it follows therefore that there can be no breach of confidence on the part of an auditor in giving to the liquidator information to which the company itself is entitled.
- 410.57 The auditor of a company which is in liquidation may be approached by the police for assistance in enquiries which may lead to a director or other individual being prosecuted. A member who is approached in this way need not give to the police any information obtained in the course of his professional duties and normally he should not do so unless he has the permission of the liquidator (the liquidator being the person who could exercise the right of the company to release the auditor from his duty of confidence). But such a release should not normally be sought by the member. His appropriate course is to make available to the liquidator all relevant information, leaving with the liquidator the responsibility of deciding whether under section 277 of the Companies Ordinance the liquidator has a duty to make a report to the Attorney General. If such a report is made by the liquidator then the auditor is, by subsection (4), one of the persons having a statutory duty to give assistance to the Attorney General, so that in these circumstances his duty of confidence is overridden by the statutory provisions. There may, however, be exceptional circumstances in which a member would be justified in giving assistance or information without referring to the liquidator. (For a discussion of these circumstances see paragraphs 410.8 to 410.18 above).
- 410.58 The appointment of a member to the office of liquidator or receiver of a company does not give rise to a professional, client relationship vis-a-vis the company and a member would not therefore in such circumstances normally be under any duty of confidence towards the company. If, however, the member is already the auditor of the company at the time of his appointment as liquidator *in a members voluntary winding up*, he is clearly under a duty of confidence in respect of matters which came to his knowledge while as auditor and the normal considerations would apply except to the extent that as liquidator he is under a statutory duty to disclose or report certain matters. Though a receiver appointed under the powers contained in an instrument is normally appointed as agent of the company, a receiver of the property of a company, whether appointed by the Court or under hand, is not a representative of the company in the way in which a liquidator is. Therefore an auditor of the company should continue to regard the company or its liquidator as his client, the appointment of a receiver notwithstanding.

Companies under Investigation

- 410.59 Under section 145 of the Companies Ordinance, the auditor is one of the persons who has a statutory duty to produce to the Inspector all books and documents of or relating to the company or, as the case may be the other body corporate (subsidiary, holding or similarly controlled company) that is in his custody or power and otherwise to give to the Inspector all assistance in connection with the investigation that he is reasonably able to give. Where these provisions apply the auditor's duty of confidence is overridden by his statutory duty.

Special Points In Connection with Sole Traders and Partnerships

- 410.60 For sole traders and partnerships a practising member may have to work from incomplete records and within limits laid down by his client. Such clients are not subject to statutory requirements similar to those relating to the accounts and audit of companies incorporated under the Companies Ordinance. Such a company has statutory obligations in regard to its accounting records and the auditor has a statutory duty to report when in his opinion those obligations have not been complied with: moreover such a company is required to have its accounts audited and it cannot limit the duties and powers of the auditor or the responsibility he undertakes for satisfying himself that the accounts show a true and fair view except as provided for private companies under section 141D of the Companies Ordinance. As such statutory requirements are not present in the case of sole traders and partnerships, it is important that anyone who sees the accounts should be made aware, by the member's report, of the significance of the association of his name with the accounts.
- 410.61 Where a member is acting for a client in taxation matters he may receive from the Inland Revenue Department questions designed to ascertain whether all receipts have been properly accounted for, or whether disallowable expenditure is included in amounts charged in the accounts, or whether stock has been valued on proper and consistent principles. A member should not undertake responsibility for replies to such questions unless he is satisfied from his examination of the books and records that all relevant information is available to him. Where he is not so satisfied his proper course is to obtain answers from his client and pass them on as such to the Inland Revenue Department, in doing so he would of course not pass on information which he does not believe to be correct or which he knows to be incorrect.
- 410.62 In the event of a member discovering that past accounts which he has prepared or audited were false or misleading through his having been deceived by his client, the procedure he should follow in relation to the Inland Revenue Department has been indicated in paragraphs 410.29 to 410.31. With regard to third parties other than the Inland Revenue Department the member should act, where necessary, on the basis of the advice given in paragraph 410.54 (c).

Special Points in Connection with Independent Commission Against Corruption Investigation Procedures

- 410.63 Members may find that they are requested in their professional capacity by the Independent Commission Against Corruption ("ICAC") to "assist" in investigation of certain corruption allegations, mainly against their own clients. Such assistance usually is requested in the form of furnishing information to ICAC officers either orally or in writing.

Since the relevant Ordinances do not cover all the procedural aspects arising from different practical situations, where members have duties under the Prevention of Bribery Ordinance and ICAC Ordinance, the following procedures have been the subject of agreement with the Commission.

Principles Underlying an Approach Made by ICAC

- 410.64 No investigation will be commenced by the ICAC without reasonable suspicion that an offence has been committed. In other words, "fishing expeditions" will not be conducted.

When an approach is made by ICAC to firm of Certified Public Accountants (Practising), such approach will in all cases be made firstly to the senior partner or someone designated by him. If the matter is extremely urgent and the most senior partner is not available, the most senior member of the firm available will be

approached. In the event of an urgent or confused situation arising, liaison can be maintained by the Registrar on the part of the Institute.

ICAC will do its best to ensure that investigating officers who approach members for information and assistance are sufficiently qualified to be able to understand what they are being given. In return, members of the Institute will be expected to do their utmost to explain matters in clear and simple terms to ICAC officers.

Access to Documents

- 410.65 Where copies of documents are taken by ICAC officers from members a receipt will be given by the officer concerned. If required, the accountant can make out his own form of receipt which will be signed by the officer.

Where files are being used currently for the purpose of an interim or final audit which will suffer if the files are removed during an investigation by ICAC, ICAC officers will either take copies of the files they require or take the originals and give copies back. In such an instance the member concerned shall contact the officer in charge of the investigation to come to a suitable arrangement. ICAC will pay for copies of documents prepared by members provided that such charges are reasonably computed. No remuneration will be paid for man-hours expended in locating information required by investigating officers.

Member under Investigation

- 410.66 It is not possible for ICAC to advise the Institute when a member is under investigation. This would be an infringement of section 30 of the Prevention of Bribery Ordinance. In the event of an investigation uncovering improper activities which ICAC do not prosecute it will be possible, with the approval of the Operations Review Committee, for information to be lodged with the Registrar, in confidence, to enable disciplinary proceedings to be commenced by the Institute itself.

Client under Investigation

- 410.67 If ICAC shall require information on a client under investigation from a member which for some reason will result in that member disclosing to the client that he is under investigation, the member should immediately contact the investigating officer in charge and ask for advice.

Responsibilities of a Member who Discovers During his Work that His Client is Committing or Has Committed an Offence under the Prevention of Bribery Ordinance

- 410.68 Although in the absence of compulsion by due process of law, a member is not at liberty and is generally under no legal obligation to disclose to the ICAC information acquired during the performance of his duties, he should, in the event of his discovering a corruption offence, urge his client to report the offence to the ICAC. If the client fails to do so, then the member should review his position having regard to paragraphs 410.8 to 410.18 above.
- 410.69 Under the Prevention of Bribery Ordinance certain powers of investigation are conferred on the Commissioner or a duly authorised investigating officer. Where such powers are properly invoked a member will be compelled under sections 13 and 14 of the Ordinance to disclose any relevant information or produce any relevant documents. In such circumstances a member has no privilege to withhold the information.

Special Points in Connection with Investigation Procedures under the Drug Trafficking (Recovery of Proceeds) Ordinance

- 410.70 The law enforcement agencies primarily responsible for narcotics enforcement are the Royal Hong Kong Police Force and the Customs and Excise Department and as such they have each set up a Financial Investigation Group (FIG) to deal with all investigations under the Ordinance.

Members may be requested, in their professional capacity, to assist in an investigation of certain drug trafficking allegations against their clients by FIG officers. Such assistance is usually in the form of providing information to requesting officers either orally or in writing.

As the Ordinance does not cover all the procedural aspects arising from different practical situations where members have duties under the Ordinance, the following procedures have been accepted by the relevant law enforcement authorities.

- 410.71 When an approach is made by the law enforcement authorities to a firm of Certified Public Accountants (Practising), such approach will in all cases be made to the firm's Compliance Officer, if one has been appointed, or someone designated by him. Information should only be divulged to the authorities in response to a valid production order or search warrant. If the matter is extremely urgent and the Compliance Officer, if one has been appointed, is not available the senior partner of the firm or someone designated by him will be approached. In the event of an urgent or confused situation arising, liaison can be maintained by the Registrar on the part of the Institute. In no circumstances should the member disclose the identity of the party under investigation.

The FIG has advised the Institute that it will do its best to ensure that investigating officers who approach members for information and assistance are sufficiently qualified to be able to understand what they are being given. In return, members of the Institute will be expected to do their utmost to explain matters in clear and simple terms to FIG officers.

Access to Documents

- 410.72 Documents requested will be specified in a production order or search warrant. The accountant should ensure that the existence of all documents so specified is disclosed to the officers. The contents of those documents which are the subject of legal privilege in accordance with section 20(4)(b)(ii) do not need to be disclosed, but this may be contested in the courts by the authorities. All other documents specified in the production order or search warrant should be made available to the authorised officers.

- 410.73 Where copies of documents are taken by investigating officers from members a receipt will be given by the officer concerned. If required, the accountant can make out his own form of receipt which will be signed by the officer.

Where files are removed by FIG for an investigation, FIG officers will normally take the originals and give copies back if requested. In such an instance the member concerned should contact the officer in charge of the investigation to come to a suitable arrangement. The investigating authorities will pay for copies of documents prepared by members provided that such charges are reasonably computed. No remuneration will be paid for man-hours expended in locating information required by investigating officers.

Member under Investigation

- 410.74 It is not possible for FIG to advise the Institute when a member is under investigation. This would be an infringement of section 24 of the Drug Trafficking

(Recovery of Proceeds) Ordinance. In the event of an investigation uncovering improper activities which FIG do not prosecute, it may be lawful for FIG to pass the information on to the Registrar, in confidence, to enable disciplinary proceedings to be commenced by the Institute itself.

Client under Investigation

- 410.75 If FIG shall require information on a client under investigation from a member which for some reason will result in that member disclosing to the client that he is under investigation, the member should immediately contact the investigating officer in charge and ask for advice. Any disclosure to the client which may indicate that he is under investigation could prejudice the investigation and is an offence under section 24.

Responsibilities of a member who discovers during his work that his client is committing or has committed an offence under the Drug Trafficking (Recovery of Proceeds) Ordinance

- 410.76 Members should familiarise themselves with the provisions of section 25 of the Drug Trafficking (Recovery of Proceeds) Ordinance and in particular with subsection (1).
- 410.77 Subsection (1) is aimed at persons (including professional accountants) who become concerned in arrangements whereby the retention or control of proceeds of drug trafficking is facilitated. If a person becomes knowingly involved in this way, or has reasons to believe that he has become so involved, he commits a criminal offence. Subsection (3) makes provisions for disclosure of suspicion or belief by persons who have become thus involved, and relieves them of criminal and civil liability in certain circumstances. The disclosure should be made to the firm's Compliance Officer (if one has been appointed) or to the FIG. Subsection (3) expressly states that such disclosure shall not be treated as a breach of any restriction upon disclosure of information imposed by contract or by rules of professional conduct.
- 410.78 Under the Ordinance certain powers of investigation are conferred on the courts of a duly authorised investigating officer. Where such powers are properly invoked a member will be compelled under sections 20 and 21 of the Ordinance to disclose any relevant information or produce any relevant documents. In such circumstances a member has no privilege to withhold the information, except that subject to legal privilege. Items subject to legal privilege may include communications between a legal advisor and an accountant representing his client, or legal advice on behalf of his client and in the possession of the accountant.

Other Matters

Member's Relationship with a successor

- 410.79 It is the duty of any member of the Institute, before accepting nomination for appointment as auditor for a company, partnership or individual, to communicate with the previous auditor. In this connection attention is drawn to the Institute's Statement 1.207 "Changes in a Professional Appointment" wherein the Council makes it clear that it is essential for a member who is proposed for appointment as auditor to have an opportunity of knowing all the reasons for the change, that this requirement can only be fulfilled by direct communication with the holder of the only be fulfilled by direct communication with the holder of the existing appointment and that a member should not accept the appointment if he is refused permission to make this communication.

410.80 Where a member resigns his appointment or indicates to his client that he will not accept reappointment, or where the client terminates the appointment, the question arises whether the member should inform his prospective successor of the reasons for the change where they relate to fraud on the Inland Revenue Department or other unlawful acts or defaults. Members are advised as follows:

- (a) the initiative in the matter of communication rests with the prospective successor: the retiring member should not volunteer information in the absence of any communication;
- (b) the prospective successor should seek the permission of the client to make this communication and should not accept the appointment if permission to make the communication is refused;
- (c) subject to what is said in the next sub-paragraph, when a member receives a communication from a prospective successor he should inform the prospective successor of at least the general nature of the reason for the change: and to the extent that it seems necessary in order to put the prospective successor adequately on his guard he should be informed of the facts constituting that reason;
- (d) where a member has unconfirmed suspicion but no actual knowledge that the client has defrauded the Inland Revenue Department or been guilty of some other unlawful act or default, no general rule can be laid down as to whether and if so in what detail he should communicate his suspicion to a prospective successor who communicates with him. It must rest with the individual member in the particular circumstances of the case to determine what he considers to be a proper course. Where, however, there has been failure or refusal by the client to supply the member with information required by him for the performance of his duties, he should in any event so inform a prospective successor who communicates with him;
- (e) the legal position of the retiring member depends not upon whether the prospective successor has received the client's permission to communicate with the retiring members but upon whether the retiring member has been authorised by the client to discuss the client's affairs with the prospective successor. The retiring member could obtain this authorisation either by having made it a term of his contract with his client that he should be entitled to comply with the statements of the Council of the Institute regarding these communications or by informing his client when the prospective successor communicates with him and getting express permission to tell the prospective successor the reasons for his retirement. If he has this authorisation then provided he says what he honestly believes to be true he can state the reasons for his retirement without any fear of an action for either breach of contract or defamation. If he does not have this authorisation the Council is advised that he would nevertheless have a strong measure of protection against an action for defamation in that his communication would be the subject of qualified privilege, which means that he would not be liable to pay damages for defamatory statements, even though untrue, if they were made without malice: and provided he stated only what he sincerely believed to be true the chances of his being held malicious are remote. Moreover although in making a communication without authorisation a retiring member might technically be in breach of contract and although there could be circumstances in which the resulting damages were substantial, the likelihood of an action being brought against him is small and in most cases the damages awarded in such an action would be nominal;

- (f) the prospective successor should treat in the strictest confidence any information given to him by the retiring member. After due consideration of the information it is for the prospective successor to decide whether as a matter of professional conduct or as one of personal inclination he can properly accept the appointment. If he does so, the advice given in this section would then be applicable to him.

410.81 The consideration arising on a change of auditor apply to a large extent also where a member is invited to undertake other recurring professional work in place of another accountant.

Prosecution of a Client or Former Client

410.82 It follows from paragraphs 410.8 to 410.18 above that it would depend upon the nature of the offence and other circumstances connected with it whether or not a member would be acting in breach of his contractual duty of confidence or contrary to proper professional standards if he were, except under legal compulsion or with his client's consent, to assist the police, Inland Revenue Department, Independent Commission Against Corruption or other authority by giving information about his client's affairs for the purposes of enquiries leading towards a prosecution of the client for an offence other than treason. A member should therefore be careful, and if time allows seek legal advice, before volunteering any such information. If he is requested to give information he should discover from the person requesting the information whether or not he has a statutory right to demand it. Unless it is clear that there is statutory authority for the request and that the member is bound to give the information the member would be wise to decline to do so until he has obtained his client's authority to give the information or has consulted his solicitor and been advised that he should give the information whether or not his client consents. He should state that in the meanwhile he is not in a position to discuss his client's affairs.

410.83 A member should not normally appear in Court as a witness for the Crown in a case against a client or former client, unless he is served with a subpoena or other lawful summons to do so, in which case he must of course answer truthfully any questions that the Court allows to be put to him even though this involves disclosure of facts of which he obtained knowledge in his confidential professional capacity. Moreover he cannot lawfully refuse to produce in Court any documents in his ownership or possession which the Court may direct him to produce. If the persons in charge of the prosecution have indicated that they will call upon the member to produce certain documents in Court, the member would be wise to have the documents with him but the power to order their production in Court rests with the Court.

410.84 A member would be wise to keep in close touch with his solicitor on the legal aspects of his position in relation to a prosecution or possible prosecution of a client or former client.

Section 411 [previously Statement 1.290C]

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

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

A statement by the Council for the guidance of members in business.

Occasions sometimes arise where a member, in the course of his work, acquires knowledge indicating that his employer, or someone acting on behalf of his employer, may have been guilty of some default or unlawful act. A member may consequently find himself the subject of allegations that he ought to have communicated what he had discovered to others, either within or outside the company. This section gives guidance to members concerning some of the questions of professional conduct and legal obligation which arise in these circumstances. It does not cover obligations of company directors.

The section is intended for general guidance only and does not deal with the special circumstances of regulated sectors such as banks and investment businesses. Although examples are given to illustrate the duties of members it should be borne in mind that they are examples only. Every case depends upon its own circumstances and if a member is in doubt as to his correct course of action he should seek independent legal or other professional advice or contact the Hong Kong Institute of Certified Public Accountants' (the "Institute") Registrar.

Part 1 - Introduction

411.1 It is not practicable to set out all the offences which members may encounter in the course of their work but the principal statutory and common law offences concerned are:

- (a) theft, obtaining by deception, false accounting, and suppression of documents;
- (b) fraud, forgery and offences in relation to companies;
- (c) corruption offences;
- (d) bankruptcy or insolvency offences, frauds on creditors or customers, false trade descriptions, and offences arising out of relations between employers and employees;
- (e) conspiracy, soliciting or inciting to commit crime and attempting to commit crime;
- (f) offences in relation to taxation;
- (g) insider dealing.

411.2 If a member acquires knowledge indicating that his employer or someone acting on behalf of his employer may have been guilty of some default or unlawful act he should normally raise the matter with management internally at an appropriate level. If his concerns are not satisfactorily resolved, he should consider reporting the matter to non-executive directors where these exist. Where this is not possible or fails to resolve the matter a member may wish to consider making a report to a third party. Guidance is provided below on reporting suspected defaults or unlawful acts to third parties outside the organisation for which he works.

Part 2 - Relations between a Member and His Employer

Disclosure of Information by His Employer to a Member

- 411.3 Where a member is employed to prepare accounts or to deal with taxation or any other work he can only do so on the basis of full disclosure of all information relevant to the work in question. A member in employment is responsible for his work and, if he is aware that there has not been full disclosure to him of all relevant information, he should raise the matter internally at an appropriate level. The member should make clear to his employer the effect of this professional obligation of integrity, which requires that if there is still not full disclosure, he should indicate this in any accounts or reports that he prepares. If this is not possible, he would be well-advised to consider his position in the company in the light of his responsibility for the accounts or reports in question.

Disclosure to Third Parties of Defaults or Unlawful Acts

- 411.4 There is no general obligation in law for a member who becomes aware that a default or unlawful act has been committed by or on behalf of his employer to disclose what he knows to any third party. Rather an employed member has a general duty to his employer to act with good faith and fidelity, including a duty to keep confidential information obtained as a result of this employment. If no such express term appears in his contract of employment it will be implied by law.
- 411.5 Provided that the information is not public knowledge it can be confidential irrespective of whether or not it appears trivial to the employee. The employer will be entitled to restrain the use of such information during the period of employment and disclosure of confidential information without good cause may entitle the employer to dismiss the member from his employment. Therefore an employed member should not generally disclose any confidential information without his employer's prior authority, or without first exhausting internal reporting channels.
- 411.6 There are, however, circumstances in which, in spite of any duty of confidentiality, a member may be obliged to disclose. Even if not obliged to disclose, he may be free to do so if he wishes and may conclude that it is right to do so in the public interest or for his own protection. Obligation to disclose and freedom to disclose are dealt with at paragraphs 411.7 – 411.8 and 411.9 - 411.13 respectively below.

Obligation to Disclose

- 411.7 A member will be obliged to disclose information if compelled to do so by the process of law, for example under a court order. He may also be obliged to disclose information by statute, for example:
- (a) a member may be obliged to disclose specified information to the liquidator, administrative receiver or administrator of his employer;
 - (b) he may be obliged to give information on oath to an inspector appointed by the Financial Secretary to investigate an alleged insider dealing offence;
 - (c) he may be obliged to disclose information to the ICAC under a statutory notice.

In each case the member need not disclose any information which would incriminate himself.

411.8 Under section 141(5) of the Companies Ordinance, the auditors of a company have a right of access at all times to the company's books, accounts and vouchers, and are entitled to require from the company's officers such information and explanations as they think necessary for the performance of their duties as auditors. Under section 134 of the Ordinance, an officer of a company commits an offence if he knowingly or recklessly makes to a company's auditors a statement (whether written or oral) which:

- (a) conveys or purports to convey any information or explanations which the auditors require, or are entitled to require, as auditors of the company; and
- (b) is misleading, false or deceptive in a material particular.

A person guilty of an offence under this section is liable to imprisonment or a fine, or both.

Freedom to Disclose

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

Disclosure in the Public Interest

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

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

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

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

- any legal advice obtained.

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

Disclosure for the Protection of the Member's Own Interest

- 411.11 A member may disclose to the proper authorities information concerning his employer where the protection of the member's own interest requires disclosure of that information:
- (a) to enable the member to defend himself against a criminal charge or to clear himself of suspicion; or
 - (b) to resist proceedings for a penalty in respect of a taxation offence, for example in a case where it is suggested that he assisted or induced his employer to make or deliver incorrect returns or accounts; or
 - (c) to resist a legal action brought against him by his employer or some third person; or
 - (d) to enable the member to defend himself against disciplinary proceedings, or against criticism of him which is the subject of enquiry under the Institute's disciplinary rules; or
 - (e) to enable the member to take legal action in relation, for example, to an unfair dismissal claim or redundancy payment claim.

Disclosure Authorised by Statute

- 411.12 In some cases the public interest in disclosure of information to a proper authority is such that the authorities have made express statutory provision for the duty of confidentiality to be set aside. An example of this is to be found in the Drug Trafficking (Recovery of Proceeds) Ordinance. (Guidance on the implications of this Ordinance was included in Section 410 and Statement 1.301.)
- 411.13 Each example of a statutory freedom to disclose must be considered separately since the scope of the freedom and the protection offered to the person making the disclosure varies from statute to statute.

Disclosure to Non-governmental Bodies

- 411.14 Members are sometimes approached by recognised but non-governmental bodies seeking information concerning suspected acts of misconduct not amounting to a crime or civil wrong. Some non-governmental bodies enjoy statutory powers to require persons to supply information for that purpose, in which case the member should comply. In other cases, however, the member will not ordinarily be at liberty to comply with the bodies' requests without his employer's consent. A member who is in any doubt as to the position should consult the Institute's Registrar or take legal advice promptly.

Prosecution of an Employer or Former Employer

- 411.15 Where a member is approached by the police, the Inland Revenue Department, or other public authority making enquiries which may lead to the prosecution of an employer or former employer for an offence, the member should act with caution. He should ascertain whether or not the person requesting information has a legal right to demand it, and unless obliged to give the information by court order or some statutory authority should decline to do so unless he has the authority of his employer or former employer, or is so advised by an independent legal or professional adviser.

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

Criminal Offences

- 411.16 A member himself commits a criminal offence:
- (a) if he incites anyone to commit a criminal offence, whether or not his advice is accepted; or
 - (b) if he helps or encourages anyone in the planning or execution of a criminal offence which is committed; or
 - (c) if he agrees with anyone to pervert or obstruct the course of justice by concealing, destroying or fabricating evidence or by misleading the police by statements which he knows to be untrue; or
 - (d) if with a view to obtaining property or to obtaining for himself or another a pecuniary advantage he deceives any person, either by making a statement which he knows to be false or (in certain circumstances) by stating a "half-truth", i.e. making a statement but suppressing matters relevant to a proper appreciation of its significance.
- 411.17 Where a member knows or believes that an arrestable offence has been committed the member would himself commit a criminal offence if he were to do any act with the intention of impeding the arrest or prosecution of the person in question unless the member has lawful authority or reasonable excuse (section 90 of the Criminal Procedure Ordinance). The mere fact that he was the suspect's employee or fellow-employee would not be a reasonable excuse. An arrestable offence is one for which the sentence is fixed by law or "serious" offences for which a person not previously convicted can be sentenced to imprisonment.
- 411.18 A member would have to do some positive act to assist the suspect to escape arrest or prosecution for an arrestable offence in order to be convicted of the offence of impeding the arrest or prosecution of the suspect. If a member refuses to answer questions by the police about the suspect's affairs or refuses to produce documents relating to the suspect's affairs without the suspect's consent, the refusal would not be an act to impede the arrest or prosecution of the suspect.
- 411.19 Where a member knows or believes an arrestable offence has been committed and the member has information which might be of material assistance in the prosecution of the suspect for the offence, the member would be committing a criminal offence if he were to accept or agree to accept any consideration in return for not disclosing that information (section 91 of the Criminal Procedure Ordinance).

- 411.20 In these circumstances, the acceptance of reasonable remuneration for employment would not be an offence. However, if the remuneration were wholly or partly paid in consideration for the member not disclosing the information, the member would be committing an offence. The acceptance of unusually high remuneration might be used as evidence against a member.
- 411.21 A member must give full disclosure in his dealings with the Inland Revenue Department. Fraudulent evasion and attempted evasion of taxes are criminal offences. The making of false statements with intent to defraud the Revenue is also an offence. Some tax legislations (for example section 82 of the Inland Revenue Ordinance) create specific criminal offences, whilst breach of other provisions leads to the imposition of penalties.

Civil Liability

- 411.22 A member may himself incur civil liability to third parties if, knowing of a course of unlawful conduct by his employer or any co-employee, he allows himself to become implicated in it by assisting in its planning or execution. In some cases the nature of a member's work may make it impossible to avoid implication in the execution of another person's wrong unless disclosure is made.

Section 420 [previously Statement 1.213]

Use of Designations and Institute's Logo

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

Use of Designations

Designations of Certified Public Accountant

Certified Public Accountant

- 420.1 Use of the designation "Certified Public Accountant (會計師)" or the initials "CPA" is governed by By-law 22 of the Professional Accountants By-laws (Cap. 50A) (By-laws).
- 420.2 With effect from the commencement of the Professional Accountants (Amendment) Ordinance 2004 on 8 September 2004, all current members on the Hong Kong Institute of Certified Public Accountants (the "Institute") membership register are deemed to be registered as certified public accountants under section 22(4) of the Professional Accountants Ordinance (Cap. 50) (PAO). They therefore acquire the designation "Certified Public Accountant (會計師)" and are entitled to use the initials "CPA" under By-law 22.
- 420.3 The designation "Certified Public Accountant (會計師)" or the initials "CPA" is used to describe a member's professional qualification. Under sections 42(1)(h), (ha), (i) and (ia) of the PAO the right to the use of the description "certified public accountant", the initials "CPA" or the characters "會計師" to carry on a business, trade or profession is reserved only for practice units as defined in section 2 of the PAO. Practice unit means a firm of Certified Public Accountants (Practising) practising accountancy, a Certified Public Accountant (Practising) practising on his own account or a Corporate Practice. Accordingly,
- (a) a CPA not holding a practising certificate, who carries on a business, trade or profession whether by himself or through an entity, should not include the description "Certified Public Accountant" or the initials "CPA" or the characters "會計師" in his trade or business name or the trade or business name of the entity; and
 - (b) A CPA not holding a practising certificate, who registers his own name or the name of his entity as a trade or business name under the Business Registration Ordinance, should not include the description "Certified Public Accountant" or the initials "CPA" or the characters "會計師" in the trade or business name.

Fellow

- 420.4 Use of the designation "Fellow of the Hong Kong Institute of Certified Public Accountants (資深會計師)" or the initials "FCPA" is governed by By-law 22.
- 420.5 Under a Council Ruling, a Fellow of the Hong Kong Institute of Certified Public Accountants who holds a practising certificate may describe himself as a "Fellow of the Hong Kong Institute of Certified Public Accountants (Practising) (執業資深會計師)" and use the initials "FCPA (practising)".

Practice of Public Accountancy

- 420.6 Under the PAO, the use of the description “Certified Public Accountant (Practising)” is restricted to a certified public accountant holding a practising certificate.
- 420.7 Under By-law 25 however:
- (a) a certified public accountant holding a practising certificate has the option of describing himself as “Certified Public Accountant (會計師)” or “Certified Public Accountant (Practising) (執業會計師)” and using the initials “CPA” or “CPA (practising)”; and
 - (b) a firm of Certified Public Accountants (Practising) or a Corporate Practice has the option of describing itself as “Certified Public Accountants” or “Certified Public Accountants (Practising)”, or in Chinese “會計師事務所” or “會計師行”.

Designation of Affiliate

- 420.8 Use of the designation “International Affiliate of the Hong Kong Institute of Certified Public Accountants” is governed by By-law 22A.

Members in Overseas Countries

- 420.9 Outside Hong Kong, the rights of members to use the designations to which they are entitled as members of the Institute depend upon the law of the country concerned.

Use of Institute’s Logo

- 420.10 In the light of the provisions laid down in sections 42(1)(h), (ha), (i) and (ia) of the PAO, which restrict the use of the description “certified public accountant”, the initials “CPA” or the characters “會計師” for business purposes by practice units, only practice units are permitted to use the logo of the Institute on their stationery and only those CPAs working for practice units and holding practising certificates are allowed to use the logo of the Institute on their business name cards.
- 420.11 Guidelines on the use of the logo of the Institute are available on the Institute’s website.

Section 430 [previously Statement 1.210]

Ethics in Tax Practice

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

Fundamental Principles

430.1 The fundamental principles to be observed when developing ethical requirements relating to tax practice include all five Fundamental Principles by which a member is governed in the conduct of his professional relations with others. These principles are enumerated in Section 100 "Introduction and Fundamental Principles", paragraphs 100.4 and expanded upon in the rest of the Code.

Development of the Fundamental Principles

430.2 A member rendering professional tax services is entitled to put forward the best position in favour of his client, provided he can render the service with professional competence, it does not in any way impair his standard of integrity and objectivity, and is in his opinion consistent with the law. He may resolve doubt in favour of his client if in his judgment there is reasonable support for his position.

430.3 A member should not hold out to clients the assurance that the tax return he prepares and the tax advice he offers are beyond challenge. Instead, he should ensure that his clients are aware of the limitations attaching to tax advice and services so that they do not misinterpret an expression of opinion as an assertion of fact.

430.4 A member who undertakes or assists in the preparation of a tax return should advise his client that the responsibility for the content of the return rests primarily with the client. The member should take the necessary steps to ensure that the tax return is properly prepared based on the information received from the client.

430.5 Tax advice or opinions of material consequence given to a client should be recorded either in the form of a letter to the client or in a memorandum for the files.

430.6 A member must not associate himself with any return or communication which he has reason to believe:

- (a) contains a false or misleading statement;
- (b) contains statements or information furnished by the client recklessly or without any real knowledge of whether they are true or false; or
- (c) omits or obscures information required to be submitted and such omission or obscurity would mislead the Inland Revenue Department.

If any of the above situations prevails, the member's responsibility is to resign from acting as the client's tax representative. Having resigned the member should:

- (a) inform the Inland Revenue Department that he has withdrawn his services.
- (b) give no further information to the authorities without the consent of the client, unless required to do so by law.

430.7 A member may prepare tax returns involving the use of estimates if such use is generally acceptable or if it is impractical under the circumstances to obtain exact data. When estimates are used, they should be presented as such in a manner so as to avoid the implication of greater accuracy than exists. The member should be satisfied the estimated amounts are reasonable under the circumstances.

430.8 In preparing a tax return, a member ordinarily may rely on information furnished by his client provided that the information appears reasonable. Although the examination or review of documents or other evidence in support of the client's information is not required, the member should encourage his client to provide such supporting data, where appropriate.

In addition, the member:

- (a) should make use of his client's returns for prior years whenever feasible.
- (b) is required to make reasonable inquiries where the information presented appears to be incorrect or incomplete.

430.9 The member's responsibility when he learns of a material error or omission in a client's tax return of a prior year (with which he may or may not have been associated), or of the failure of a client to file a required tax return, is as follows:

- (a) He should promptly advise his client of the error or omission and recommend that the client make disclosure to the Inland Revenue Department. Normally, the member is not obligated to inform the Inland Revenue Department, nor may he do so without his client's permission.
- (b) If the client does not correct the error:
 - (i) the member should inform the client that he cannot act for him in connection with that return or other related information submitted to the authorities;
 - (ii) the member should consider whether continued association with the client in any capacity is consistent with his professional responsibilities;
 - (iii) and if the member concludes that he can continue with his professional relationships with the client, he should take all reasonable steps to assure himself that the error is not repeated in subsequent tax returns.
- (c) If because of the error or omission, the member ceases to act for the client, in these circumstances, the member should advise the client of the position before informing the authorities of his having ceased to act and should give no further information to the authorities without the consent of the client, unless required to do so by law.

Section 431 [previously Statement 1.292]

Corporate Finance Advice

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

Introduction

- 431.1 This section applies to all members, and is issued by the Council not as a directive but to assist members to conduct themselves in a manner which the Council considers appropriate to the members of the Hong Kong Institute of Certified Public Accountants (the "Institute").
- 431.2 Its objective is to provide ethical guidance that will safeguard corporate finance clients by ensuring that they can rely on the objectivity and integrity of the advice given to them by members.
- 431.3 Failure to follow such guidance does not of itself necessarily constitute misconduct, but means that a member concerned may be at risk of having to justify his actions in answer to a complaint to the Institute. In addition, matters discussed in this section may have legal implications and a member who is in doubt as to his position should consider obtaining legal advice.
- 431.4 Corporate finance activities are wide-ranging in their nature and members are frequently involved in giving corporate finance advice, to both audit and non-audit clients. The role and nature of advice expected of a member may change in character when the client becomes involved in or anticipates a particular transaction, such as a takeover bid, issue of securities or acquisition or disposal of securities, in respect of which advice or an opinion is required from a member. It is at that point that problems of independence and conflict of interest can arise. The guidance which follows is designed to assist members who find themselves advising in these and related circumstances.
- 431.5 A definition of corporate finance activities is set out in Annex I.

Objectivity and Integrity

- 431.6 Section 110 "Integrity", Section 120 "Objectivity" and Section 290 "Independence – Assurance Engagements" include the guidance on integrity, objectivity and independence for members which is applicable to corporate finance activities.
- 431.7 Subject to paragraph 431.6 above, and provided that a member maintains objectivity and integrity throughout, both in regard to the client and to other interested third parties, there can be no objection to a firm accepting an engagement which is designed primarily with a view to advancing the client's case.

Conflicts of Interest

- 431.8 It may be in the best interests of a client company for corporate finance advice to be provided by its auditor and there is nothing improper in the auditor supporting a client in this way. There are however a variety of situations in which conflict can arise.
- 431.9 It would not on the face of it be improper for the firm to continue to act as auditor to both parties in a takeover situation, even if the takeover were contested.

Avoiding Conflicts of Interest

- 431.10 All reasonable steps should be taken to ascertain whether a conflict of interest exists or is likely to arise in the future between a firm and its clients, both in regard to new engagements and to the changing circumstances of existing clients, and including any implications arising from the possession of confidential information. (See section below headed “Documents for client and public use/confidentiality”.)
- 431.11 A firm should not accept or continue an engagement in which there is or is likely to be a significant conflict of interest between the firm and its clients.
- 431.12 Whether a significant conflict of interest exists will depend on all the circumstances of the case. The test is whether a reasonable observer, seized with all the facts, would consider the interest as likely to affect the objectivity of the firm. However, any material financial gain which accrues or is likely to accrue to the firm as a result of the engagement, otherwise than in the form of fees or other reward from the client for its services, or commission, etc. properly earned and declared will always amount to a significant conflict of interests.
- 431.13 Relationships with clients and former clients need to be reviewed before accepting a new appointment and annually thereafter. A relationship which ended over two years before is unlikely to constitute a conflict. Where it is clear that a material conflict of interest exists a firm should decline to act as corporate finance adviser.

Conflict between Interests of Different Clients

- 431.14 There is, on the face of it, nothing improper in a firm having two or more clients whose interests may be in conflict. In such a case however, the work of the firm should be so managed as to avoid the interests of one client adversely affecting those of another. Where the acceptance or continuance of an engagement would, even with safeguards, materially prejudice the interests of any client, the appointment should not be accepted or continued, or one of the appointments discontinued.
- 431.15 It would be neither reasonable nor necessary to discontinue acting in any capacity in anticipation of every potential conflict. It could in some instances give rise to harmful rumour or speculation for a firm to disengage from a situation before a transaction had become public knowledge.
- 431.16 Where there appears to be a conflict of interests between clients but after careful consideration the firm considers that the conflict is not material and unlikely seriously to prejudice the interests of any of those clients, the firm may accept or continue the engagement, but not without first informing the clients concerned and obtaining the consent of both in writing.
- 431.17 A firm should not act or continue as lead adviser for two or more clients if the disclosure called for in paragraph 431.16 would materially prejudice the interests of a client.
- 431.18 For the purposes of the preceding paragraph the “lead adviser” is the firm or person primarily responsible for advising on, organising and presenting an offer or the response to an offer acting in its or his capacity as a sponsor or independent financial adviser. This definition would include the “independent financial adviser” required by a defending company under Rule 2.1 of the Hong Kong Takeovers and Share Repurchase Codes (see below).
- 431.19 Where a conflict of interests is likely to materially prejudice the interests of a client an engagement should not be accepted or continued even at the informed request of the clients concerned.

- 431.20 Where a firm is required for any reason to disengage from an existing client it should do so as speedily as practicable having regard to the interests of the client.
- 431.21 Wherever there is identified a significant conflict between the interests of different clients or potential clients, sufficient disclosure in writing should be made to the clients or potential clients concerned together with details of the safeguards proposed below so that they may make an informed decision as to whether to engage the firm or continue their relationship with the firm.

Safeguards

- 431.22 Where a firm acts or continues to act for two or more clients following disclosure in accordance with paragraph 431.16, all reasonable steps should be taken to manage the conflict which arises and thereby avoid any adverse consequences. These steps should include the following safeguards except to the extent that they are inappropriate:
- (a) the use of different partners and teams for different engagements;
 - (b) standing instructions and all other necessary steps to prevent the leakage of confidential information between different teams and sections within the firm;
 - (c) regular review of the situation by a senior partner or compliance officer not personally involved with either client; and
 - (d) advising at least one or all the clients to seek additional independent advice.
- 431.23 Any decision on the part of a sole practitioner should take account of the fact that the safeguards at (a) to (c) of paragraph 431.22 will not be available to him. Similar considerations apply to a small practice.

Documents for Client and Public Use/Confidentiality

- 431.24 Information acquired in the course of professional work should not be disclosed except where consent has been obtained from the client, employer or other proper source, or where there is a public duty to disclose or where there is a legal or professional right or duty to disclose (see Section 140 "Confidentiality").
- 431.25 Where in the course of corporate finance advice a firm prepares information for a client (for example a critique of the accounts of another company) it may be called upon to do so:
- (a) in a document which is for the consumption of the client only;
 - (b) in order to assist the client to produce a document which will go out solely under the client's name and authority, whether including quotations from the original document or not; or
 - (c) as part of a document which is to be published over the name of the firm.
- 431.26 Any statements or observations in a document prepared for a client must be such as, taken individually and as a whole, are justifiable on an objective examination of the available facts.
- 431.27 In the case of a document prepared solely for the client and its professional advisers, it should be a condition of the engagement that the document should not be disclosed to any third party without the firm's express permission.

- 431.28 Any document whether for private or public use should be prepared in accordance with normal professional standards of integrity and objectivity and with a proper degree of care.
- 431.29 A firm is, in the absence of any indication to the contrary, entitled to assume that the published accounts of the company on which it is commenting have been prepared properly and in accordance with all relevant Accounting Standards. Where scope for alternative accounting treatment exists, and the accuracy of the comment or observation is dependent on an assumption as to the actual accounting treatment chosen, that assumption must be stated, together with any other assumptions material to the commentary. Where the firm is not in possession of sufficient information to warrant a clear opinion this should be declared in the document.
- 431.30 A firm must take responsibility for anything published under its name, and the published document should make clear the identity of the client for whom the firm is acting. To prevent misleading or out-of-context quotations, it should be a condition for the engagement that, if anything less than the full document is to be published, the text and its context should be expressly agreed with the firm.
- 431.31 A firm should ensure that public documents and circulars include prominently the name of the brokers, investment bank or other advisers responsible for promoting or underwriting the share or securities described in the document or circular, where different from that firm which has accepted the roles of sponsor, in order to make abundantly clear the roles undertaken by the various advisers.

The Hong Kong Takeovers and Share Repurchase Codes (the Codes)

- 431.32 A member who provides takeover services for clients is required to comply with the Codes which are expressly applied to professional advisers as well as to those engaged in the securities market. Members' attention is particularly drawn to Annex II - Guidance note: Compliance with the Hong Kong Takeovers and Share Repurchase Codes.
- 431.33 The Codes apply to what are described as "public companies in Hong Kong" and the persons to whom the Codes apply are stated to be as follows:
- (a) directors of public companies;
 - (b) persons or groups of persons who seek to gain or consolidate control of public companies;
 - (c) their professional advisers; and
 - (d) those who are actively engaged in the securities market in all its aspects.
- 431.34 There is a definition of a "private company" under section 29 of the Companies Ordinance. It is a company which has three restrictions imposed by its articles:
- (a) the right to transfer shares must be restricted;
 - (b) the maximum number of members, exclusive of employees, is 50; and
 - (c) the company may not offer its shares or debentures to the public.
- 431.35 There is no definition in the Companies Ordinance of a "public company". However, a company which does not have the above three restrictions in its articles or which fails to comply with any of these three restrictions is regarded as a public company. Section 30 of the Companies Ordinance stipulates that a private company may alter its articles so that they no longer include the three restrictions required to constitute

it as a private company; from the date of alteration the company will be regarded as a public company.

Requirement for Independent Advice

- 431.36 Rule 2.1 of the Codes states the general principle that the financial adviser must be independent. Rule 2.6 of the Codes provides that:

A person who has, or had, a connection, financial or otherwise, with the offeror or offeree company of a kind likely to create a conflict of interest will not be regarded as a suitable person to give independent advice.

Independence is particularly important in Hong Kong, where many companies are dominated by a single shareholder. Rule 2.7 of the Codes, which gives guidance on relationships which are inconsistent with the independence of the financial adviser, takes exception not only to a relationship between the financial adviser and the offeror or offeree company, but also to a relationship between the financial advisers with the controlling shareholder of either the offeror or offeree company.

- 431.37 The onus is on the financial adviser to ensure that no conflict of interest exists which might affect, or be perceived to affect, the impartiality of the advice he gives. When there is any doubt, the financial adviser should disclose the conflict to the Takeovers and Mergers Executive (the Executive). The adviser should not assume that the Executive is aware of the conflict or that the independence of the adviser is accepted by the Executive merely because an announcement of the offer and appointment of the adviser is published. Consulting the Executive is always advisable to minimise the risk of any objection to the appointment after it has been publicly announced. When consulting the Executive, the financial adviser must disclose all relevant information which the Executive will require in order to render a fully informed decision.

It should be noted that the Codes do not provide a strict definition of independence and the Executive will decide if the independent financial adviser is qualified to so act on a case by case basis.

Takeovers Subject to the Codes

- 431.38 A firm may find itself acting as auditor or corporate finance adviser for two or more parties involved in a takeover subject to the Codes. For the firm to cease to act for a client within the limited period of the takeover, on the basis that conflict might arise, could damage the client's interests.

Accordingly in such circumstances a firm may continue to act for more than one party as auditor, as reporting accountants on any profit forecast, and in the provision of incidental advice consistent with these roles. However the firm should not act as lead adviser for any party involved or issue a critique of a client's accounts, and should implement proper safeguards (see paragraph 431.22 above).

- 431.39 The attention of firms is also directed to those sections of the Codes dealing with conflict of interest in particular Note 1 "Conflicts of interest" to paragraph 2.9 in the Chapter headed "Rules" including the possession of "material confidential information". Members in doubt as to their position under the Codes should consult the Takeovers and Mergers Panel.

Takeovers Not Subject to the Codes

- 431.40 Where a takeover is not subject to the Codes, and there is no substantial public interest involved, a firm may, subject to the implementation of appropriate safeguards (see paragraph 431.22 above), continue to advise both sides. However the firm should ensure that the interests of minority shareholders are protected, and

in such cases should consider the desirability of one company having a wholly independent adviser.

The Stock Exchange of Hong Kong Limited's (Stock Exchange) Rules Governing the Listing of Securities (Listing Rules)

431.41 Members' attention is also drawn to the Listing Rules in particular when acting as a sponsor or as an independent financial adviser.

When a firm accepts the responsibilities of a sponsor set out in Chapter 3 of the Listing Rules in respect of a client where it acts as auditor or reporting accountant, it should adopt steps described in paragraph 431.22 above and additionally set up procedures to review and to identify any potential conflicts of interest which could compromise the firm's objectivity.

Connected Transactions

431.42 Whilst the Listing Rules do not provide a strict definition of independence, when a firm accepts the responsibility to act as an independent financial adviser in relation to a connected transaction under Chapter 14 of the Listing Rules, it should take care to ensure that it has not previously advised the client on a previous transaction such as advising the shareholders of a listed issuer, which, because it is in possession of material confidential information of a kind likely to create a conflict of interest, could result in the firm being regarded as not suitable to give independent advice.

It will ultimately be the Stock Exchange who will decide if the independent financial adviser is qualified to so act, but the onus is on the financial adviser to ensure that no conflict of interests exists which might affect, or be perceived to affect, the impartiality of the advice he gives.

Promoting an Issue or Sale to the Public of Shares or Securities

431.43 A firm should not promote an issue or sale to the public of shares or securities of a company on which it has reported or is to report. Neither should the firm undertake to accept nomination as auditor or reporting accountant of the company whose shares it is promoting to the public. Involvement of this kind would endanger the independence of the firm in the audit and/or reporting function.

431.44 It is not inappropriate however:

- (a) for an auditor or reporting accountant to assist a client in raising capital;
- (b) for a firm to conduct an acquisition search, which could identify another client as a target, provided the search is based solely on information which is not confidential to that client;
- (c) for an auditor or reporting accountant to provide independent advice to a client or its professional advisers in connection with the issue or sale of shares or securities to the public; or
- (d) for an auditor or reporting accountant to fulfil the responsibilities of a sponsor

Fees

431.45 Where a member undertakes an engagement for a fee which is contingent upon the successful outcome of a transaction such as a bid, offer, purchase, sale or raising finance, the member should take particular care to ensure that the arrangements do not prejudice his independence and objectivity with regard to any other role which

the member may have, notably as auditor or reporting accountant of either the bidder or the target.

- 431.46 In some circumstances, such as advising on a management buy-out, the raising of venture capital, acquisitions search or sales mandates, fees cannot realistically be charged save on a contingency basis; to require otherwise would, in certain cases, deprive potential clients of professional assistance, for example where the capacity of the client to pay is dependent upon the success or failure of the venture.
- 431.47 Where work is subject to a fee on a contingency, percentage or similar basis the capacity in which a member has worked and the basis of the remuneration should be made clear in any document prepared by the member in contemplation that a third party may rely on it.

Overseas Transactions

- 431.48 This section has been drafted with regard to the situation in Hong Kong. Members should apply the spirit of the guidance, subject to local legislation and regulation, to overseas transactions of a similar nature.

ANNEX I to Section 431**Definition of Corporate Finance Activities**

In this section, corporate finance activities shall include any of the following matters:

1. general corporate or general financial advice or assistance, in relation to the affairs of a company or any of its associates, to the company or officers thereof, including in particular advice or assistance as to borrowing profile, capital requirements and fund raising, investment and foreign exchange policies, dividend policies, share incentive schemes, investor relations, general meetings and proxy solicitation, board composition and management structure;
2. a takeover, acquisition, management buy-out, management buy-in or disposal of a business or a merger, de-merger, division, reconstruction or reorganisation:
 - (a) by or on behalf of the client; or
 - (b) concerning any securities issued by any business carried on by or for the client;
3. the valuation or appraisal of any investment, asset, business or security;
4.
 - (a) giving advice to any country or its central bank or other monetary authority or an international banking or financial institution whose members are countries (or their central banks or monetary authorities) with respect to financial matters including in particular the management, restructuring and securitisation of external debt and the promotion of inward investments; or
 - (b) any scheme for providing finance in connection with (a) above;
5. any kind of financing, refinancing or rescheduling or reorganisation of debt or any interest rate or currency swap or comparable operation related to any financing, refinancing or rescheduling or reorganisation of debt which has previously been effected or which is in contemplation;
6. the financing of a construction or other commercial or industrial project or the establishment of a new business or the expansion of a business;
7. the raising of borrowed moneys, whether by the issue of securitised debt instruments or otherwise, and including the formation and management of a syndicate to provide such finance;
8.
 - (a) an offering or placement or other distribution of investments whether by the issuer or any other person or group of persons to the public or privately for subscription or purchase; or
 - (b) a listing of, or the admission of any securities to dealings on an investment exchange or a suspension or discontinuance of, or other matters arising from, any such listing or admission to dealings;
9.
 - (a) an exchange, conversion, redemption, sale, purchase, re-issue or cancellation of any securities; or
 - (b) an alteration in the terms of any securities; or
 - (c) a reduction of capital or share premium account or a scheme of arrangement or similar operation involving or affecting any securities;

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

10. the underwriting of securities whether by the client himself or by a third party on behalf of the client or making arrangements with a view to or in connection with any such underwriting; and
11. provision of advice in relation to any transaction governed by the Listing Rules.

ANNEX II to Section 431

Guidance Note Compliance with the Hong Kong Takeovers and Share Repurchase Codes

(see paragraph 431.32 of Section 431)

1. A member who provides takeover services for clients is required to comply with the Hong Kong Takeovers and Share Repurchase Codes (the Codes), and with all rulings made and guidance issued under them by the Takeovers and Mergers Panel (the Panel).
2. Accordingly a member proposing to provide takeover services to a client should at the outset:
 - (a) explain that these responsibilities will apply; and
 - (b) include in the terms of the engagement recognition of the member's obligation to comply with the Codes including any steps which the member may be obliged to take in performing those responsibilities. A specimen clause for the engagement letter is set out in paragraph 10 below.

Note: For breaches of the Codes, members are referred to Chapter 1 "Introduction to the Codes" and in particular paragraph 12 "Disciplinary proceedings".

3. As regards contractual relationships existing at the date of publication of this Guidance Note, members should seek to amend the relevant engagement letter to include such wording. Where this does not prove possible, members should inform clients of their intention to comply with the Codes. If the client objects to this, the member should carefully consider the reasons given for such objection and then consider whether it is appropriate to continue to act for the client. In such a situation it may be necessary for the member to take separate legal advice.
4. In this Guidance, "takeover services" means any professional services provided by a member to a client in connection with a transaction to which the Codes apply.
5. In the case of accountants, the kinds of activities most commonly relevant for this purpose include:
 - (a) acting as financial adviser to one of the parties;
 - (b) reporting on profit forecasts and/or valuations for the purposes of takeover documents;
 - (c) conducting acquisition searches for clients, and introducing clients to other parties with a view to potential acquisitions; and
 - (d) advising in relation to acquisitions and disposals of securities to which the Codes may apply.
6. Whilst the Codes do not define precisely the range of activities and transactions within its scope, paragraph 4 "Companies to which the Codes apply" of Chapter 1 "Introduction to the Codes" describes the companies which are subject to the Codes. In practice, those engaging in providing takeover services rarely experience difficulty in determining whether the Codes are or may be relevant to the activities proposed to be undertaken for any particular client.

7. A member who has provided or is providing takeover services to a client should:
- (a) supply to the Panel any information, books, documents or other records concerning the relevant transaction or arrangement which the Panel may properly require and which are in the possession or under the control of the member; and
 - (b) otherwise render all such assistance as the member is reasonably able to give to the Panel,
- provided that in each case the relevant information, books, documents or other records were acquired by the member in the course of the member providing the relevant takeover services.
8. Except with the consent of the Panel, a member should not provide or continue to provide takeover services for any person if the Panel has stated that it considers that the facilities of the securities markets in the Hong Kong should be withheld from that person and has not subsequently indicated a change in this view.
9. If members have included in the engagement letter agreed with their client a provision to the effect of that recommended in paragraph 2(b) above, they will be able to discharge their responsibilities under paragraphs 7 and/or 8 above, without any breach of confidentiality or duty to the client. While members should include such a provision, it is recognised that, on occasion, compliance with such responsibilities may still involve a breach of confidentiality to a third party or a breach of some other duty owed to the client. In such circumstances members should consider obtaining legal advice.
10. The client agrees and acknowledges that where the services provided by the firm relate to a transaction within the scope of the Codes, the client and the firm will comply with the provisions of the Codes and the firm will observe Section 431 issued by the Institute relevant to such services or transactions. In particular, the client acknowledges that:
- (a) if the client or its advisers or agents fail to comply with the Codes then the firm may withdraw from acting for the client; and
 - (b) the firm is obliged to supply to the Panel any information, books, documents or other records concerning the services or transaction which the Panel may properly require.

Section 432 [previously Statement 1.203 (supp.)]

Integrity, Objectivity and Independence in Insolvency

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

Introduction

- 432.1 The fundamental principles direct the attention of each member to the overriding importance in his or her professional life of integrity and objectivity. These elements are as important in the acceptance and conduct of insolvency work as in any other area of professional life. In certain insolvency roles the preservation of objectivity needs to be protected and demonstrated by the maintenance of a member's independence from influences which could affect his or her objectivity.
- 432.2 This section provides specific guidance on members' independence in insolvency appointments. It should be read in conjunction with the provisions of the general guidance on integrity, objectivity and independence in Sections 110, 120 and 290.

Scope

- 432.3 Insolvency appointments include appointments as liquidator, special manager, administrative or other receiver, trustee in bankruptcy or trustee under a Deed of Arrangement.
- 432.4 The following paragraphs refer to specific situations in relation to insolvency appointments in which a member may not properly accept appointment. In situations other than those dealt with, a member should only accept office in any insolvency role sequential to one in which the member or his or her practice or a current employee of the practice has previously acted after giving careful consideration to the implications of acceptance in all the circumstances of the case and satisfying himself or herself that objectivity is unlikely to be compromised by a prospective conflict of interest or otherwise.

Receivership Appointment

- 432.5 Where there has been a material professional relationship (as to which see paragraphs 432.8 to 432.11 below) with a company, no partner in or employee of the practice should accept appointment as receiver or as receiver and manager of that company.

Appointment as Liquidator

- 432.6 Where there has been a material professional relationship (as to which see paragraphs 432.8 to 432.11 below) with a company, no partner or employee of the practice should accept appointment as liquidator of the company if the company is insolvent. Where the company is solvent such appointment should not be accepted without careful consideration being given to the implications of acceptance in that particular case, and a member should satisfy himself or herself that the directors' declaration of solvency is likely to be substantiated by events.

Appointment as Trustee in Bankruptcy or Trustee under a Deed of Arrangement

432.7 Where there has been a material professional relationship (as to which see paragraphs 432.8 to 432.11 below) with a client, no partner or employee of the practice should accept appointment as a trustee in bankruptcy or as a trustee under a Deed of Arrangement.

Material Professional Relationship

432.8 A material professional relationship with a client, such as is referred to in paragraphs 432.5 to 432.7 above arises where a practice or a partner or employee of a practice is carrying out, or has during the previous two years carried out, material professional work for that client. Material professional work would include the following:

- (a) where a practice or person has carried out, or has been appointed to carry out, audit work for a company or individual to which the appointment is being considered; or
- (b) where a practice or person has carried out one or more assignments, whether of a continuing nature or not, of such overall significance or in such circumstances that a member's objectivity in carrying out a subsequent insolvency appointment could be or could reasonably be seen to be prejudiced.

432.9 A material professional relationship with a company or individual (as referred to in paragraphs 432.5 to 432.7 above) includes any material professional relationship with companies or entities controlled by that company or individual or under common control where the relationship is material in the context of the company or individual to whom appointment is being sought or considered. A material professional relationship could also arise where a practice or person has carried out professional work for any director or shadow director of a company, of such a nature that a member's objectivity in carrying out a subsequent insolvency appointment in relation to that company could be or could reasonably be seen to be prejudiced.

432.10 In forming views as to whether a material professional relationship exists, members should have regard to existing or previous relationships with firms with which they are, or have been, associated which might affect or appear to affect their objectivity, including relationships whereby they or their firm are held out by name association or other public statements as being part of a national or international association.

432.11 A member should take reasonable steps prior to his or her acceptance of any insolvency appointment to ascertain whether any of the above work has been performed.

Appointment as Investigating Accountant at the Instigation of a Creditor

432.12 A material professional relationship would not normally arise where the relationship is one which springs from the appointment of the practice by, or at the instigation of, a creditor or other party having an actual or potential financial interest in a company or business to investigate, monitor or advise on its affairs, provided that there has not been a direct involvement by a partner or employee of the practice in the management of the company or business.

432.13 If the circumstances of the initial appointment are such as to prevent the open discussion of the financial affairs of the company with the directors, the investigating member or other partners in the practice may be called upon to justify the propriety of their acceptance of the subsequent appointment.

Conversion of Members' Voluntary Winding Up into Creditors' Voluntary Winding Up

- 432.14 Where a member has accepted appointment as liquidator in a members' voluntary winding up and is obliged to summon a creditors' meeting under section 237A of the Companies Ordinance, because it appears that the company will be unable to pay its debts in full within the period stated in the directors' declaration of solvency, the member's continuance as liquidator will depend on whether he or she believes that the company will eventually be able to pay its debts in full or not.
- (a) If the company will not be able to pay its debts in full and the member has previously had a material professional relationship with the company such as is set out in paragraphs 432.8 to 432.11 above, he or she should not accept nomination under the creditors' winding up.
 - (b) If the company will not be able to pay its debts in full but the member has had no such material professional relationship, he or she may accept nomination by the creditors and continue as liquidator with the creditors' approval, subject to giving the careful consideration as to the implications, etc. referred to in paragraph 432.4 above.
 - (c) If the member believes that the company will eventually be able to pay its debts in full he or she may accept nomination by the creditors and continue as liquidator. However, if it should subsequently appear that this belief was mistaken the member must then offer his or her resignation and may not accept re-appointment if he or she has previously had a material professional relationship with the company.
- 432.15 A member should not appoint a principal or employee of his or her practice, or any close connection of any of the above, or of the member as non employer, as independent trustee of the pension scheme of a company of which he or she is the liquidator, or administrative or other receiver. A member should be aware of the threat to objectivity if he or she were to engage in regular or reciprocal arrangements in relation to such appointments with another practice or organisation.

Insolvent Liquidation Following Receivership

- 432.16 Where a partner in or an employee of a practice is, or in the previous two years has been, receiver of any of the assets of a company, no partner in or employee of the practice should accept appointment as liquidator of the company in an insolvent liquidation. This restriction does not apply where the appointment was sanctioned by the court.

Audit Following Receivership

- 432.17 Where a partner in or an employee of a practice has been receiver of any of the assets of a company, neither the practice nor any partner in or employee of the practice should accept appointment as auditor of the company, or of any company which was under the control of the receiver, for any accounting period during which the receiver acted or exercised control.

Other Potential Conflicts of Interest

Group, associated and "family-connected" companies

- 432.18 Members should be particularly aware of the difficulties likely to arise from the existence of inter-company transactions or guarantees in group, associated or "family-connected" company situations. Acceptance of an insolvency appointment in relation to more than one company in the group or association may raise issues of conflict of interest. Nevertheless, it may be impracticable for a series of different insolvency practitioners to act. A member should not accept multiple appointments

in such situations unless he or she is satisfied that he or she is able to take steps to minimise problems of conflict and that his or her overall integrity and objectivity are, and are seen to be, maintained.

Relationships between Insolvent Individuals and Insolvent Companies

- 432.19 A member who, or a partner or employee of whose practice, is acting as insolvency practitioner in relation to an individual may be asked to accept an insolvency appointment in relation to a company of which the debtor is a major shareholder or creditor or where the company is a creditor of the debtor. It is essential, if the member is to accept the new appointment, that he or she should be able to show that the steps indicated in paragraph 432.18 above have been taken. Similar considerations apply if it is the company appointment which precedes the individual appointment.

Transfer of Principals and Employees including Practice Merger

- 432.20 When two or more practices merge, partners and employees of the merged practice become subject to common ethical constraints in relation to accepting new insolvency appointments to clients of either of the former practices. However, existing appointments which are rendered in apparent breach of the guidance by such merger need not be determined automatically, provided that a considered review of the situation by the practice discloses no obvious and immediate conflict, such as a potential need to sue a new colleague.
- 432.21 Where a partner or an employee of a practice has, in any former practice, undertaken work upon the affairs of the company or debtor in a capacity which is incompatible with an insolvency assignment of his or her new practice, he or she should not personally work or be employed on that assignment, save in the case of an employee of such junior status that his or her duties in the former practice did not involve the exercise of any material professional judgement or direction.

Relationship with a Debenture Holder

- 432.22 A member should, in general, decline to accept an insolvency appointment in relation to a company if he or she or a partner or employee of the practice has such a personal or close and distinct business connection with the debenture holder as might impair or appear to impair the member's objectivity. It is not considered likely that a "close and distinct business connection" would normally exist between an insolvency practitioner and, for example, a clearing bank or major financial institution. However, such a close and distinct business connection would exist where a member, or a partner or employee of the practice, holds an insolvency appointment in relation to such a bank or financial institution.

Purchase of the Assets of an Insolvent Company or Debtor

- 432.23 A member appointed to any insolvency appointment in relation to a company or debtor should not himself or herself acquire directly or indirectly any of the assets of the company or debtor nor knowingly permit any principal or employee of his or her practice, or any close relative of the member or of a principal or employee, directly or indirectly to do so, save in circumstances which clearly do not impair his or her objectivity. For example, where the debtor is a major chain store or similar retailer, a bank etc. it would be quite impractical for the practitioner, his or her staff or their dependents to be banned from trading on normal terms.

Section 440 [previously Statement 1.207]

Changes in a Professional Appointment

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

The Statement

Preamble

- 440.1 Where a change of auditor is contemplated, the nominated auditor should write to the existing auditor to obtain "professional clearance". This is an important procedure to be followed to protect the interest of the nominated auditor, such that he may be made aware of any unusual circumstances surrounding the proposed change of auditor which may be relevant in determining his acceptance of nomination.
- 440.2 The existing auditor should act promptly upon receipt of such written request from the nominated auditor. Where it is the wish of a client to change auditor, the existing auditor should not cause undue hindrance to such a change, and should co-operate with the client and the nominated auditor to facilitate the flow of information and an effective change over.

Audit Appointments

- 440.3 A member who is asked to accept nomination as auditor should, save where the company or organisation has not previously had an auditor:
- (a) find out whether the change of auditor has been properly dealt with in accordance with the Companies Ordinance or other legislation; and
 - (b) request the prospective client's permission to communicate with the auditor last appointed.
- 440.4 If a member is aware that the change of auditor has not been properly dealt with in accordance with the Companies Ordinance or other legislation by the company or organisation, he should advise his prospective client of any remedial action.
- 440.5 A member should decline nomination if the prospective client:
- (a) fails to properly deal with the change of auditor in accordance with the Companies Ordinance or other legislation; or
 - (b) refuses permission for him to communicate with the auditor last appointed.
- 440.6 On receipt of permission to communicate with the auditor last appointed, a member should request in writing of the latter if there are any unusual circumstances surrounding the proposed change which he should be aware of, so that he may determine whether he should accept nomination. An example of such written request is given in the Appendix.
- 440.7 A member receiving such written request should act expeditiously and:
- (a) if there is no professional or other reason why the proposed nominee should not accept nomination, reply accordingly without delay; or

- (b) if he considers it appropriate to discuss the client's affairs with the proposed nominee, request permission of the client to do so freely. If this request is not granted the member should report that fact to the proposed nominee who should not accept nomination.

440.8 On receipt of permission from the client, the member should advise the proposed nominee of his concern about the circumstances surrounding the proposed change and disclose fully all information needed by the proposed nominee to enable him to decide whether to accept nomination.

Other Appointments

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

440.10 A member invited to undertake professional work additional to that already being carried out by the auditor and/or another accountant, who will still continue with his/their existing duties, should notify the auditor and/or the other accountant of the work he is undertaking. This notification need not be given if the client advances a valid reason against it. The member undertaking the additional work has the right to expect of the continuing auditor and/or accountant full co-operation in carrying out his assignment.

Guidelines

General

440.11 Although the guidance which follows takes as its basis the replacement of an auditor of a company, that basis is adopted as but one example of a change in a professional appointment. It follows that the considerations arising on a change of auditor also apply, in appropriate fashion, when a member is invited to undertake advisory work of a recurring nature (including the provision of services such as, e.g. accountancy and taxation) in place of another accountant. They apply whether the client is a company or any other corporate body, an individual, a partnership or any other kind of association, and a member invited to accept nomination or appointment as auditor of a body other than a company should be guided by the same considerations as those indicated in relation to a company. In the case of an audit client they apply in respect of non-audit work as they do to audit work. The reasons for communication as set out in this guidance are equally applicable in all cases.

440.12 A member may be invited to undertake professional work which is additional to that already being carried out by another accountant who will continue with his existing duties. In that event, the member should notify the other accountant that he is undertaking the special work unless the client gives a valid reason why such notice should not be given. The reason for this notification is not merely to adhere to a pattern of common professional courtesy, but to give the existing accountant notice of the scope of the new appointment which may have an important bearing on the way he discharges his own continuing responsibilities to the client and to enable him to meet the obligation placed on him under paragraph 440.2 to offer full co-operation to the member carrying out the new assignment.

Audit Appointments

440.13 In this guidance the term "existing auditor" means the individual or firm currently filling or who last filled the office. The term "member" is used to denote the individual member or firm invited to accept appointment, whilst the term "proposed new auditor" is used when referring to the obligations of an existing auditor to any prospective successor.

- 440.14 The client has an indisputable right to choose its auditors and other professional advisors and to change to others if it so decides.
- 440.15 Auditors of a company are usually appointed to hold office until the conclusion of the next general meeting at which accounts are submitted. Provided the relevant statutory procedure is followed, the shareholders are entitled in general meeting to appoint an auditor other than the existing auditor, just as, when the necessary notice of such an intention is received, the existing auditor is entitled under the Companies Ordinance to make written representations and to address the meeting.
- 440.16 A member who is invited to accept nomination in replacement of an existing auditor should endeavour to ascertain the reasons for the proposed change. This he cannot effectively do without direct communication with the existing auditor. The member, therefore, should not accept nomination without first communicating in writing with the existing auditor to enquire whether there is any reason for or circumstance behind the proposed change of which he should be aware when deciding whether or not to accept nomination.
- 440.17 When a member is first approached by a prospective client he should explain his duty to communicate with the existing auditor and request authority to do so. If authority is refused he should explain to the client that in that case he may not accept nomination and the matter can proceed no further. He should, in any event, make it clear that he must not be nominated until he has informed the client in writing that he is prepared to accept nomination. The member should ask that the client inform the existing auditor of the proposed change, making it clear that the member has not at that stage accepted nomination, before he himself communicates with the existing auditor. He should also ask that, at the same time, the client should give the existing auditor written authority to discuss the client's affairs with the member. The member should decline to accept nomination if he is informed by the existing auditor that the client has refused to give the existing auditor authority to discuss its affairs with him.
- 440.18 The initiative in the matter of communication rests with the member. The existing auditor should not volunteer information in the absence of such communication and of authority from the client.
- 440.19 The purpose of finding out the background to the proposed change is to enable the member to determine whether, in all the circumstances, it would be proper for him to accept nomination. In particular, members will wish to ensure that they do not unwittingly become the means by which any unsatisfactory practices of the company or any impropriety in the conduct of its affairs may be enabled to continue or may be concealed from shareholders or other legitimately interested persons. Communication is meant to ensure that all relevant facts are known to the member who, having considered them, is then entitled to accept the nomination if he wishes so to do. The need to communicate exists whether or not the existing auditor intends to make representations to the proprietors, including his statutory right to make representations to the shareholders of a client company, and whether or not he still holds office as auditor. Communication of the facts to a prospective successor cannot relieve the existing auditor of his duty to continue to press on the client his views on any technical or ethical matters which may have led him into dispute with the client, nor does it affect the freedom of the client to exercise his right to a change of auditor.
- 440.20 The existing auditor should answer without delay the communication from a proposed new auditor. If there are no matters of which the new auditor should be made aware, the existing auditor should write to say that this is the case. Subject to what is said in paragraphs 440.13, 440.14 and 440.17, if there are such matters, he should inform the proposed new auditor of those factors of which in his opinion the latter should be aware. The proposed auditor may wish to confer with the existing

auditor and the latter may explain why in his opinion it is not advisable for the proposed auditor to accept nomination. He may prefer to explain this orally.

- 440.21 The existing auditor should give information as to the professional considerations which arise. This information may indicate, for example, that the reasons for the change which are advanced by the client are not in accordance with the facts. It may disclose that the proposal made to displace the existing auditor is put forward because he has stood his ground and carried out his duties as auditor in the face of opposition or evasion on an occasion on which important differences of principle or practice have arisen between him and the client.
- 440.22 Should it be represented to the member, by the client or by the existing auditor, that the desire to replace the existing auditor is prompted by disagreement over such matters as the truth and fairness of the view shown by the client's accounts or the depth or methods of audit work performed, the member should, after ascertaining the existing auditor's views, discuss with the client the areas of disagreement and satisfy himself either that the client's view is one which he can accept as reasonable, or that, if he does not accept it, the client will accept his right to that contrary opinion, and, if appropriate, his duty to express it in his audit report. Only if he is so satisfied should the member be prepared to accept nomination.
- 440.23 Where an existing auditor believes but cannot be certain that the client or its directors or servants may have been guilty of some unlawful act or default, or that any aspect of the conduct of the client or its directors or servants which is relevant to the carrying out of an audit ought to be investigated, he should impart his belief to a proposed new auditor who communicates with him in accordance with this section.
- 440.24 Where there has been failure or refusal by the client to supply him with information properly required by him for the performance of his duties, the existing auditor should so inform the proposed new auditor.
- 440.25 It may be essential for the performance of his professional obligations defined in this guidance or (if the member subsequently accepts appointment) for the proper discharge of his duties as auditor, that the member should disclose information given to him by his predecessor. For example, disclosure to officers or employees of the client may be unavoidable if the matters brought to his attention by his predecessor are to be properly investigated. However, such disclosure should be no wider than is necessary for the performance of these obligations and duties. Unless the foregoing considerations apply, the member should treat in the strictest confidence any information given to him by an outgoing auditor. He should give due weight to the reply of that auditor and to any representations which the latter may inform him he intends to make to the shareholders. Resentment on the part of the existing auditor of the actions taken by those who propose a change or at the possible loss of an audit is not a valid argument against the change.
- 440.26 If the member does not receive within a reasonable time a reply to his communication to the existing auditor and he has no reason to believe that there are any unusual circumstances surrounding the proposed change, he should endeavour to get into touch with the existing auditor by some other means. If he is unable to do so, or is unable to obtain a satisfactory outcome in this way he should send a further letter, preferably by recorded delivery service, stating that unless he receives a reply within a specified time, he will assume that there are no matters of which he should be aware before deciding whether to accept.
- 440.27 The Hong Kong Institute of Certified Public Accountants' (the "Institute") solicitors have advised that an existing auditor who communicates to a proposed new auditor matters damaging to the client or to any other individuals concerned with the client's business, will have a strong measure of protection were any action for defamation to be brought against him, in that his communication would be

protected by qualified privilege. This means that he would not be liable to pay damages for defamatory statements, even if they turn out to be untrue if they were made without malice. The chances of an existing auditor being held malicious are remote provided that (i) he states only what he sincerely believes to be true, and (ii) he does not make reckless imputations against the client or individuals connected with it which he can have no reason for believing to be true. Moreover, although in making a communication without authorisation the existing auditor might technically be in breach of contract and although there could be circumstances in which the resulting damages were substantial, the likelihood of an action being brought against him is small and in most cases the damages awarded in such an action would be nominal.

- 440.28 The foregoing paragraphs indicate the general principles by which a member should be guided when invited to act as auditor of a company. Additional considerations on matters of detail are indicated below.

Appointment of a Joint Auditor

- 440.29 When a member receives an invitation to accept nomination as a joint auditor either with a prospective new joint appointee or with an existing auditor he should be guided by similar principles to those set out above in relation to nomination as sole auditor.

Retirement of a Joint Auditor when the Fellow Joint Auditor Continues in Office

- 440.30 The appointment of joint auditors confers joint and several responsibility on all the joint auditors appointed by a company. The proposed withdrawal or displacement of a joint auditor creates a circumstance in which the nature of the appointment is substantially changed so that a surviving joint auditor should communicate formally with his fellow joint auditors as though he was being asked to undertake a completely new appointment.

Filling a Casual Vacancy

- 440.31 When a member is invited by the directors to accept appointment to fill a casual vacancy, he should be guided by principles similar to those set out above in relation to an ordinary nomination. He may, however, need to adapt his procedure in the light of the particular circumstances, obtaining such information as he may need from the previous auditor's partners, if any, or the administrators of his estate or such other source as seems appropriate.

Business Acquired by a New Company

- 440.32 When a member is asked to accept appointment as auditor of a new company formed to acquire an existing business and the ownership of the company is substantially the same as it was of the acquired business, the member should, in his own interest, communicate with the auditor or accountant who acted for that business.

Unpaid Fees of Previous Auditor

- 440.33 The fact that there may be fees owing to the existing auditor is not of itself a reason why the member should not accept nomination. If he does accept, it may be appropriate for him to assist in any way open to him towards achieving a settlement of the fees outstanding; whether or not he does so is entirely a matter for his own judgement in the light of all the circumstances. He should not seek to interfere with the exercise of any lien which the existing auditor may have (see Statement 1.301, paragraphs 29 et seq).

Transfer of Books and Papers

- 440.34 The existing auditor should transfer promptly to his successor after he has been duly appointed all books and papers of the company which are in his possession, unless he is exercising a lien thereon for unpaid fees. As to the exercising of a lien, see Statement 1.301 and, in particular, in relation to corporate clients, paragraphs 33 - 40 thereof.

Providing Information to a Successor

- 440.35 The new auditor will often need to ask his predecessor for information as to the client's affairs, lack of which might prejudice the client's interests. Such information should be promptly given and, unless there is good reason to the contrary, such as an unusual amount of work involved, no charge should be made.
- 440.36 The existing auditor is under no legal obligation to make any of his working papers available for review by the new auditor but he has an ethical obligation to respond to the new auditor's specific enquiries and, inter alia, should make available, in respect of those specific areas, working papers relating to matters of continuing accounting significance, including information which may assist the new auditor in determining consistent application of accounting principles.

Statutory Provisions

- 440.37 By statute, an outgoing auditor or one whose replacement is proposed, is entitled and may be obliged to communicate to shareholders or creditors matters connected with his ceasing to hold office and which he considers should be brought to their notice. Nothing in this section applies to the exercise of those statutory rights or duties. The relevant provisions are:
- (a) By section 141(7) of the Companies Ordinance the auditors of a company are entitled to attend any General Meeting of the company and to be heard at such a meeting on any part of the business of that meeting which concerns them as auditors. This right may appropriately be exercised by an auditor whose removal or replacement is being proposed or who has elected not to let his name go forward for re-appointment at the conclusion of his term of office).
 - (b) By section 132(3) of the Companies Ordinance where a resolution is proposed at a General Meeting of the company for appointing as auditor a person other than a retiring auditor or for removing an auditor before the expiry of his term of office, the auditor whom it is proposed to replace may make written representations about his proposed replacement, and those representations must be put before the members of the company).
 - (c) By section 140A(2) of the Companies Ordinance an auditor who resigns his office before the expiry of its term must, if the resignation is to be effective, include in his resignation a statement of any circumstances connected with his resignation which he considers ought to be brought to the notice of members or creditors of the company, or a statement that there are no such circumstances.
 - (d) By section 132(6) of the Companies Ordinance, an auditor of a company who has been removed shall be entitled to attend the general meeting at which his term of office would otherwise have expired and any general meeting at which it is proposed to fill the vacancy caused by his removal. Such an auditor is entitled to receive all notices of, and other communications relating to any such meeting which any member of the company is entitled to receive, and to be heard at any such meeting which he attends on any part of the

business of the meeting which concerns him as former auditor of the company.

The Institute's solicitors have advised that communications made by an auditor in any of these circumstances would enjoy qualified privilege. The effect of that privilege as a potential defence in an action for defamation is dealt with at paragraph 440.27.

APPENDIX

AN EXAMPLE OF A “CLEARANCE LETTER”

Dear Sirs,

We have been nominated to act as auditors of Limited.

In order to assist us in determining whether to accept such nomination, we should be grateful if you would advise if there are any circumstances surrounding the proposed change of which we should be aware.

Yours faithfully,

Section 441 [previously Statement 1.207A]

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

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

- 441.1 The Stock Exchange of Hong Kong Limited (SEHK) and the Securities and Futures Commission (SFC) have raised concerns with the Hong Kong Institute of Certified Public Accountants concerning announcements made by listed issuers of the SEHK of the reasons for changes in auditors. In many cases, fee disputes are stated to be the reason for the change. Concern has been expressed that certain auditors have been relying on purported fee disputes to disguise the real reasons for the change. As a result, potentially significant and fundamental matters about the listed issuer may not be disclosed to investors and creditors and the market is not therefore being kept fully informed. It is important that the situation concerning the change of auditors should be disclosed in full to avoid the possibility of the market being misled.
- 441.2 The purpose of this section, which has been prepared in consultation with the SEHK and the SFC, is to establish a framework to enhance communication by auditors with a listed issuer where there is a change of auditors. The framework requires the outgoing auditors to prepare a letter to the audit committee and the board of directors setting out the circumstances leading to their resignation or termination.
- 441.3 This section deals with changes of auditors of a listed issuer including auditors who resign before the expiration of their term of office, decide not to seek re-election at the Annual General Meeting, are notified by the directors that they will not be nominated for re-appointment, or are removed during their term of office.
- 441.4 This section should be read in conjunction with Section 210 “Professional Appointment” and Section 440 “Changes in a Professional Appointment”.
- 441.5 Auditors of Hong Kong incorporated listed issuers are reminded that section 140A(2) of the Companies Ordinance requires an auditor who resigns from office before the expiry of its term must, if the resignation is to be effective, include in his resignation a statement of any circumstances connected with his resignation which he considers ought to be brought to the notice of members or creditors of the company, or a statement that there are no such circumstances. However, auditors are to note that this section is not intended to provide guidance regarding the requirements of section 140A(2) of the Companies Ordinance.
- 441.6 The terms “listed issuer”, “incoming auditors” and “outgoing auditors” are used throughout this section and are defined as follows:
- (a) “Listed issuer” means a company listed on the Main Board or Growth Enterprise Market (GEM) of the SEHK.
 - (b) “Incoming auditors” means the auditors or the auditors to be nominated for the current period who did not audit the preceding period’s financial statements.
 - (c) “Outgoing auditors” means the auditors who were previously the auditors and have been or are to be replaced by any incoming auditors.

Duty to the Shareholders to Report on the Financial Statements

- 441.7 Auditors are reminded that once they are appointed, they have a duty to the shareholders to report to them on the financial statements, and should make every reasonable effort to discharge this duty. Auditors should not attempt to avoid the responsibility of reporting on the financial statements by resigning.
- 441.8 The auditors' proper course of action, once appointed, is to report on the financial statements. If they are considering resigning during their term of office they should discuss the contentious issues which may lead to their resignation with the audit committee and seek the audit committee's assistance to resolve the issues with management and to complete the audit. Having completed the audit, if they do not wish to be re-appointed, they should decline to stand for re-appointment when their term of office expires.

Communication with the Audit Committee and the Board of Directors

- 441.9 This section requires the outgoing auditors to prepare a letter to the audit committee and the board of directors of the listed issuer, whenever:
- (a) the outgoing auditors resign or decline to stand for re-appointment (Resignation); or
 - (b) the listed issuer decides to propose to its shareholders that the outgoing auditors be removed from office during the auditors' term of office, or there is a proposal or intention not to re-appoint them on the expiry of their term of office (Termination).
- 441.10 The outgoing auditors' letter to the audit committee and the board of directors should set out the circumstances leading to their Resignation or Termination, hereafter referred to as "Letter of Resignation or Termination". The circumstances to be disclosed in the Letter of Resignation or Termination are all occurrences that, in the opinion of the outgoing auditors, affect the relationship between the listed issuer and the outgoing auditors.
- 441.11 Occurrences that affect the relationship between the listed issuer and the outgoing auditors include, but are not limited to, "disagreements" and/or "unresolved issues", as discussed below. The disagreements and unresolved issues to be disclosed will generally be those that occurred in connection with:
- (a) the audit of the listed issuer's most recently completed financial year;
 - (b) any period subsequent to the most recently completed financial period for which an audit report has been issued up to the date of the Resignation or Termination.
- 441.12 Disagreements refer to any matter of audit scope, accounting principles or policies or financial statement disclosure that, if not resolved to the satisfaction of the outgoing auditors, would have resulted in a qualification in the audit report.
- 441.13 Disagreements include both those resolved to the outgoing auditors' satisfaction which affect the relationship between the listed issuer and the outgoing auditors, and those not resolved to the outgoing auditors' satisfaction. Disagreements should have occurred at the decision making level, i.e., between personnel of the listed issuer responsible for the finalization of its financial statements and personnel of the

auditors responsible for authorizing the issuance of audit reports with respect to the listed issuer.

- 441.14 The term disagreement is to be interpreted broadly. It is not necessary for there to have been an argument for there to have been a disagreement, merely a difference of opinion. The term disagreement does not include initial differences of opinion, based on incomplete facts or preliminary information, that were later resolved to the outgoing auditors' satisfaction, provided that the listed issuer and the outgoing auditors do not continue to have a difference of opinion upon obtaining additional facts or information.
- 441.15 Unresolved issues refer to matters which come to the outgoing auditors' attention and which, in the outgoing auditors' opinion, materially impact on the financial statements or audit reports (or which could have a material impact on them), where the outgoing auditors have advised the listed issuer about the matter and:
- (a) the outgoing auditors have been unable to fully explore the matter and reach a conclusion as to its implications prior to a Resignation or Termination;
 - (b) the matter was not resolved to the outgoing auditors' satisfaction prior to a Resignation or Termination; or
 - (c) the outgoing auditors are no longer willing to be associated with the financial statements prepared by management of the listed issuer in relation to circumstances described in HKSA 560 "Subsequent Events" when it becomes effective on "Facts discovered after the financial statements are laid before the shareholders or equivalent" resulting in the withdrawal of an audit report.
- 441.16 The outgoing auditors should note that disclosing the circumstances leading to their Resignation or Termination in the Letter of Resignation or Termination is the appropriate method of discharging their responsibilities during a change in a professional appointment without having to be concerned with the professional duty of confidentiality owed to the listed issuer. In the event that the incoming auditors approach the outgoing auditors for professional clearance and ask whether the outgoing auditors are aware of any unusual circumstances surrounding the proposed change of auditors which may be relevant in determining their acceptance of nomination, as required by Section 440 "Changes in a Professional Appointment", the outgoing auditors can refer the incoming auditors to their Letter of Resignation or Termination.

The Incoming Auditors

- 441.17 Since the outgoing auditors are required to disclose the circumstances leading to their Resignation or Termination in the Letter of Resignation or Termination, the incoming auditors should request a copy of the Letter of Resignation or Termination and any correspondence referred to in the letter directly from the listed issuer for consideration in addition to requesting professional clearance from the outgoing auditors before accepting the appointment.
- 441.18 If the listed issuer refuses to provide the incoming auditors with a copy of the Letter of Resignation or Termination and any correspondence referred to in the Letter of Resignation or Termination, the incoming auditors should decline to accept nomination.

Announcement Made by the Listed Issuer on the Change of Auditors

- 441.19 Auditors of a listed issuer should be cognizant of the provisions of the Main Board and GEM Listing Rules (Listing Rules) regarding changes in audit appointments.

- 441.20 The outgoing auditors should note that the listed issuer is required to make an announcement pursuant to the Listing Rules setting out the reason(s) for the change of auditors and any other matters that need to be brought to the attention of holders of securities of the issuer (including, but not limited to, circumstances set out in the outgoing auditors' Letter of Resignation or Termination in relation to the change of auditors). In the Letter of Resignation or Termination, the outgoing auditors should remind the listed issuer of this obligation and should give their express consent to the letter being supplied to the SEHK.
- 441.21 The outgoing auditors should read and assess whether the circumstances as reported in their Letter of Resignation or Termination, which, in their opinion, need to be brought to the attention of the shareholders, are reflected in the announcement made by the listed issuer. In the event that the outgoing auditors notice that the circumstances leading to their Resignation or Termination as announced by the listed issuer are materially different from the circumstances as reported by them in their Letter of Resignation or Termination in respect of matters that need to be brought to the attention of the shareholders, they should write to the audit committee and board of directors of the listed issuer regarding those matters.
- 441.22 In practice, it is recommended that the listed issuer should agree with the outgoing auditors the details relating to the circumstances in the announcement before its issuance. This is to help avoid the situation described in paragraph 441.21 above. However, it should be noted that such an approach should not unduly delay the listed issuer's announcement of the change of auditors.
- 441.23 If the outgoing auditors write in accordance with paragraph 441.21 above and the listed issuer takes no adequate action in response, they should consider whether the market has been adequately informed as to the circumstances leading to their Resignation or Termination. If not, the outgoing auditors should consider whether these should be brought to the attention of the relevant regulatory authority.
- 441.24 The outgoing auditors should note that if they were to report those matters to the SEHK, there might be a breach of confidentiality.
- 441.25 Should the outgoing auditors decide it necessary to report those matters to the SFC, they will be subject to the protection of sections 380 and 381 of the Securities and Futures Ordinance. Sections 380 and 381 of the Securities and Futures Ordinance provide immunity to a person who is or was an auditor of a company which is listed, or any associated company of the company, who reports to the SFC matters which come to his attention that suggest that at any time since the formation of the listed company, its shareholders have not been given all the information with respect to its affairs that they might reasonably expect. The outgoing auditors are advised to consult their lawyers before communicating.

Section 450 [previously Statement 1.205]

Practice Promotion

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

Introduction

This section sets out the requirements for practice promotion activities, including all forms of publicity and advertising. This section comprises four parts:

Part 1 deals with scope and responsibilities;

Part 2 sets out the general principles which must be observed in respect of all practice promotion activities;

Part 3 sets out additional principles which apply to advertising; and

Part 4 sets out prohibited media.

Part 1 - Scope and Responsibilities

Scope

- 450.1 This section applies to:
- (a) Certified Public Accountants (Practising), including member practices, their affiliates and, members who are employees of member practices; and
 - (b) members advertising themselves as professional accountants providing professional and other services, whether as individuals, partnerships or through other entities over which they exercise control.
- 450.2 For the purposes of this section, an affiliate of a Certified Public Accountants (Practising) is deemed to be any individual or entity over which the Certified Public Accountants (Practising) exercises control or significant influence, regardless of whether such control or significant influence results from direct or indirect ownership, common ownership or other arrangement.
- 450.3 The provisions of this section are applicable to all forms of practice promotion, including publicity sought by members for their services, achievements and products and any advertising thereof.
- 450.4 The principles set out in this section apply equally to all forms of communication by members, e.g. letterheads, invoices, name cards and via electronic media.

Responsibilities

- 450.5 Members to whom this section applies will be held responsible for the form and content of any advertisement, publicity, or solicitation, whether undertaken personally or by another person or organisation on behalf of the member or his practice. Any practice promotion activity or material relating to a member or member practice shall be presumed, subject to proof by the member to the contrary, to have been issued (in the form in which it was issued) with his authority.

- 450.6 Where members receive the benefits of promotional activities by third parties they are reminded that they are not permitted to do through others what they are prohibited from doing themselves by the Code of Ethics for Professional Accountants issued by the Hong Kong Institute of Certified Public Accountants (the "Institute").
- 450.7 Members are required to use their best endeavours to ensure that promotional activities in Hong Kong by connected or associated individuals or entities outside Hong Kong, comply with this section.
- 450.8 In the event of a complaint being received by the Institute relating to the promotion of professional services, members will be required to justify their position or actions.

Part 2 - General Principles Applicable to All Forms of Practice Promotion

- 450.9 The general principles set out in this Part must be observed in respect of any practice promotion activities.
- 450.10 Where publicity, advertising or other forms of practice promotion are carried out, such activities should:
- (a) be aimed at informing the recipients or the public in an objective manner;
 - (b) conform to the basic principles of legality, decency, clarity, honesty and truthfulness; and
 - (c) not project an image which is inconsistent with that of a professional person bound to high ethical and technical standards.
- 450.11 In no circumstances should any promotional activities be conducted in such a way or to such an extent as to amount to harassment or coercion of prospective clients.
- 450.12 Activities which are expressly prohibited include those which:
- (a) create false, deceptive or unjustified expectations of favourable results;
 - (b) imply the ability to influence any court, tribunal, regulatory agency or similar body or official;
 - (c) make unjustified claims to be an expert or specialist in a particular field;
 - (d) contain purported statements of fact which cannot be verified or which are misleading by reason of the context in which they appear;
 - (e) make disparaging references to or disparaging comparisons with the services of others;
 - (f) contain testimonials or endorsements other than where:
 - (i) the prior consent has been obtained from the giver of the testimonial or endorsement;
 - (ii) the giver of the testimonial or endorsement is clearly identified; and
 - (iii) the testimonial or endorsement has not been obtained for reward;
 - (g) contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

- 450.13 Practising members should not give any commission, fee or reward to a third party, unless he/she is either their employee or another professional accountant, in return for the introduction of a client.

Part 3 - Principles Applicable to Advertising

- 450.14 This Part sets out additional principles which must be observed with regard to advertising or other forms of promotional material which are widely circulated or on public display (subject to the restrictions set out in Part 4).
- 450.15 An advertisement should be clearly identified as such.
- 450.16 Advertising and promotional material should not contain references to scale charges or amounts of fees for professional and other services, nor should members make comparisons between their fees and the fees of others. It is, however, permissible to make reference to a free initial consultation at which levels of fees will be discussed. This Part of the section refers to advertising and therefore does not preclude members from quoting fees or a range of fees in proposals where they have been requested to do so by a prospective client.
- 450.17 As the "Homepage" of a website of a member or member practice is considered analogous to a newspaper advertisement, it is not allowed to contain any references to scale charges or amounts of fees. However information on scale charges or amounts of fees contained in a separate file on the website which is linked to the "Homepage" is allowed as the user is required to act to gain access to such information by clicking the relevant "icon" on the "Homepage".
- 450.18 Members should not make generalised claims as regards size or quality. A claim to be, for example, the "largest" or "fastest growing" member practice in any area or field of practice is likely to be misleading, as it is impossible to know whether such a claim refers to the number of partners or staff, the number of offices or the amount of fee income. A claim to be the "best" or the "leading" member practice is subjective and cannot be substantiated.
- 450.19 Signboards and other notices on public display should be maintained at all times to a high standard and consistent with the dignity of the profession. Notices in the nature of handbills, stickers, etc. are unacceptable.

Part 4 - Prohibited Media

- 450.20 This Part sets out prohibitions and restrictions on the use of certain media for practice promotion activities including publicity and advertising.
- 450.21 The restrictions set out below do not apply to members standing as candidates for public office. Such members are, however, required to ensure that they are not using their election campaigns to advertise their professional services.

Direct Mailing

- 450.22 Except as permitted by paragraph 450.23 below, members should not mail, deliver or send directly or indirectly (whether by mail, fax, electronic mail or other means) material promoting their services.
- 450.23 The general exceptions to the above prohibition on direct mailing are:
- (a) direct mailing of material to clients, close associates and other practising members or upon receipt of an unsolicited request from the recipient;

- (b) direct mailing of material in relation to seminars, provided that it is strictly relevant to the seminar in question and should not be capable of being construed as an advertisement for the general professional services of the member;
- (c) a member may send a letter introducing his practice and its range of services to another professional adviser, such as a solicitor or banker, provided that it is made clear that this is not done with the aim of procuring the professional adviser itself as a client.

Cold Calling

- 450.24 A member should not make or instigate an unsolicited approach to a non client for the purpose of obtaining professional work, for example by making an uninvited visit or by telephone either to solicit business or to make an appointment to visit.

Distribution of Leaflets, Promotional Gifts and Other Items

- 450.25 Leaflets, flyers, handbills, promotional gifts or other items advertising or promoting the name of a member or member practice or its services may not be distributed in public places. It is, however, acceptable for such items to be distributed at the location of events sponsored by the member or member practice during that event.

Section 460 [previously Statement 1.212]

Clients' Monies

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

The Statement

- 460.1 A member in practice is strictly accountable for all clients' monies received by him. Such monies should be kept separate from all other monies in his hands and be applied only for the purposes of the client.

Guidelines

- 460.2 In this section, the term "clients' monies" includes all monies received by a practice to be held or disbursed by it on the instructions of the person from whom or on whose behalf they are received.
- 460.3 Clients' monies should under normal circumstances be paid within five working days into a separate bank account, which may be either a general account or an account in the name of a specific client but which shall in all cases include in its title the word "client". Any such bank account is referred to herein as "a client account". It is desirable for a member to open a general client account at the commencement of his practice.
- 460.4 Whenever a practice opens a client account appropriate notice of the nature of the account should be given in clear terms to the bank at which the account is to be opened. Legal advice has been received to the effect that if this is done no question will arise of set-off by the bank against the member's other accounts or of sequestration by a trustee in bankruptcy of a member of the amounts held in the client account for the benefit of the general creditors of the bankrupt member.
- 460.5 Where a practice receives a cheque or draft which includes both clients' monies and other monies he should cause the same to be credited to a client account. Once the monies have been received into such client account a practice may withdraw from that account such part of the sum received as can properly be transferred to the office account in accordance with the principles set out in paragraph 460.7 below.
- 460.6 Save as referred to in paragraph 460.5 above, no monies other than clients' monies should be paid into a client account.
- 460.7 Drawings on a client account may be made only:
- (a) to meet payments due from a client to the practice for professional work done by the practice for that client provided that:
 - (i) a bill has been rendered; and
 - (ii) the client has been informed in writing, and has not disagreed within a reasonable period of time, that money held or received for him will be so applied;
 - (b) to cover disbursements made on a client's behalf;
 - (c) to, or on the instructions of, a client.

- 460.8 A practice must be careful to differentiate, both in its records and, where appropriate, in its use of client accounts, between monies held on behalf of a client in his personal capacity and those, within the knowledge of the practice, held on behalf of the same client as trustee for others. Save where the size of the fund does not, on grounds of expense, warrant it, a separate client account should be opened to receive the trust monies of each separate trust.
- 460.9 In no circumstances should a practice permit any payment to be made to or on behalf of a client from a client account, whether by transfer to office account of the practice or otherwise, which will result in a drawing on the relevant client account exceeding the balance held in that account on such client's behalf.
- 460.10 Interest on client account monies:
- (a) In the absence of express agreement to the contrary any interest received on a client's monies may be retained by the practice.
 - (b) Variations to sub-paragraph (a) above should be agreed between members and their clients. Any such agreement might conveniently be recorded in the engagement letter, or in any subsequent correspondence.
 - (c) Where a practice receives monies of a client for retention and it is under instructions from the client that the monies be deposited at interest, the practice shall so deposit them in a designated client deposit account in respect of which notice shall have been given as provided in paragraph 460.4. It may be appropriate for a practice to charge a fee for this service. If monies belonging to more than one client are held in the same client bank account, any interest arising thereon should be apportioned as appropriate among the clients concerned.
- 460.11 Money held by a member as stakeholder should be regarded as clients' money and should be paid into a separate bank account maintained for the purpose or into a client bank account. The disposition of interest arising from such monies should be the subject of an agreement between the parties.
- 460.12 Every member in practice should at all times maintain records so as to show clearly the money he has received, held or paid on account of his clients, and the details of any other money dealt with by him through a client account, clearly distinguishing the money of each client from the money of any other client and from his own money.

Section 470 [previously Statement 1.290D]

Financial and Accounting Responsibilities of Directors

This section should be read in conjunction with Section 330 “Acting with Sufficient Expertise”.

Scope and Purpose

- 470.1 Directors of companies, whether public or private, have various responsibilities towards their companies, breach of which may not only be detrimental to those companies and their shareholders, but also may lead to civil and criminal liability of the individual director concerned. The aim of this section is to provide guidance for directors who are members of the Hong Kong Institute of Certified Public Accountants as to their responsibilities, in particular in relation to their financial and accounting responsibilities.
- 470.2 In discussing these responsibilities, companies which are subject to the Companies Ordinance are considered, differentiating between public and private companies as appropriate. Special categories of companies are not dealt with in detail.
- 470.3 It is to be stressed that the aim is to guide directors and not to provide them with a detailed analysis of the law on the topics under discussion. Interpretation of the law often depends upon the particular circumstances and if directors are in difficulty over interpretation of their duties they should seek legal advice.

Directors’ Status, Powers and Duties

Who is a Director

- 470.4 A director, by whatever title, is one who is in practice responsible for the management of company affairs. There is no comprehensive definition of a director in statute, the only guidance given being that the term “director” includes any person occupying the position of director, by whatever name called (Companies Ordinance, section 2). Anyone who acts as a director will thus bear the responsibilities of that position regardless of whether he carries the title “director”.
- 470.5 Since August 1984, statute requires a minimum of two directors. The method of appointment of directors will normally be governed by the company’s articles of association. The first directors are chosen by the subscribers of the company’s memorandum and thereafter by the company in annual general meeting (Companies Ordinance, Table A, regulations 77 and 91). The appointment of each director must be voted on individually at the annual general meeting of a public company unless a resolution that a single resolution will suffice has been first agreed unanimously by the meeting (Companies Ordinance, section 157A).

Nominee Directors

- 470.6 The fiduciary duties owed by nominee directors to act for the benefit of the company have been modified by some courts in England, Australia and New Zealand. Nominee directors are those persons who in the performance of their office act in accordance with some understanding, arrangement or status which give rise to an obligation to the appointor.
- 470.7 On the traditional view, nominee directors are required to disregard the interests of their appointors in favour of the shareholders as a whole. However if they do so, it is likely that the appointor will take steps to remove them. The courts have therefore in some instances taken an alternative approach which recognises the commercial

requirement for directors to be able to have regard to the interests of their appointors. In re *Broadcasting Station 2GB Ltd.* [1964 - 65] NSW 1648 it was said that a nominee is entitled to have in mind the interests of his appointor, and to advance the interests of his appointor, provided that in so doing he has a reasonable belief that he is acting consistently with the interests of the company as a whole.

Non-executive Directors

470.8 In law there is no such thing as an “executive” or “non-executive” director. Other than as indicated at paragraph 470.23(d), below, all directors have the same responsibilities in law. An “executive director” is merely a director who has separate responsibilities with the company, as an executive. The role of the non-executive director is discussed further in paragraphs 470.15 and 470.16 below.

Who cannot be a Director

470.9 Normally, the company’s articles of association (see Note 1 below) will deal with the appointment and powers of the directors (Companies Ordinance, Table A, regulations 77 to 111), but there are certain statutory restrictions:

- In occasions where a thing has to be done by a director and a secretary, a person cannot be a company’s director and its secretary at the same time (Companies Ordinance, section 154B);
- Certain fraudulent persons or ex-directors of insolvent companies may not, without leave of the court, act as a director (Companies Ordinance, sections 157E(1) and 157F(1));
- A body corporate cannot act as a director of a listed company or its subsidiary (Companies Ordinance, section 154A);
- A person cannot be a company’s auditor and a director at the same time (Companies Ordinance, section 140(2));
- Anyone below the age of 18 cannot be appointed as a director (Companies Ordinance, section 157C).

Status of Directors

470.10 A director is an officer of the company but is not necessarily an employee. The status of an employee is governed by the contract under which he serves the company. As indicated above, an executive director is both a director and an employee.

470.11 A director may enter into a contract, other than a contract of service, with the company, whereby the director undertakes the management and administration of the company. The contract must be available for inspection at each AGM held during the period of the contract (Companies Ordinance, section 162A).

Note 1: Throughout this section where it is considered appropriate to refer to articles of association, reference is made to the relevant articles of the current version of Table A of the Companies Ordinance. It by no means follows that the articles of association of any particular company will be in the same form.

- 470.12 A director owes fiduciary duties to his company. He is in some senses an agent and in some senses a trustee but he is neither precisely one nor the other.
- 470.13 A director is regarded as acting as the company's agent when entering into transactions on behalf of the company (*Great Eastern Railway v Turner* [1872] LR 8 Ch. App. 149). This imposes duties of loyalty and good faith.
- 470.14 A director is entrusted with the powers given to him in the articles of association and is said to be a trustee of the company's money and property (*Great Eastern Railway v Turner*). Unlike trustees in other branches of the law however, a director is not subject to the Trustee Ordinance.
- 470.15 A director may have executive status or operate in a non-executive capacity. The non-executive director has a positive contribution to make in ensuring that the board fulfills its main objectives. He can exercise an impartial influence and bring to bear experience gained from other fields; executive directors would therefore be well advised to consider the appointment of such directors to serve alongside them.
- 470.16 Professional accountants are well qualified for these positions because of the special skills and experience which they have to offer. It is important therefore that, before accepting a board appointment, prospective non-executive directors should be aware that, other than as indicated at paragraph 470.23(d). below, their responsibilities in law are no different from those of directors holding executive status. They should ensure that, because of their skills, they are not acting as professional advisors to the board, and would be well advised to satisfy themselves that the company has access to and gets all the outside professional advice that it needs.
- 470.17 One consideration a board of directors might wish to bear in mind is the formation of an audit committee from amongst their number. This committee, which may comprise both executive and non-executive directors, can be used to liaise with the auditors and be the main channel through which information, advice and suggestions may flow between the board and the auditors. The duties of the committee may include a review of the company's internal controls, internal audit systems and procedures, the scope and result of the external audit and the financial statements, and approval of the auditors' remuneration.

Powers of Directors

- 470.18 Directors derive their power from the articles of association and they should study carefully the articles of their particular company. Directors also should have regard to the powers given to the company, which are to be found in the memorandum of association, in particular the objects clause, for the company cannot do what is not authorised by its objects clause (*Ashbury Railway Carriage Co v Riche* [1875] LR 7 H.L. 653 and *Rolled Steel Products (Holdings) v British Steel Corporation* [1986] CH 246).
- 470.19 The company in general meeting may in certain circumstances exercise powers normally vested in directors, for example, where there is deadlock on the board (*Barron v Potter* [1914] 1 CH 895) or where there are no directors (*Alexander Ward & Co v Samyang Navigation Co* [1975] 1 WLR 673), but these circumstances will be rare.
- 470.20 Directors must exercise their powers collectively and the majority decision will prevail. The articles of association will govern how the directors are to proceed (Companies Ordinance, Table A, regulations 100 - 108) and will often authorise directors to delegate the exercise of their powers to a committee consisting of one or more directors, or to a managing director (Companies Ordinance, Table A, regulations 104 and 111).

Duties of Directors

470.21 The duties of directors are owed to the company as a whole. Their duties and responsibilities arise both out of status and out of common law and can be classified as follows:

- fiduciary duty to act honestly and in good faith;
- duty to exercise skill and care; and
- statutory duty.

Fiduciary duty

470.22 Directors must act honestly and in good faith for the benefit of the company. In particular, directors must:

- (a) act in good faith in what they believe to be the best interests of the company. Generally speaking, the interests of the company are to be equated with the interests of its members as a whole. Directors must not act just for the economic advantage of the majority of shareholders disregarding the interests of the minority. The position and interests of creditors must be considered in any case where the company is not fully solvent. The interests of the company's employees must also be taken account of;
- (b) act for a proper purpose, that is, directors must not abuse the powers given to them by using those powers for purposes other than those for which they were granted (*Howard Smith Ltd v Ampol Ltd* [1974]AC 821 PC);
- (c) not obtain a personal profit from transactions entered into by the company without the prior approval of the shareholders; otherwise such profits will be regarded as being held in trust for the company and they may have to account for them;
- (d) not agree to fetter their discretion. As the powers delegated to directors by the memorandum and articles are held in trust by them for the company, they must not restrict their exercise of future discretion; and
- (e) act in such a way that there is no possibility of conflict between personal interests and company interests. Directors' interests in contracts with the company are examined later (see paragraphs 470.37 - 470.40 below). Directors should also avoid any conflict of interest by not using corporate property, information or opportunity for any purpose other than in the company's interests.

470.23 The following particular responsibilities have been recognised in recited cases. In no sense are these the sole responsibilities of directors:

- (a) Directors should ensure that the company's moneys are properly invested, unless the articles of association permit delegation of this duty (re *City Equitable Fire Insurance Co* [1925] Ch. 407).
- (b) Directors should be satisfied that the company's assets are physically safeguarded and properly insured.
- (c) Directors should ensure that payments are properly made and supported by adequate documentation.

In re *City Equitable Fire Insurance Co*, it was said that a list of cheques to be authorised should be presented at each board meeting, but it is unlikely that this will be feasible in most cases today. While it may not be possible for the board to authorise all payments, directors should exercise care to ensure that only those authorised may issue cheques and that all payments are supported by proper documentation.

- (d) Directors ought to be satisfied that the company's securities are kept in a safe place, although day to day responsibility for this may be delegated to a responsible official (re *City Equitable Fire Insurance Co*).

Duty of Skill and Care

470.24 A director must exercise reasonable care and skill in the performance of his duties. The wide range of skills required of directors has meant that there have been no precise standards of skill and care established in case law. In the past the courts have required that directors display the degree of skill and care which may reasonably be expected from a person with that director's knowledge and experience.

470.25 Using principles drawn from the law of agency, the following guidelines can be laid down:

- (a) Full-time executive directors should devote as far as possible their whole time and energies to company matters during office hours. This does not preclude them from acting as non-executive directors of other companies with the corresponding responsibilities that such appointments bring, subject to the provisions of their contract with the company (see paragraphs 470.8, 470.15 and 470.16 above).
- (b) If employed as having particular skills, for example, as being a professional accountant, a director should display the skill or ability expected from a person of that profession. A professional accountant may, depending on the circumstances, be held professionally responsible if he should be found negligent in the discharge of his duties as a director.
- (c) Having regard to the articles of association and the demands of business, certain duties may properly be left to some other official, and directors are justified in trusting that official to perform such duties honestly in the absence of grounds for suspicion (re *City Equitable Fire Insurance Co*).
- (d) Non-executive directors do not need to give continuous attention to company affairs but should acquaint themselves with the company's financial situation and attend board meetings and any committee of the board on which they sit when reasonably able to do so (re *City Equitable Fire Insurance Co*).

Statutory Duty

470.26 Various company law statutes impose a number of duties on directors, such as the preparation of annual accounts, and these are dealt with in the following paragraphs, under subject title. However, one specific duty will be examined in the following paragraphs, namely, duties in relation to auditors.

470.27 Duties in relation to auditors: it is the duty of the company at each general meeting to appoint its auditors for the year. At any time before a company's first general meeting, the directors may appoint the company's first auditors (Companies Ordinance, section 131(3)).

- 470.28 Auditors have a statutory right of access, at all times, to the company's books and accounts and vouchers and to require from officers of the company such information as the auditors think necessary for the performance of their duties (Companies Ordinance, section 141(5)). Directors must therefore ensure that the auditors have adequate information for the performance of their duties. Further, the auditors of a holding company may require information and explanations from subsidiary companies and their auditors. Any officer who knowingly or recklessly makes a statement to the auditors in the course of their audit which is misleading, false or deceptive in a material particular is guilty of a criminal offence (Companies Ordinance, section 134).
- 470.29 The statutory rights of auditors cannot be restricted in any way (*Newton v Birmingham Small Arms Co* [1906] 2 Ch. 378).
- 470.30 Directors may be asked by the company's auditors to make written representations to confirm information on which the auditors have placed reliance in forming an opinion. This may be done by letters of representation or by board minutes. Such confirmations are sought as part of the auditor's duty to obtain audit evidence, and will arise when knowledge of the facts is confined to management or where the matter is principally one of judgment and opinion, and no independent corroborative evidence is available.
- 470.31 It is common practice for auditors to send a management letter to the board of directors after an audit, drawing attention to any weakness in the company's systems and making suggestions for possible improvements. While there are no specific legal requirements relating to management letters, directors should consider them with care, since such a letter may contain information which should put the directors on enquiry as to inadequacies in systems or personnel. The auditors may request a reply to the points raised in the management letter and in certain cases, may request that the directors' discussion of the letter be recorded in the board minutes.
- 470.32 There are also occasions when directors need auditors' reports on matters other than the annual accounts, for example, when a payment out of a capital is being made for use by a company in purchasing its own shares (Companies Ordinance, section 49K(5)) or when a private company is giving financial assistance for the purpose of purchasing its own shares (Companies Ordinance, sections 47E and 47F).

Directors' Relationship with Company

- 470.33 A director stands in a fiduciary relationship to his company. He should not therefore place himself in a position where his personal interest or his duty to others could conflict with his duty to the company (see paragraph 470.22 above). If such a conflict does arise, the director will be personally liable to the company for any loss suffered by the company or will have to account for any benefit which has accrued to him. This rule is strictly applied by the courts (*Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378).
- 470.34 Further, in the event of a director having an interest in a contract to which his company is a party, at common law, the company may in certain circumstances avoid the contract. If, however, the director discloses his interest in the contract to the board of directors and their approval of his involvement is given, the contract will cease to be voidable and the director may retain any profit he has received by virtue of his interest if so authorised by the articles.
- 470.35 The articles of association will usually contain provisions concerning contracts between the company and its directors (Companies Ordinance, Table A, regulation

86) and lay down the procedure to be followed. Directors should therefore study the particular provisions of their company's articles of association.

470.36 Statute has, however, increasingly intervened to lay down rules relating to various types of contracts. These can be divided into:

- contracts in which a director is interested; ·
- substantial asset disposals; ·
- arrangements of a financial nature; ·
- share transactions.

Contracts in which a Director is Interested

470.37 Where a director is directly or indirectly interested in a contract or a proposed contract with the company, he must declare his interest at a meeting of directors at the first opportunity (Companies Ordinance, section 162). His duty is to declare the nature of his interest, but a general notice that a director is a member of a specific company or firm or that he is to be regarded as being interested in any contract made with a specified person who is connected with him, is deemed to be sufficient. This provision will not save a contract which is voidable under common law; therefore the contract should also be authorised by the articles of association or by the company in general meeting. Some articles provide that a director interested in any contract may not vote or be counted in the quorum when matters relating to that contract are resolved.

470.38 Where a director is materially interested in a contract, either directly or indirectly, disclosure must be made in the accounts, whether individual accounts or group accounts. This provision operates to catch not only contracts in the strict sense but also any transactions or arrangements. The Companies Ordinance, section 129D should be consulted for the details.

470.39 Certain contracts are excluded from the above. Examples are transactions which are purely intra-group and contracts of service between a company and one of its directors.

470.40 If a contract is one in which a director is materially interested, the following details must be disclosed (Companies Ordinance, section 129D):

- (a) whether the contract was made or subsisted during the financial year in question;
- (b) the name of the person for whom it was made and, if that person was connected with a director, the name of that director;
- (c) the name of the director with the material interest and the nature of that interest; and
- (d) the nature and value of the contract.

Arrangements of a Financial Nature

470.41 A company shall not, directly or indirectly (Companies Ordinance, section 157H(2)):

- (a) make a loan to a director of the company or its holding company;

- (b) enter into any guarantee or provide any security in connection with a loan made by any person to such a director; or
 - (c) if one or more of the directors holds a controlling interest in another company, make a loan to that other company or enter into any guarantee or provide any security in connection with a loan made by any person to that other company.
- 470.42 In the case of a company which is listed on a recognised stock exchange or which is a member of a group which includes a listed company, the definition of a director is extended to include (Companies Ordinance, section 157H(9)):
- (a) his spouse, child or step-child;
 - (b) a person acting as trustee (other than a trustee under an employees' share scheme or pension scheme) of any trust where the beneficiaries of which include the director, his spouse, child or step-child;
 - (c) a person acting as partner of that director, spouse, child, step-child or trustee.
- 470.43 Child or step-child shall include any illegitimate child but not any person who has attained the age of 18 years (Companies Ordinance, section 157H(10)).
- 470.44 Different disclosure requirements apply to authorized institutions under the Banking Ordinance.
- 470.45 Transactions which are excepted from the prohibition are:
- (a) where a company is a member of a group of companies and the loan, guarantee or the provision of security is made to a company which is the member of the same group (Companies Ordinance, section 157H(3)(a)).
 - (b) anything done by a private company which has been approved by the company in general meeting save where the company is member of a group which includes a listed company (Companies Ordinance, section 157H(3)(b)).
 - (c) those which provide a director with funds to meet expenditure incurred or to be incurred for the purpose of the company or for the purpose of enabling him properly to perform his duties as an officer of the company (Companies Ordinance, section 157H(3)(c)). The purpose of the expenditure and the amount of the loan or the extent of the company's liability under the guarantee or in respect of the security are disclosed to the general meeting and approved prior to it being made or the provision is made on condition that if the approval is not given at or before the next following AGM, the loan shall be repaid or that liability discharged within six months from the conclusion of that meeting (Companies Ordinance, section 157H(4)).
 - (d) a loan for the acquisition or improvement of the whole of, or part of the director's sole or main residence (Companies Ordinance, section 157H(3)(d)) if:
 - (i) the company ordinarily makes loans of that description to its employees on terms no less favourable than those on which the loan is made to the directors;
 - (ii) the loan does not exceed 80% of the value of the property as certified by a professionally qualified valuation surveyor and the valuation was carried out within three months prior to the loan being made;
 - (iii) the loan is secured by a legal mortgage on the property (Companies Ordinance, section 157H(5)).

- (e) where the ordinary business of the company includes the lending of money or the giving of guarantees in connection with loans made by any other person. This exception is allowed only if the loan or guarantee is no greater than the amount which would normally be offered to an unconnected person of the same financial standing and is granted on terms which are no more favourable (Companies Ordinance, section 157H(6)).
- 470.46 Any director who knowingly and wilfully authorised or permitted the transaction, or was himself a beneficiary of it, will be liable to account to the company for any gain which he made either directly or indirectly as a result of the transaction, and to indemnify the company for any loss or damage resulting from it (Companies Ordinance, section 157I).
- 470.47 Where a company enters into a transaction in breach of section 157H of the Companies Ordinance, the following persons are guilty of a criminal offence:
- (a) the company;
 - (b) any director who wilfully authorised or permitted the transaction to be entered into; and
 - (c) any person who knowingly procured the company to enter into the transaction (Companies Ordinance, section 157J).
- 470.48 The accounts which are to be laid before the company in general meeting must contain the following particulars of every relevant loan:
- (a) the name of the borrower;
 - (b) the terms of the loan including the rate of interest and the security for the loan;
 - (c) the amount outstanding on the loan, in respect of principal and interest, at the beginning and at the end of the company's financial year and the maximum amount so outstanding during that financial year; and
 - (d) the amount of interest which has not been paid and the amount of any provision for bad debts in respect of principal and/or interest (Companies Ordinance, section 161B(1)).
- 470.49 Group accounts must also disclose information concerning loans, guarantees and security provided to an officer of a company by its subsidiary company (Companies Ordinance, section 161B(4)).
- 470.50 It is the duty of the director to give notice in writing to the company of such matters relating to himself as may be necessary for the purposes of section 161B. Any person who fails to provide written notice shall be liable to a fine (Companies Ordinance, section 161C).
- 470.51 It should be noted that there are specific disclosure requirements for authorized financial institutions (Companies Ordinance, section 161BA).

Disclosure of Share Transactions

- 470.52 Under the Securities (Disclosure of Interests) Ordinance (Cap. 396), a director, chief executive or shadow director (as defined in section 2 of the Ordinance) of a listed company has a duty to notify the company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") of his interest in shares or debentures of the listed company or any associated corporation (as defined in the Ordinance).

- 470.53 Moreover, a director or chief executive or shadow director of a listed company is required to notify the company and the Stock Exchange after the occurrence of any of the following events within five days after the date on which the occurrence comes to knowledge of the director or chief executive:
- (a) any event in consequence of whose occurrence he becomes, or ceases to be, interested in shares in, or debentures of, the listed company or any associated corporation;
 - (b) the entering into by him of a contract to sell any such shares or debentures;
 - (c) the assignment by him of a right granted to him by the listed company to subscribe for shares in, or debentures of the company;
 - (d) the grant to him by another company, being an associated company, of a right to subscribe for shares in, or debentures of that associated corporation, the exercise of such right granted to him and the assignment by him of such a right so granted; or
 - (e) any event in consequence of which a company becomes an associated corporation where he is immediately after the event interested in shares in, or debentures of the company.
- 470.54 The notification must state the number or amount, and class of shares or debentures involved (Securities (Disclosure of Interests) Ordinance).
- 470.55 A director or chief executive of a listed company is taken to be interested in any shares or debentures in which his spouse, any child under the age of 18 or a company controlled by him (in the manner specified in the Securities (Disclosure of Interests) Ordinance) is interested.
- 470.56 The articles of association of a company may specify a share qualification for directors. A director not already qualified is required to obtain his holding within two months of his appointment, or such shorter time as may be fixed by the articles (Companies Ordinance, section 155(1)).

Disclosure

- 470.57 Every listed company has a duty to keep a register of the holdings of directors and shadow directors. The register is to be updated within three days after the receipt of the information. If the company has granted a right to a director, chief executive or shadow director to subscribe for shares in or debentures of the company, the register should also be updated by the company with the details of the right within three days.
- 470.58 If the listed company is an authorized financial institution, it is also required to notify the Commissioner of Banking of the information received by the next day.

Insider Dealing

- 470.59 The Securities (Insider Dealing) Ordinance 1990 has come into effect as from 1 September 1991, replacing Part XIIA of the Securities Ordinance, Cap. 333.
- 470.60 Under section 9 of the new Ordinance, insider dealing in relation to the listed securities of a corporation takes place when, inter alia, a person who is "connected with the corporation" (as defined in the Ordinance) and who is knowingly in possession of "relevant information" (as defined in the Ordinance) deals in listed securities of the corporation or counsels or procures another person to do so knowing or having reasonable cause to believe that such person would deal in them. Relevant information is specific information about a corporation which is not

generally known to persons accustomed or likely to deal in the listed securities of that corporation but which would materially affect the price of the securities if it were.

- 470.61 No transaction shall be void or voidable by reason only that it is an insider dealing (Securities (Insider Dealing) Ordinance, section 14).
- 470.62 The Financial Secretary may require the Insider Dealing Tribunal, which is established under this Ordinance to inquire into suspected insider dealing (Securities (Insider Dealing) Ordinance, section 16).
- 470.63 Where a person has been identified in a written report by the Tribunal as an insider dealer, the Tribunal may make any or all of the following orders:
- (a) An order that the person shall not without the leave of the High Court, be a director or a liquidator or a receiver or a manager of the property of a listed company or any other specified company or in any way, whether directly or indirectly, be concerned or take part in the management of a listed company or any other specified company for such period (not exceeding five years) as may be specified in the order;
 - (b) An order that that person shall pay to the Government an amount not exceeding the amount of any profit gained or loss avoided by that person as a result of the insider dealing;
 - (c) An order imposing on that person a penalty of an amount not exceeding three times the amount of any profit gained or loss avoided by any person as a result of the insider dealing.

Stock Exchange

- 470.64 In addition to the statutory rules, The Stock Exchange of Hong Kong Limited in its Rules Governing the Listing of Securities has produced a model code for directors of a listed company as to directors' dealings in their company's shares.

Directors' responsibilities

Fraudulent Trading

- 470.65 Directors, as persons involved in the carrying on of the company's business, will be held responsible should the company trade with intent to defraud creditors if they are knowingly a party to such conduct, and may be liable to a fine, imprisonment or both (Companies Ordinance, section 275).

Responsibilities of Directors of Holding or Subsidiary Companies

- 470.66 A subsidiary company's directors should not act in accordance with the instructions of the directors of the holding company unless they are satisfied that the act required to be done is prudent and in the interests of the subsidiary: to act blindly in accordance with instructions will expose those directors to liability in respect of breach of duty.

Theft Ordinance

- 470.67 Under the Theft Ordinance, criminal liability is imposed for obtaining property or pecuniary advantage by deception and for false accounting. Where such an offence is committed by a company with the consent or connivance of a director or other officer, that person will be liable as well as the company. Also, an offence will be committed by an officer of a company who, with the intention of deceiving members or creditors of the company, publishes any written statement or account which he

knows is or may be misleading, false or deceptive in a material particular (Theft Ordinance, section 21).

Accounting Records

Contents

470.68 A company is required to keep accounting records, which are sufficient to show and explain the company's transactions (Companies Ordinance, section 121). More specifically they must disclose:

- (a) all sums of money received and expended and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods by the company; and
- (c) the assets and liabilities of the company.

Proper books of account shall not be deemed to be kept if they do not give a true and fair view of the state of the company's affairs and explain its transactions (Companies Ordinance, section 121(2)).

470.69 Failure to keep accounting records in accordance with section 121 may render a director of the company liable to a fine, imprisonment or both (Companies Ordinance, section 121(4)).

470.70 In addition to the statutory requirement to keep proper accounting records, the directors have an overriding responsibility to ensure that they have adequate information to enable them to discharge their duty to manage the company's business.

470.71 The duty to manage the company's business will involve ensuring that adequate control is kept over its records and transactions, for example:

- (a) cash;
- (b) debtors and creditors;
- (c) stock and work in progress;
- (d) capital expenditure; and
- (e) major contracts.

470.72 The nature and extent of the accounting and management information needed to exercise this control will depend upon the nature and extent of the company's business.

470.73 Directors must also be aware of a company's prospects. It may therefore be prudent to prepare a plan against which the subsequent performance of the business can be measured. Periodic management accounts assist in enabling the actual operating results and cash position to be compared with the plan. Once again, the need for, the extent and frequency of the preparation of such accounts and the level of management to which they are presented will depend upon the size, scope and nature of the business.

Retention of Records

- 470.74 Accounting records are required to be kept at the company's registered office or at such other place as the directors think fit and such records must be open at all times to inspection by the company's directors. Special provisions apply where the records are kept outside Hong Kong (Companies Ordinance, section 121(3)).
- 470.75 Subject to any directions in respect of the disposal of records in a winding up, the records must be preserved for seven years from the end of the financial year to which the last entry made or matter recorded therein relates (Companies Ordinance, section 121(3A)).
- 470.76 However, directors may feel that it is wise to keep documents for longer in view of the periods which the law allows for legal actions to be brought. The main limitation periods are:
- (a) in the case of actions founded on simple (ie. non specialty) contract or tort (except for personal injury) six years from the date on which the cause of action arose;
 - (b) in the case of specialty contracts (ie. contracts under seal), 12 years from the date on which the cause of action arose;
 - (c) in cases of damages in respect of personal injury, three years from the date the cause of action became apparent;
 - (d) where the facts relevant to a cause of action for negligence are not known at the date on which the cause of action accrued, the time limit for an action for latent damage not including personal injury, subject to a maximum limit of 15 years for the negligent act (Limitation Ordinance, sections 31 and 32), will be the later of:
 - (i) six years from the date on which the cause of action accrued; or
 - (ii) three years from the earliest date on which the plaintiff, or any person in whom the cause of action was vested before him, had the knowledge required to bring an action and a right to bring such action.
- 470.77 Every person (including companies) carrying on a trade, profession or business in Hong Kong is required to keep sufficient records of his income and expenditure to enable the assessable profit of such trade, profession or business to be readily assessed and shall retain such records for a period of not less than seven years after the completion of the transactions, acts, or operation to which they relate (Inland Revenue Ordinance, section 51C(1)).

Annual Accounts

- 470.78 Directors have a number of responsibilities in relation to the preparation and filing of annual accounts and returns.

Shares and Dividends

Share Issues

- 470.79 Shares cannot be allotted by directors unless they are authorised to do so either by the company in general meetings except in the case of an allotment to the subscribers to the memorandum and an allotment under a pro-rata offer by the company to the members (ie. a rights issue).

Financial Assistance

- 470.80 The Companies (Amendment) Ordinance 1991 (No. 77 of 1991) (the “Amendment Ordinance”) has come into effect as from 1 September 1991.
- 470.81 The Ordinance makes substantial amendments to the Companies Ordinance as to the giving of financial assistance for the purchase of its own shares. The Ordinance also contains provisions for the redemption and purchase by a company of its own shares, and provisions relating to distribution of profits as assets. Section 49 of the Amendment Ordinance contains detailed provisions for the redemption or purchase by a company of its shares. The redemption or purchase of shares must normally be made out of distributable profits or out of the proceeds of a fresh issue of shares made for that purpose, but private companies are in certain cases allowed to make the redemption or purchase out of capital.
- 470.82 Under the old section 48 of the Companies Ordinance, the company was prohibited either directly or indirectly, from giving financial assistance to any person to acquire shares in the company. Such assistance would represent an unauthorised reduction in capital.
- 470.83 Although section 47A of the Amendment Ordinance replacing the old section 48 of the Companies Ordinance still generally prohibits financial assistance, certain transactions are now permitted provided that the funds applied in the acquisition do not result in a reduction of the net assets, or derive from distributable profits of the company. Distributable profits are now defined by section 47B of the Amendment Ordinance. This provision is important both for the purposes of financial assistance, and for the declaration of a dividend by the company which can only be made out of profit (see Note 2 below).
- 470.84 Section 47D of the Amendment Ordinance permits listed companies to give financial assistance only if either the net assets are not reduced or, if they are reduced, the assistance comes from the distributable profits of the company. Sections 47E to 48 of the Amendment Ordinance set up the conditions that are required for unlisted companies to give assistance. The principle for unlisted companies is similar to that for listed companies, ie. they may give financial assistance only if either the net assets are not reduced, or if they are reduced, the assistance comes from the distributable profits of the company.
- 470.85 Detailed provisions contained in section 47 of the Amendment Ordinance must be consulted to determine whether or not the company can use its funds in acquiring its own shares.

Public Issues

- 470.86 When a company wishes to make a public issue of its shares for the first time, or to make subsequent offering to the public, there are several methods that it may use. The purpose of this section is to examine the duties placed upon the company’s directors with regard to the issue of a prospectus or similar documents, rather than to attempt to provide guidance on the methods of making a public offer. The marketing of public issues is controlled by, inter alia, including the Protection of Investors Ordinance, the Securities Ordinance, the Companies Ordinance and the Rules Governing the Listing of Securities made by The Stock Exchange of Hong Kong Limited.

Note 2: “Distribution” is defined in section 79A and “Distributable profits” is defined in section 47B of the Amendment Ordinance.

- 470.87 The Protection of Investors Ordinance provides that it is an offence by fraudulent or reckless misrepresentation to induce another person, inter alia, to enter into an agreement with a view to acquiring or subscribing securities. Equally it is an offence to issue an advertisement or invitation to enter into an agreement with a view to acquiring or subscribing for securities, subject to various exceptions, including the issue of a prospectus which complies with or is exempt from compliance with Part II of the Companies Ordinance.
- 470.88 The offering of shares to the public in a Hong Kong company is controlled by Part II of the Companies Ordinance. There are specific requirements controlling the form of prospectus (Companies Ordinance, section 38 and the Third Schedule). In certain circumstances, these requirements may be relaxed provided that an appropriate certificate of exemption has been obtained from the Registrar (Companies Ordinance, section 38A). Furthermore no extract or abridged version of the prospectus may be published, subject to certain exceptions (Companies Ordinance, section 38B). A prospectus must be delivered to the Registrar for registration prior to its issue. A prospectus may not be registered with respect to an intended company (Companies Ordinance, section 38D(4)), and the Registrar retains a general discretion to refuse a prospectus registration if it fails to comply in all respects with the Ordinance or contains any information likely to mislead or is misleading in the form and context in which it is included.
- 470.89 Directors may incur civil liability for any damage sustained as a result of any untrue statements in a prospectus by a person who subscribes for shares or debentures (Companies Ordinance, section 40(1)). A director may also face criminal liability for untrue statements in a prospectus (Companies Ordinance, section 40A). Any document whereby a company allots or agrees to allot any shares in or debentures of the company for sale to the public is deemed to be a prospectus issued by the company (Companies Ordinance, section 41). The provisions controlling the allotment of shares are also set out in detail (Companies Ordinance, sections 42 to 45).
- 470.90 Public company directors must consider the provisions of the Securities Ordinance. Section 72 of the Securities Ordinance prescribes the way in which an offer may be made by a dealer in securities and section 74 of the Securities Ordinance prohibits the hawking of securities to any member of the public subject to certain exemptions. Under section 147 of the Securities Ordinance if a corporation commits an offence under the Securities Ordinance with the consent or connivance, or which is attributable to any neglect on the part of a director, such director is guilty of an offence.

Stock Exchange Listing

- 470.91 The complex rules in relation to the public listing of shares on the Stock Exchange are beyond the scope of this work and are set out in great detail in the Rules Governing the Listing of Securities issued by The Stock Exchange of Hong Kong Limited pursuant to the Stock Exchange Unification Ordinance.
- 470.92 Once listing has been granted, the company is required to prepare an interim report which sets out specific information relating to the company's activities and profit and loss during the relevant six month period. The interim report must be either sent to shareholders or advertised within four months at the end of the period to which it relates (Rules Governing the Listing of Securities).

Takeovers and Mergers

- 470.93 With respect to a listed company, relevant takeover, merger or offer transactions are required to be notified to the Stock Exchange pursuant to Chapter 14 of the Rules Governing the Listing of Securities and must comply with the provisions of

the Hong Kong Code on Takeovers and Mergers and Shares Repurchases which sets out rules of conduct with respect of the making of a takeover offer.

Taxation

- 470.94. The directors are responsible for the maintenance and retention of the company's tax records (see paragraph 470.77 above). Normally the tasks of computing tax and making the proper returns will be delegated. The fact that a task may be delegated will not relieve a director of all responsibility. If it is delegated, a director must ensure that the person concerned is suitable for the job and the director should reasonably monitor the work. In any event, a director may, depending on all the circumstances, rely on co-directors and the officers of the company but such reliance should not be totally unquestioning (re *City Equitable Fire Insurance Co*).
- 470.95 The principal taxes with which directors will be concerned is the company's profits tax.

Inspection of a Company's Books and Papers

- 470.96 The Financial Secretary may at any time, if he thinks there is good reason to do so, order the inspection of a company's books and papers. This power includes the right to take copies from any such documents, require an explanation of them from any past or present officer or employee of the company and to obtain a warrant for the entry and search of premises where the documents might reasonably be expected to be found (Companies Ordinance, section 152A). Books and papers include all accounts, deeds, writings and documents of the company. Any company or person who fails to comply with a requirement to produce books or papers or to provide any explanations as to them is liable to criminal penalties.

Investigation of a Company's Affairs

- 470.97 The Financial Secretary must appoint inspectors to investigate and report on the affairs of a company when ordered to do so by the Court and may make such an appointment in a number of situations (Companies Ordinance, section 143). The situations of particular relevance to directors are, if it appears that:
- (a) the business of the company is being or has been conducted with the intent of defrauding its own creditors, the creditors of any other person or for another fraudulent or unlawful purposes;
 - (b) the company was formed for a fraudulent or unlawful purpose;
 - (c) the promoters or officers of the company have been guilty of fraud, misfeasance or other misconduct towards the company or its members; or
 - (d) the company's members have not been given all the information which they might reasonably expect.

The Financial Secretary may also appoint inspectors on the application of members of a company if the company passes a special resolution declaring that affairs ought to be investigated.

- 470.98 It is the duty of all officers and agents of the company to give inspectors all assistance which they are reasonably able to give, including the production of company books and documents, and they may be examined on oath by the inspectors. An inspector may also require a director, past or present, to produce any documents relating to his own bank account, if the inspector has reasonable grounds for believing that receipts and payments which should have been disclosed in the company's accounts have been passed through the director's account. Any

officer or agent of the company who fails to assist an inspector may be reported to the High Court and punished as if he had been in contempt of Court.

- 470.99 The Financial Secretary has wide powers to investigate the ownership of a listed company whenever he thinks there is good reason to do so for the purpose of determining the true persons who are or have been financially interested in the success or failure (real or apparent) of the company or able to control or materially to influence its policy (Securities (Disclosure of Interests) Ordinance).
- 470.100 If it appears to the Financial Secretary that there have been breaches of the requirements concerning directors' share dealings or of the duty of directors to notify interests in shares and debentures, he may investigate in order to establish whether or not such breaches have occurred (Securities (Disclosure of Interests) Ordinance).

Personal Liability

- 470.101 Where a liquidator has been appointed, he will take over full control of the running of the company from the directors until it is dissolved. However, directors should bear in mind that they can be held personally liable for a variety of circumstances occurring both prior to and after the commencement of winding up proceedings, including:
- (a) trading with intent to defraud creditors;
 - (b) misapplication of company money or property or other breach of duty or trust;
 - (c) concealing company property and falsifying its books;
 - (d) failing to keep proper accounting records;
 - (e) acting as a director or being involved in any way in the promotion, formation or management of any company or business carried on under a prohibited name; or
 - (f) failing to provide a statement of affairs.

These are discussed in paragraphs 490.102 to 490.105 below.

- 470.102 Trading with intent to defraud creditors: in addition to the criminal offence created by the Companies Ordinance, section 275 (see paragraph 490.65 above), in the case of a company in the course of winding up, the liquidator can apply to the court for a declaration that persons knowingly party to trading with intent to defraud creditors be liable to make a contribution to the company's assets.
- 470.103 Misapplication of company money or property or other breach of duty or trust: the liquidator, official receiver or any creditor or contributory may apply to the court for the examination of a director or officer or past director, if it appears that he has misapplied or obtained or become accountable for any money or other property of the company or been guilty of any misfeasance or breach of duty in relation to the company. The court may then order a delinquent director to repay or restore company money or property or make other reparations.
- 470.104 Concealing or disposing of company property and falsifying its books: when a company is in voluntary or compulsory liquidation, any past or present officer of the company (including a shadow director), commits an offence and will be liable to a fine, imprisonment or both, if he has:
- (a) committed fraud in anticipation of winding up;

- (b) been involved in any transaction in fraud of creditors (Companies Ordinance, section 275);
- (c) committed misconduct in the course of winding up (Companies Ordinance, section 271); or
- (d) falsified company books (Companies Ordinance, section 272).

470.105 Failing to provide a statement of affairs: in a creditors' voluntary liquidation the directors are required to prepare and verify by affidavit a statement as to the affairs of the company in a prescribed form, and to lay it before a meeting of creditors (Companies Ordinance, section 241). Directors failing to comply with their obligations under the above sections will be liable to a fine and, for continued contravention, to a daily default fine.

DEFINITIONS

In this Code of Ethics for Professional Accountants the following expressions have the following meanings assigned to them:

Advertising	The communication to the public of information as to the services or skills provided by professional accountants in public practice with a view to procuring professional business.
Assurance client	<p>The responsible party that is the person (or persons) who:</p> <p>(a) In a direct reporting engagement, is responsible for the subject matter; or</p> <p>(b) In an assertion-based engagement, is responsible for the subject matter information and may be responsible for the subject matter.</p> <p>(For an assurance client that is a financial statement audit client see the definition of financial statement audit client.)</p>
Assurance engagement	<p>An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.</p> <p>(For guidance on assurance engagements see the Hong Kong Framework for Assurance Engagements which describes the elements and objectives of an assurance engagement and identifies engagements to which Hong Kong Standards on Auditing (HKSAAs), Hong Kong Standards on Review Engagements (HKSREs), Hong Kong Standards on Investment Circular Reporting Engagements (HKSIRs) and Hong Kong Standards on Assurance Engagements (HKSAEs) apply.)</p>
Assurance team	<p>(a) All members of the engagement team for the assurance engagement;</p> <p>(b) All others within a firm who can directly influence the outcome of the assurance engagement, including:</p> <p>(i) those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement. For the purposes of a financial statement audit engagement this includes those at all successively senior levels above the engagement partner through the firm's chief executive;</p> <p>(ii) those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and</p> <p>(iii) those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement; and</p>

- (c) For the purposes of a financial statement audit client, all those within a network firm who can directly influence the outcome of the financial statement audit engagement.

Clearly insignificant	A matter that is deemed to be both trivial and inconsequential.
Close family	A parent, child or sibling, who is not an immediate family member.
Contingent fee	A fee calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. A fee that is established by a court or other public authority is not a contingent fee.
Direct financial interest	<p>A financial interest:</p> <ul style="list-style-type: none"> • Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or • Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control.
Director or officer	Those charged with the governance of an entity, regardless of their title, which may vary from country to country.
Engagement partner	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
Engagement quality control review	A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.
Engagement team	All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
Existing accountant	A professional accountant in public practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for a client.
Financial interest	An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.
Financial statements	The balance sheets, income statements or profit and loss accounts, statements of changes in financial position (which may be presented in a variety of ways, for example, as a statement of cash flows or a statement of fund flows), notes and other statements and explanatory material which are identified as being part of the financial statements.

Financial statement audit client	An entity in respect of which a firm conducts a financial statement audit engagement. When the client is a listed entity, financial statement audit client will always include its related entities.
Financial statement audit engagement	A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared in all material respects in accordance with an identified financial reporting framework, such as an engagement conducted in accordance with Hong Kong Standards on Auditing. This includes a Statutory Audit, which is a financial statement audit required by legislation or other regulation.
Firm	<ul style="list-style-type: none"> (a) A sole practitioner, partnership or corporation of professional accountants; (b) An entity that controls such parties; and (c) An entity controlled by such parties.
Immediate family	A spouse (or equivalent) or dependant.
Independence	<p>Independence is:</p> <ul style="list-style-type: none"> (a) Independence of mind – the states of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional judgment. (b) Independence in appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm’s, or a member of the assurance team’s, integrity, objectivity or professional skepticism had been compromised.
Indirect financial interest	A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.
Listed entity	An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
Network firm	An entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally.
Office	A distinct sub-group, whether organized on geographical or practice lines.
Professional accountant	An individual who is a member of the Hong Kong Institute of Certified Public Accountants.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

Professional accountant in business	A professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not for profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.
Professional accountant in public practice	A professional accountant, irrespective of functional classification (e.g., audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.
Professional services	Services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services.
Related entity	<p>An entity that has any of the following relationships with the client:</p> <ul style="list-style-type: none">(a) An entity that has direct or indirect control over the client provided the client is material to such entity;(b) An entity with a direct financial interest in the client provided that such entity has significant influence over the client and the interest in the client is material to such entity;(c) An entity over which the client has direct or indirect control;(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and(e) An entity which is under common control with the client (hereinafter a “sister entity”) provided the sister entity and the client are both material to the entity that controls both the client and sister entity.

EFFECTIVE DATE

The Code of Ethics for Professional Accountants is effective on 30 June 2006. Section 290 is applicable to assurance engagements when the assurance report is dated on or after 30 June 2006. Earlier application is encouraged.

APPENDIX

Comparison with the IFAC Code of Ethics for Professional Accountants

This comparison appendix, which was prepared as at December 2005 and deals only with significant differences in the Code of Ethics for Professional Accountants extant, is produced for information only and does not form part of the Code of Ethics for Professional Accountants.

The international standard comparable with the Code of Ethics for Professional Accountants is the IFAC Code of Ethics for Professional Accountants.

The following sets out the major textual differences between the Code of Ethics for Professional Accountants and the IFAC Code of Ethics for Professional Accountants and the reasons for the differences.

	Differences	Reasons for the Differences
1.	Paragraph 290.26 of the IFAC Code is modified by deleting the wording “ <i>When a member body chooses not to differentiate between listed entities and other entities, the examples that relate to financial statement audit engagements for listed entities should be considered to apply to all financial statement audit engagements.</i> ”	The Code of Ethics for Professional Accountants differentiates between listed entities and other entities.
2.	Paragraph 290.34 of the IFAC Code concerning provision of non-assurance service to a non-listed financial statement audit client that becomes a listed financial statement audit client is deleted.	The Institute takes the view that any non-assurance service that is not permissible under Section 290 for listed financial statement audit clients should be terminated once the non-listed financial statement audit client becomes listed.
3.	Paragraphs 290.109, 290.116, 290.165 of the IFAC Code are modified by deleting or revising certain safeguards.	The Institute takes the view that the threats created in the specified circumstances would be so significant that the safeguards should be tightened or no safeguard could reduce the threat to an acceptable level.
4.	Paragraph 290.151 of the IFAC Code which relates to serving as the company secretary for a financial statement audit client is modified.	The modification reflects the legal requirement in Hong Kong.
5.	Paragraphs 290.155 to 290.157 of the IFAC Code providing flexibility for partner rotation are modified or deleted. z	The Institute takes the view that rotation of the engagement partner or the individual responsible for the engagement quality control review on a financial statement audit should be mandatory; otherwise, the familiarity threat created would be so significant that no safeguard could reduce the threat to an acceptable level.

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

	Differences	Reasons for the Differences
6.	Paragraph 290.168 of the IFAC Code concerning provision of assistance and advice to a financial statement audit client in preparing accounting records and financial statements during the audit process is expanded.	The expanded paragraph seeks to clarify that the responsibilities for the preparation of accounting records and financial statements rest with the audit client and the auditor only assumes an advisory role.
7.	Paragraph 290.171 of the IFAC Code is modified by deleting the wording “ <i>when the services fall within the statutory audit mandate</i> ”.	The wording is not relevant in Hong Kong.
8.	Paragraph 290.180 of the IFAC Code concerning provision of taxation services to financial statement audit clients is expanded.	The Institute takes the view that certain taxation assignments do create threats to independence. The expanded paragraph seeks to reiterate the general requirement that when accepting an engagement for taxation services, professional accountants need to assess the threats to independence.
9.	(a) Section 290 Interpretations – Interpretation 2003-01 of the IFAC Code which deals with the transitional provisions for the provision of non-assurance services to assurance clients is deleted. (b) Section 290 Interpretations – Interpretation 2003-02 of the IFAC Code which deals with the transitional provisions for lead engagement partner rotation for audit clients that are listed entities is deleted.	The transitional periods have expired.
10.	(a) Part D on additional ethical requirements is added. (b) Paragraphs 100.2 and 100.3 of the IFAC Code are modified to refer to Part D.	Part D sets out the additional ethical requirements on specific areas which are primarily derived from local legal or regulatory requirements.